



HALCYON CAPITAL LIMITED

11TH FLOOR

8 WYNDHAM STREET

CENTRAL

HONG KONG

9 June 2022

To the Independent Board Committee and the Independent Shareholders

Dear Sirs,

**CONTINUING CONNECTED TRANSACTION IN RELATION TO
THE NEW LABOR SUBCONTRACT 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 Labor Subcontract 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 9 June 2022, 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 26 May 2022, the Company and Baoding Tianli entered into the New Labor Subcontract Framework Agreement to renew the Labor Subcontract Framework Agreement dated 31 December 2019, pursuant to which Baoding Tianli shall provide labor subcontract services to the Group in the ordinary course of business of the Group, including but not limited to contracting for building construction projects and infrastructure construction projects, for which Baoding Tianli will charge the Group subcontract fees (including subcontract service fees, labor wages and social insurance expenses, taxation, auxiliary materials and tools costs, and other fees).

Since Baoding Tianli is a wholly-owned subsidiary of Zhongming Zhiye, while 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 of the Company, Baoding Tianli 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 Labor Subcontract 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 the independent non-executive Directors, has been formed to advise the Independent Shareholders as to (i) the New Labor Subcontract Framework Agreement and its proposed annual caps (the “**Annual Caps**”) are conducted in ordinary and usual course of business of the Group, are on normal commercial terms which are fair and reasonable, and are in the interests of the Group and the Independent Shareholders as a whole; and (ii) how the Independent Shareholders should vote on the relevant resolutions regarding the New Labor Subcontract Framework Agreement and the Annual Caps at the AGM.

Our role, as the independent financial adviser to the Independent Board Committee and the Independent Shareholders in relation to the New Labor Subcontract Framework Agreement and the transactions contemplated thereunder, is to (i) provide the Independent Board Committee and the Independent Shareholders an independent opinion and recommendations as to whether the New Labor Subcontract 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 Labor Subcontract Framework Agreement and the Annual Caps at the AGM.

We are not associated with the Company, Baoding Tianli 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 Labor Subcontract 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 8 December 2021), there was no other engagement between the Group and Halcyon Capital in 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 Labor Subcontract 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 reviewed, among other documents, the Labor Subcontract Framework Agreement, the New Labor Subcontract Framework Agreement, the financial statements of the Company, the estimation of the Annual Caps and relevant industry information as further elaborated in our letter. 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. 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 note 1 to Rule 13.80 of the Listing Rules.

Our review and analysis were based upon, among others, the information provided by the Group including the New Labor Subcontract Framework Agreement, the annual report of the Company for the year ended 31 December and 2020 and 2021 (the “**2020 Annual Report**”, and “**2021 Annual Report**”, respectively), 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 Labor Subcontract 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, Baoding Tianli 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 Labor Subcontract 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 Annual 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 including service concession arrangements. 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 2021 was derived from the provision of construction contracting services.

According to the 2021 Annual Report, approximately 60.95% of the value of the new contracts of the Group in year 2021 were attributable to Beijing-Tianjin-Hebei Region, as compared to approximately 49.04% in year 2020, and over 60% of the value of the new contracts of the Group's contracting construction business were attributable to building construction in both years 2020 and 2021, followed by infrastructure construction of over 20% in both years 2020 and 2021.

Financial highlights

Set out below is the summary of key financial information of the Group for each of the two years ended 31 December 2021 as extracted from the 2021 Annual Report:

	For the year ended 31	
	December	
	2021	2020
	RMB'mil	RMB'mil
Revenue	47,828	40,150
Cost of sales	(45,341)	(38,010)
(Loss)/Profit before tax	(495)	936
Income tax credit/(expense)	137	(184)
Net (loss)/profit	(358)	752

As illustrated in the above table, the Group recorded increase in revenue for the year ended 31 December 2021 while recorded loss before and after tax for the year ended 31 December 2021, as compared to a net profit before and after tax for the year ended 31 December 2020. According to the 2021 Annual Report, the increase in revenue was principally attributable to the increase in revenue derived from the building construction business and infrastructure construction business, and the gross profit rate of the construction contracting business remained stable at approximately 5.0% for the year ended 31 December 2021, as compared to 31 December 2020. The net loss recorded by the Group for the year ended 31 December 2021 was principally attributable to the increase in credit impairment losses and

asset impairment losses of approximately RMB679 million and RMB976 million, respectively, as compared with that in 2020. The increases in impairment recorded were mainly attributable to the deterioration in the credit standing of certain customers of property developers.

Financial position

Set out below is the highlight of the financial position of the Group as at 31 December 2021 extracted from the 2021 Annual Report:

	As at 31 December 2021
	<i>RMB' mil</i>
Total assets	66,947
Total liabilities	61,075
Net assets	5,873

The Group recorded total assets of approximately RMB66,947 million as at 31 December 2021 and over 90% of which were current assets. As at 31 December 2021, the current assets of the Group principally comprised contract assets of approximately RMB39,658 million, accounts receivable of approximately RMB7,740 million, cash and cash equivalents of approximately RMB8,810 million.

The Group recorded total liabilities of approximately RMB61,075 million as at 31 December 2021 and over 95% of which were current liabilities. As at 31 December 2021, the current liabilities of the Group principally comprised accounts payable of approximately RMB37,937 million, other payables of approximately RMB6,073 million and contract liabilities of approximately RMB6,007 million.

The Group recorded a decrease in net assets attributable to owners of the Company from approximately RMB6,246 million as at 31 December 2020 to approximately RMB5,694 million as at 31 December 2021 which was mainly attributable to the effect of dividend distribution of approximately RMB247 million during 2021 and the net loss of approximately RMB358 million recorded by the Group in 2021.

2. Reasons for and benefits of entering into of the New Labor Subcontract Framework Agreement

As stated in the Letter from the Board, Baoding Tianli and its associates have become familiar with the Group's business needs and operational requirements through their long-term cooperation with the Group and thus can provide the Group with a sufficient number of laborers who have the requisite expertise and experience for the Group's construction business, in a timely manner and in accordance with applicable laws and regulations. Accordingly, the Directors (including the independent non-executive Directors) are of the view that the New Labor Subcontract Framework Agreement and its proposed annual caps are entered into on

normal commercial terms in the ordinary and usual course of business of the Group, are fair and reasonable, and in the interests of the Group and its Shareholders as a whole.

We have obtained and reviewed the 2021 Annual Report and as stated, the Group was also responsible for engaging subcontractors in providing construction services and the labor force for construction projects. As advised by the Group, labor subcontracting fee is one of the major costs of the Group, and, we understand from the prospectus of the Company dated 5 December 2017 that the provision of labor subcontract services by Baoding Tianli to the Group already commenced prior to 2014. On the other hand, according to the All-China Federation of Industry and Commerce¹, Baoding Tianli is one of the top 100 private enterprises in Heibei Province in 2021. Although the Group has established business relationship with Baoding Tianli for a number of years, according to the pricing policy under the New Labor Subcontract Framework Agreement, when the Group subcontracts labor supply for the construction projects, public bidding procedures will still be applied and the bidder with the highest score comprehensively determined by the review panel wins, and the bidding price offered by the bidder will be implemented. Accordingly, we concur with the view of the Directors that engaging Baoding Tianli and its associates for the provision of labor subcontracting services under the New Labor Subcontract Framework Agreement is in the ordinary and usual course of business of the Group and the continuation of provision of labor subcontracting services by Baoding Tianli to the Group is in the interests of the Group and the Independent Shareholders as a whole.

3. Principal terms of the New Labor Subcontract Framework Agreement

As set out in the Letter from the Board, the principal terms of the New Labor Subcontract Framework Agreement are set out below:

(1) Date

26 May 2022

(2) Parties

The Company (as the contractor); and

Baoding Tianli (as the sub-contractor).

(3) Principal terms

Baoding Tianli and its associates shall provide labor subcontract services to the Group in its ordinary course of business, including but not limited to contracting for building

¹ http://www.acfic.org.cn/gdgs1_362/hb/hbfgdt/202109/t20210907_265853.html

construction projects and infrastructure construction projects, for which Baoding Tianli will charge the Group total subcontract fees (including subcontract service fees, labor wages and social insurance expenses, taxation, auxiliary materials and tools costs, and other fees). The New Labor Subcontract Framework Agreement shall commence on 1 January 2023 and end on 31 December 2025 (both days inclusive). Subject to compliance with relevant laws and regulations and the Listing Rules, it can be renewed for another three years upon its expiry as agreed by relevant parties, upon which the Company will continue to comply with the applicable requirements under the Listing Rules. Relevant subsidiaries or associated companies of both parties will enter into separate specific agreements which will set out the specific terms and conditions according to the principles provided in the New Labor Subcontract Framework Agreement.

(4) Pricing policy

In accordance with the New Labor Subcontract Framework Agreement, the total subcontract fee to be paid by the Group to Baoding Tianli and its associates will be determined based on the following pricing policy:

When the Group subcontracts labor supply for the construction projects, public bidding procedures will be applied. Prior to the bidding procedures, the Group will publish announcements on its bidding invitation on public websites. There must be at least three Independent Third Party bidders attending the bidding procedures, otherwise the bidding will be canceled, and the Company will publish new bidding information and perform the bidding procedures again.

The review panel for any bidding consists of experts selected by the Group as well as the project manager, and the comparable quoted bidding prices (including subcontract service fees, labor wages and social insurance expenses, taxation, auxiliary materials and tools costs, and other fees) is an important, but not the only, factor to be considered. The review panel shall consist of an odd number of three or more experts, all of whom are internal management personnel of the Group, including the general managers and deputy general managers of the production safety department, operational management department, financial management department and quality and technology department of the Group; the deputy general managers and business department managers in charge of safety, production, technology, quality, finance and operation of the branches; and the persons in charge of operation, technology, quality, production and finance of the project management department. The experts are selected by taking into account their professionalism, business competence, years of experience and other factors. To avoid conflict of interest, the management staff in charge of the tender project shall not participate in the evaluation as an expert member of the review panel for such tender project.

The review panel will also take into consideration factors including, but not limited to, the bidder's sufficient licenses and qualifications, business scale and capacities and its historical results, as well as make reference to prevailing market terms and prices. The bidder with the highest score comprehensively determined by the review panel wins, and the bidding price offered by such bidder will be implemented.

Therefore, only in the event that Baoding Tianli and its associates win the bidding with the highest score determined by the review panel, the Group will enter into business agreements with Baoding Tianli under the New Labor Subcontract Framework Agreement.

4. Pricing policies and internal control measures regarding price determination for the continuing connected transactions under the New Labor Subcontract 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 Labor Subcontract Framework Agreement, the Group has adopted the following internal control measures (the "**Internal Control Measures**") and will apply these measures while determining the price of products in respect of the continuing connected transactions under the New Labor Subcontract Framework Agreement:

- The Company has adopted and implemented a set of management system on connected transactions (the "**Management System**"). Under such system, the Audit Committee under the Board is responsible for the review on compliance with relevant laws, regulations, the Company's policies and the Listing Rules in respect of the continuing connected transactions. In addition, the Audit Committee under the Board, the office of the Board and various internal departments of the Company (including but not limited to the market operation department, the production security department, the finance management department, the financial securities department and legal department) are jointly responsible for evaluating the terms and fees (including but not limited to identifying transactions with Independent Third Parties to determine the market prices) under such framework agreement for the continuing connected transactions, in particular, the pricing policies under such transactions; the finance management department and the production security department are responsible for the approval of the annual caps and their fairness under such transactions;

The Company's production safety department, financial management department and operational management department are responsible for calculating the current and cumulative amounts of connected transactions on a monthly basis, and controlling the number of transactions conducted with connected parties when it is expected to reach the annual caps on connected transactions;

- 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 such framework agreement for the continuing connected transaction and the progress of the transaction semi-annually and quarterly, respectively. In addition, the Board will regularly review the pricing policy of such framework agreement for the continuing connected transaction on an annual basis;
- The independent non-executive Directors and auditors of the Group will conduct annual reviews of the continuing connected transactions under such framework agreement and provide annual confirmation in accordance with the Listing Rules to ensure that the transactions are conducted in accordance with the terms of the agreements, on normal commercial terms and in accordance with the pricing policy; and
- When considering the actual subcontract fees, rental, service fees, and other prices provided by the Group to the above connected persons, the Group will continue to regularly research in prevailing market conditions and practices and make reference to the pricing and terms between the Group and Independent Third Parties for similar transactions, to make sure that the pricing and terms offered by the above connected persons, either from bidding procedures or mutual commercial negotiations (as the case may be), are fair, reasonable and are no less favorable than those offered to Independent Third Parties. In particular, the Procurement Department of the Group will collect price information in the market at the end of each year and from time to time, by attending national labor service seminars (such as the annual meeting organized by the labor branch of China Construction Industry Association) and by collecting data from Yuncaai Network, a business-to-business online procurement platform that provides nationwide services to construction companies and suppliers in China.

Furthermore, as set out in the Management System and as further discussed with the management of the Company, the pricing of the connected transactions must be fair and with reference to the following principles, 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 the aforesaid prices are not available, the connected transaction shall then be determined on a cost-plus basis. We understand from the management of the Group that the Group will take into account a number of factors including, but not limited to, the nature, complexity, location and duration of the relevant transaction, and the margin of comparable projects with Independent Third Parties, in determining the margin on a case-by-case basis.

We understand from the Management System and the management of the Group that depending on the types and circumstances of connected transactions to be entered into, the pricing for connected transactions without prices fixed or determined by the government shall be determined through different pricing methodologies. These pricing methodologies are, namely, 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 is determined based on the gross profit margin of comparable transactions with Independent Third Parties. The Group provided construction contracting services to connected persons and the pricing of these projects were principally determined based on cost-plus method in accordance to the Management System. For information purpose only, as advised by the management of the Company, the gross profit margin of the ten highest revenue-contributing projects (with customers who are Independent Third Parties) for each of the three years ended 31 December 2021 ranged from approximately 0.5% to 19.5%.

Meanwhile, we also obtained and reviewed The Bidding Law of the PRC, according to which if there are less than three bidders, the tenderer shall re-bid in accordance with the law.

Taking into account the nature of services to be provided by Baoding Tianli under the New Labor Subcontract Framework Agreement, and having further confirmed with the management of the Company, in determining the pricing of the labor subcontracting services, and in accordance with the pricing policy under the New Labor Subcontract Framework Agreement, public bidding procedures will be applied and there shall be at least three bidders which was consistent with the requirement under the Bidding Law of the PRC. The bidding procedure will involve the review panel taking into consideration factors including, but not limited to, the comparable quoted bidding prices, the bidder's licenses and qualifications, business scale and capacities and its historical results in evaluating the bids. We concur with the management of the Company that the pricing policy under the New Labor Subcontract Framework Agreement is consistent with the Management System.

Meanwhile, as compared to direct hiring of subcontractors, public biddings enable the Group to select the most suitable subcontractor for a particular project among the bidders through direct comparison in price, technical and historical performance. Moreover, given the evaluation of bidders is conducted by the review panel (which shall consist of an odd number of three or more experts), we have obtained and reviewed the documents regarding the result of the bid evaluations of the bid review panel for (i) the labor subcontracting contract granted to Baoding Tianli with the largest contract value and (ii) the labor subcontracting contract granted to Independent Third Party with the largest contract value (which Baoding Tianli has participated, but not winning, in the relevant bid), for each of the six months ended (a) 30 June 2020; (b) 31 December 2020; (c) 30 June 2021; and (d) 31 December 2021, and noted that the composition of the review panels of these eight projects was different. Taking into account the contract value of relevant projects, the

relevant projects covered projects awarded to Baoding Tianli and Independent Third Parties during the two years ended 31 December 2021, we consider that these projects are representative and the reviewing of these projects is sufficient for the purpose of assessing the composition of the review panels. Therefore, the risk for the awarding of contracts to be controlled by a few persons is reduced. Further, taking into account the composition of the review panel, which may involve the general managers and deputy general managers of the production safety department, operational management department, financial management department and quality and technology department of the Group; the deputy general managers and business department managers in charge of safety, production, technology, quality, finance and operation of the branches; and the persons in charge of operation, technology, quality, production and finance of the project management department, we are of the view that the review panel involves people with different expertise which enables the review panel to evaluate the bid from more angles. Taking into account the aforesaid, we are of the view that the pricing policy under the New Labor Subcontract Framework Agreement, being public bidding, is fair and reasonable.

In addition, we have obtained and reviewed the 2020 Annual Report and 2021 Annual Report, based on which the auditors and the 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 each of the years ended 31 December 2020 and 2021 were carried out in the accordance with the terms of the relevant Labor Subcontract Framework agreement. Moreover, as stated in the 2020 Annual Report and 2021 Annual Report, the auditors of the Company confirmed that, among other things, the relevant continuing connected transactions carried out in the years ended 31 December 2020 and 2021 were carried out in the accordance with the terms of the relevant Labor Subcontract Framework Agreement and the transactions carried out in the years ended 31 December 2020 and 2021 were conducted in accordance with the pricing policies of the Company.

Meanwhile, we have obtained and reviewed the documents regarding the result of the bid evaluations of the bid review panel regarding (i) the labor subcontracting contract granted to Baoding Tianli with the largest contract value and (ii) the labor subcontracting contract granted to Independent Third Party with the largest contract value (which Baoding Tianli has participated, but not winning, in the relevant bid), for each of the six months ended (a) 30 June 2020; (b) 31 December 2020; (c) 30 June 2021; and (d) 31 December 2021. As set out in the bid evaluation forms, the assessment of each bidder would be conducted by way of a scoring system for two main parts, being (i) the competitiveness of the bidding price offered, and (ii) the technical skills and track record of the bidders (including the quality and technicality of the proposed construction plan, feasibility of the implementation of the scheduled project timetable, possession of relevant experiences in other similar projects and etc). We have also reviewed the bidding price of the relevant bidders for each of the selected projects and noted that bidders with higher bidding price got lower score for the pricing part and vice versa, and the result of the bids was determined

based on the combined score of the two parts mentioned above. We consider that our findings is in line with the pricing policy and the Management System.

5. Rationale for determining the Annual Caps

The table below sets out the historical transaction amounts between the Group and Baoding Tianli in respect of the labor subcontract services under the Labor Subcontract Framework Agreement for each of the two years ended 31 December 2021, the annual caps under the Labor Subcontract Framework Agreement for each of the three years ending 31 December 2022 and the proposed Annual Caps for each of the three years ending 31 December 2025:

	For the year ended 31 December		For the four months
	2020	2021	ended 30 April 2022
	<i>RMB 'mil</i>	<i>RMB 'mil</i>	<i>RMB 'mil</i>
Actual amount	3,455	3,835	976
Annual cap	4,000	4,000	4,000 (Note 1)
Utilisation rate	86.4%	95.9%	73.2%(Note 2)

Notes:

1. The annual cap of RMB4,000 million represents the annual cap for the year ending 31 December 2022.
2. The utilisation rate for the four months ended 30 April 2022 is calculated based on annualising the actual amount incurred for the four months ended 30 April 2022 (i.e. multiplying by 12 / 4) and divide the same by annual cap for the year ending 31 December 2022.

Proposed Annual Caps		
For the year ending 31 December		
2023	2024	2025
<i>RMB 'mil</i>	<i>RMB 'mil</i>	<i>RMB 'mil</i>
4,000	4,000	4,000

As stated in the Letter from the Board, the Annual Caps were determined mainly with reference to: (i) the labor costs of the Group; (ii) the Group's decision and consideration of supply chain safety; (iii) the estimated total subcontracting fees to be paid to Baoding Tianli and its associates as a percentage of the Group's labor costs; (iv) the historical transaction amounts with Baoding Tianli and its associates; and (v) the trend of adjustment of the business strategy of Baoding Tianli's own labor segment. Details are as follows:

- (i) For the three years ended 31 December 2019, 2020 and 2021, the Group's labor costs amounted to RMB11,471 million, RMB12,050 million and RMB12,895 million respectively. Based on the development trend of the Group's regional layout in the

market nationwide, the Group's labor costs are expected to remain stable in the next three years;

- (ii) The pandemic and supply-side reform in the PRC have led to an increase in the Group's supply chain risks. In order to enhance its resistance to the Group's overall business risks arising from supply chain risks, the Group will proactively control the proportion of a single labor service provider in the overall labor costs and reduce its reliance on a single labor service provider. The Group will consider using local labor service providers for its labor service business in other provinces and purposefully select other high-quality labor service providers to meet the demand for labor services in Hebei Province;
- (iii) The actual total subcontracting fees paid by the Group to Baoding Tianli and its associates for the three years ended 31 December 2019, 2020 and 2021 were RMB3,239 million, RMB3,455 million and RMB3,835 million respectively, representing 28.24%, 28.67% and 29.74% of the Group's labor costs respectively (the "**Baoding Tianli Transaction to Labor Cost Ratio**"), with an average figure of 28.88%. The total subcontracting fees paid to Baoding Tianli and its associates as a percentage of the Group's labor costs for the next three years are expected to be the same as or will decrease slightly as compared to the above average figure;
- (iv) The actual total subcontracting fees paid by the Group to Baoding Tianli and its associates for the three years ended 31 December 2019, 2020 and 2021 were all within RMB4 billion, and the actual total subcontracting fees paid by the Group to Baoding Tianli and its associates for the four months ended 30 April 2022 amounted to RMB976 million, and the total subcontracting fees for the whole year for 2022 are also expected to be within RMB4 billion; and
- (v) Based on the current slow-growth economic development currently in China and the impact of the pandemic, Baoding Tianli adjusted its overall business development strategy based on its own situation. In particular, it focused its main business efforts on the Baoding City area in Hebei Province, strived to expand and strengthen the scale of its headquarters area and focused on refined management and high-quality, large-scale, precise and advanced engineering projects. In addition, with its good reputation in the industry, it actively approached and cooperated with central and state-owned enterprises to expand its revenue stream. Therefore, the number of cooperation projects between the Group and Baoding Tianli is not expected to increase significantly in the next three years.

Due to the above reasons, it is expected that the total subcontracting fees to be paid to Baoding Tianli and its associates will maintain at RMB4 billion level in the next three years.

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 in relation thereto. We are given to understand that the proposed annual cap for the year ending 31 December 2023 was principally determined based on (i) the labor costs of the Group which is expected to remain stable; (ii) the Group's decision and consideration of supply chain safety which aims to proactively control the proportion of a single labor service provider in the overall labor costs and reduce its reliance on a single labor service provider; (iii) the estimated total subcontracting fees to be paid to Baoding Tianli and its associates as a percentage of the Group's labor costs which are expected to be the same as or will decrease slightly; (iv) the historical transaction amounts with Baoding Tianli and its associates which were all within RMB4 billion for each of the year ended 31 December 2019, 2020 and 2021 and is also expected to be within RMB4 billion for the year ending 31 December 2022; and (v) the trend of adjustment of the business strategy of Baoding Tianli's own labor segment as a result of which the number of cooperation projects between the Group and Baoding Tianli is not expected to increase significantly in the next three years.

Such expectations principally assumed that (i) the labor costs of the Group will remain stable; and (ii) the Baoding Tianli Transaction to Labor Cost Ratio is not expected to increase in the absence of unforeseeable circumstances.

In assessing the reasonableness of the key assumptions as stated above, we have calculated the average growth rate of the labor costs of the Group over the past three years, and the result of our calculation, being 6.0%, was comparable to the growth rate of average salary of employed personnel of construction industry in the urban private units during 2019 to 2021 according to National Bureau of Statistics of China. However, according to National Bureau of Statistics of China, the growth rate of average salary of employed personnel of construction industry in the urban private units had demonstrated a decreasing trend over the past five years, from approximately 8.4% in 2018, to 6.5% in 2019, to 5.8% in 2020 and to 5.4% in 2021. Meanwhile, we also noted the recent pandemic in different parts of the PRC, the expected slow-down in economic growth in the PRC and according to the 2021 Annual Report, (i) there is a decrease in new contract value from approximately RMB56.6 billion in 2020 to approximately RMB48.1 billion in 2021; (ii) approximately 63.6% of the new contract value in 2021 was attributable to building construction and over 40% of which were attributable to residential or commercial building construction; and (iii) the Group maintained stable operation in 2021, while due to the increase in individual provision for losses in relation to certain property developers, including China Evergrande Group, the Group made a total impairment provision of RMB1.92 billion, which eventually resulted in net loss of RMB358 million incurred by the Group. We have further obtained and reviewed an article "Exploring China market dynamics with credit data analysis" published on Bloomberg on 17 May 2022², according to which about 70% of China's high-

² <https://www.bloomberg.com/professional/blog/exploring-china-market-dynamics-with-credit-data-analysis/>

yield real-estate bonds have become uninvestable for funds with strict mandates, and the dollar-bond default rate hit a record-breaking 4.5% as of April 2022. The increase in default rate of real estate developers would also increase the credit risk for receivables from real estate developers. Taking into account the continuous worsening of default rate of real estate developers in the PRC and the Group had recorded significant increase in individual provision for losses in relation to certain property developers in 2021, we are of the view that it is reasonable for the Group to take up less real estate development projects in the near future. Nevertheless, further taking into account the development focus and positioning of the Group, in particular the large-scale construction of Xiong'an New Area (as further elaborated below) which was consistent with the increase in new contract value related to Beijing-Tianjin-Hebei area obtained by the Group in 2021, we concur with the management of the Group that it is reasonable to assume that the Group's labor costs are expected to remain stable in the next three years.

According to the article "Construction of China's 'City of Future' in full swing" published by The State Council Information Office of the PRC on 1 April 2022³ (the "Article"), it was stated that (i) the PRC Government announced plans to establish Xiong'an New Area on 1 April 2017, to relieve Beijing of functions non-essential to its role as the national capital and advance the coordinated development of the Beijing-Tianjin-Hebei region; (ii) by the end of 2021, construction has begun on 177 key projects in Xiong'an, with a total investment of RMB618.4 billion. Sixty of them have been completed; (iii) centrally-administered state-owned enterprises of the PRC are actively taking part in the construction of the Xiong'an New Area and have set up more than 100 subsidiaries and branches in the area, according to the State-owned Assets Supervision and Administration Commission of the State Council; (iv) to provide quality public service, Beijing-based universities, hospitals, and schools are building or will build branches in Xiong'an, or entering into partnerships with Xiong'an counterparts; (v) in the first quarter of 2022, construction began on 43 projects in industries, public services, infrastructure and ecological preservation in Xiong'an, with a total investment of RMB60 billion; and (vi) through 2022, 232 major projects are planned for launch in Xiong'an, with a total investment of RMB700 billion. Based on the Article, state-owned enterprises are actively taking part in the construction of the Xiong'an New Area, while, as stated above, the net loss recorded by the Group for the year ended 31 December 2021 was principally attributable to the increase in credit impairment losses and asset impairment losses which was mainly attributable to the deterioration in the credit standing of certain customers of property developers. Taking into account the aforesaid, we are of the view that it is reasonable for Baoding Tianli to increase its cooperation with central and state-owned enterprises which reduced the room for increase in business transactions between the Group and Baoding Tianli.

³ http://english.scio.gov.cn/in-depth/2022-04/01/content_78142828.htm

On the other hand, we noted the Group's decision and consideration of supply chain safety which aims to proactively control the proportion of a single labor service provider in the overall labor costs and reduce its reliance on a single labor service provider. In assessing the reasonableness for the implementation of such control, we have obtained and reviewed the gross domestic product growth rate of the PRC from The World Bank in recent years and noted that the growth rate for 2018 was approximately 6.7%, and was reduced to approximately 5.9% in 2019 and 2.3% in 2020. Although the PRC has recorded a rebound in real GDP growth for 2021 to approximately 8.1% following the low GDP growth in 2020, according to The World Bank, the growth is projected to slow to 5.0% in 2022. We have further obtained and reviewed an article "Exploring China market dynamics with credit data analysis" published on Bloomberg on 17 May 2022⁴, according to which about 70% of China's high-yield real-estate bonds have become uninvestable for funds with strict mandates, and the dollar-bond default rate hit a record-breaking 4.5% as of April 2022. We understand that the engaging subcontractors to perform construction works is not uncommon in real estate development industry, and, therefore, the increase in default in payment by real estate developers to its subcontractors may result in financial difficulties in certain subcontractors. Taking into account the aforesaid, we concur with the management of the Company that it is reasonable for the Group to implement such control to reduce concentration risk in reliance on certain suppliers or service providers without causing material disruption to the operation of the Group.

Taking into account the above and, as stated in the 2021 Annual Report, Hebei Construction Group will continue to capture various historical opportunities from collaborative development of Beijing-Tianjin-Hebei region, large-scale construction of Xiong'an New Area, Beijing Daxing Airport Economic Zone and developing Beijing-Tianjin-Hebei region into a world-class city cluster, the Group has established relationship with Baoding Tianli and the transaction amount between the Group and Baoding Tianli was relatively stable in recent years, we concur with the Company that the reduction in Baoding Tianli Transaction to Labor Cost Ratio, if any, is currently not expected to be material and, therefore, we concur with the Company that it is reasonable to assume that the Baoding Tianli Transaction to Labor Cost Ratio is not expected to increase.

In addition, we note that total subcontracting fees paid by the Group to Baoding Tianli and its associates for the four months ended 30 April 2022 was approximately RMB976 million (representing an utilisation rate of approximately 73.2% as stated above). We are being advised by the management of the Group that the relatively low utilisation rate for the four months ended 30 April 2022 was principally attributable to the government restrictions and controls in relation to the outbreak of COVID-19 in Baoding during the four months ended 30 April 2022. The relevant restrictions and controls have been eased subsequently. We have checked the number of reported COVID-19 cases of Hebei Province and noted that there was a surge in such number during March and April 2022,

⁴ <https://www.bloomberg.com/professional/blog/exploring-china-market-dynamics-with-credit-data-analysis/>

and we also noted that certain areas of Baoding were subject to lockdown measures during the four months ended 30 April 2022. Taking into account the facts that the relevant restrictions and controls have been subsequently eased, the utilisation rate for the four months ended 30 April 2022 still exceeded 70% and it is not feasible to forecast the possibility of further outbreak of COVID-19, if any, we concur with the management of the Group that although the utilisation rate for the four months ended 30 April 2022 was approximately 73.2%, it is still reasonable for the Group to maintain an annual cap of RMB4,000 million for the year ending 31 December 2023.

Taking into account the aforesaid and the fact that the proposed annual cap under the New Labor Subcontract Framework Agreement for each of the year ending 31 December 2023, 2024 and 2025 would represent approximately 31.1% of the labor costs of the Group in 2021 which was comparable to the actual Baoding Tianli Transaction to Labor Cost Ratio in 2019 to 2021, we consider that the proposed Annual Caps are fair and reasonable.

6. Conclusion

Taking into account the aforesaid, we concur with the view of the Directors that engaging Baoding Tianli and its associates for the provision of labor subcontracting services under the New Labor Subcontract Framework Agreement is in the ordinary and usual course of business of the Group, the New Labor Subcontract Framework Agreement is entered into on normal commercial terms and the terms and the proposed annual caps of the continuing connected transactions contemplated thereunder are fair and reasonable, and in the interests of the Group and its Independent Shareholders as a whole.

RECOMMENDATION

Having considered the factors and analyses above, we consider that (i) the engaging of Baoding Tianli and its associates to provide labor subcontracting services under the New Labor Subcontract Framework Agreement is part of the ordinary and usual course of business of the Group; (ii) the terms of New Labor Subcontract Framework Agreement are on normal commercial terms; (iii) the entering into of the New Labor Subcontract 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 Labor Subcontract 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 AGM to approve the New Labor Subcontract Framework Agreement and the Annual Caps.

Yours faithfully,
for and on behalf of
HALCYON CAPITAL LIMITED



Derek C.O. Chan
Chairman



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.