



RAINBOW CAPITAL (HK) LIMITED
波博資本有限公司

10 August 2022

To the Independent Board Committee and the Independent Shareholders

Chongqing Iron & Steel Company Limited
No. 2 Jiangnan Avenue,
Jiangnan Street,
Changshou District,
Chongqing

Dear Sir or Madam,

CONTINUING CONNECTED TRANSACTIONS SUPPLEMENTAL SERVICE AND SUPPLY AGREEMENT

INTRODUCTION

We refer to our appointment as the independent financial adviser to the Independent Board Committee and the Independent Shareholders in respect of the transactions contemplated under the Supplemental Service and Supply Agreement (the “**Transactions**”) and the proposed annual caps (the “**Proposed Caps**”) for the Transactions up to 31 December 2023, details of which are set out in the “Letter from the Board” (the “**Letter from the Board**”) contained in the circular issued by the Company to the Shareholders dated 10 August 2022 (the “**Circular**”), of which this letter forms part. Unless the context otherwise requires, capitalised terms used in this letter shall have the same meanings as those defined in the Circular.

On 1 April 2021, the Company entered into the Service and Supply Agreement with China Baowu, whereby the Group will provide products to China Baowu Group, and China Baowu Group will provide products, materials and services to the Group. The transactions contemplated under the Service and Supply Agreement were approved by the then independent Shareholders at the 2020 annual general meeting of the Company held on 29 June 2021. On 8 July 2022, the Company and China Baowu entered into the Supplemental Service and Supply Agreement, pursuant to which the type of products, materials and services to be sold and the annual caps for the transactions contemplated under the Service and Supply Agreement are revised.

As at the Latest Practicable Date, China Baowu was interested in approximately 26.97% of the issued share capital of the Company, among which approximately 1.46% was directly held by China Baowu and approximately 25.51% was indirectly controlled by China Baowu through Changshou Iron & Steel. China Baowu has the control of 65% equity interest in Changshou Iron & Steel by the acting in concert agreement with Chongqing Strategic Emerging Equity Investment Fund Partnership (Limited Partnership). As China Baowu is the indirect controlling shareholder of Changshou Iron & Steel, it is an indirect substantial shareholder of the Company and therefore a connected person of the Company under Chapter 14A of the Listing Rules. As such, the Transactions constitute continuing connected transactions for the Company under Chapter 14A of the Listing Rules.

As the highest applicable percentage ratio for the Proposed Caps is more than 5%, the Transactions constitute non-exempt continuing connected transactions under Chapter 14A of the Listing Rules, which are subject to the reporting, announcement, independent shareholders' approval and annual review requirements under Chapter 14A of the Listing Rules. China Baowu, Changshou Iron & Steel and Baowu Group Zhongnan Iron and Steel Co., Ltd. will abstain from voting on the resolution approving the Transactions and the Proposed Caps at the EGM.

The Independent Board Committee, comprising all the three independent non-executive Directors, namely Mr. Sheng Xuejun, Mr. Zhang Jinruo and Mr. Guo Jiebin, has been formed to advise the Independent Shareholders on whether (i) the Transactions are in the ordinary and usual course of business of the Group; (ii) the Transactions are on normal commercial terms which are fair and reasonable; (iii) the entering into of the Supplemental Service and Supply Agreement is in the interests of the Company and the Shareholders as a whole; and (iv) the Proposed Caps are fair and reasonable. We, Rainbow Capital, have been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in the same regard.

As at the Latest Practicable Date, we did not have any relationships or interests with the Group and China Baowu Group that could reasonably be regarded as relevant to our independence. We have acted as the independent financial adviser to the independent board committee and the independent shareholders of the Company in relation to (i) the major and connected transaction in relation to the lease agreement entered into with Changshou Iron & Steel in relation to certain production facilities, details of which are set out in the circular of the Company dated 14 December 2020; (ii) the continuing connected transactions between China Baowu Group and the Group, details of which are set out in the circular of the Company dated 19 February 2021; (iii) the continuing connected transactions between China Baowu Group and the Group in relation to, among others, the Service and Supply Agreement, details of which are set out in the circular of the Company dated 28 May 2021; and (iv) the discloseable and connected transaction in relation to the asset purchase agreement entered into between the Group and Changshou Iron & Steel, details of which are set out in the circular of the Company dated 26 July 2021. Other than that, there was no engagement or connection between the Group or China Baowu Group and us in the last two years. Apart from normal professional fees paid or payable to us in connection with this appointment as the Independent Financial Adviser, no arrangements exist whereby we had received any fees or benefits from the Group or China Baowu Group. Accordingly, we are qualified to give independent advice in respect of the Transactions (including the Proposed Caps).

BASIS OF OUR OPINION

In formulating our opinion and advice, we have relied on (i) the information and facts contained or referred to in the Circular; (ii) the information supplied by the Group and its advisers; (iii) the opinions expressed by and the representations of the Directors and the management of the Group; and (iv) our review of the relevant public information. We have assumed that all the information provided and representations and opinions expressed to us or contained or referred to in the Circular were true, accurate and complete in all respects as at the date thereof and may be relied upon. We have also assumed that all statements contained and representations made or referred to in the Circular are true at the time they were made and continue to be true as at the Latest Practicable Date and all such statements of belief, opinions and intentions of the Directors and the management of the Group and those as set out or referred to in the Circular were reasonably made after due and careful enquiry. We have no reason to doubt the truth, accuracy and completeness of the information and representations provided to us by the Directors and the management of the Group. We have also sought and received confirmation from the Directors that no material facts have been withheld or omitted from the information provided and referred to in the Circular and that all information or representations provided to us by the Directors and the management of the Group are true, accurate, complete and not misleading in all respects at the time they were made and continued to be so until the date of the Circular.

We consider that we have reviewed sufficient information currently available to reach an informed view and to justify our reliance on the accuracy of the information contained in the Circular so as to provide a reasonable basis for our recommendation. We have not, however, carried out any independent verification of the information provided, representations made or opinion expressed by the Directors and the management of the Group, nor have we conducted any form of in-depth investigation into the businesses, affairs, operations, financial position or future prospects of the Group, China Baowu Group or any of their respective substantial shareholders, subsidiaries or associates.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In considering whether the terms of the Supplemental Service and Supply Agreement (including the Proposed Caps) are fair and reasonable, we have taken into account the principal factors and reasons set out below:

1. Information on the Group and China Baowu Group

The Company was established in 1997 and its Shares have been listed on the Main Board of the Stock Exchange since 1997 and on the Shanghai Stock Exchange since 2007. The Group is principally engaged in the production, processing and sale of steel products including steel plates, steel sections, wire rods, bar materials, billets and thin plates as well as production and sale of coking and coal chemical products, pig iron and grain slag, steel slag and steel scrap. The Group's products are applied in various industries such as machinery, architecture, engineering, automobile, motorbike, shipbuilding, offshore oil, gas cylinder, boiler and oil and gas pipelines.

China Baowu is a state-owned capital investment company wholly-owned by the State-owned Assets Supervision and Administration Commission of the State Council. Its business scope includes operating state-owned assets within the scope authorised by the State Council, as well as carrying out relevant state-owned capital investment and operation. China Baowu has been maintaining a leading position in the iron and steel manufacturing industry, with total assets of approximately RMB1,117.1 billion as at 31 December 2021, revenue of approximately RMB972.3 billion and profit of approximately RMB60.2 billion for the year ended 31 December 2021.

2. Reasons for Entering Into the Supplemental Service and Supply Agreement

We have discussed with the management of the Company on the reasons for entering into the Supplemental Service and Supply Agreement and we understood that the Supplemental Service and Supply Agreement could assist the Group in (i) utilizing its production capacity in a more efficient manner; (ii) promoting the improvement of the procurement system; and (iii) realizing the latest strategic plan of the Group.

As stated in the annual report of the Company for the year ended 31 December 2021 (the “**2021 Annual Report**”), in December 2021, the Ministry of Industry and Information Technology of the PRC issued the “Industry Development Plan for Raw Materials in the fourteenth Five-Year-Plan period”, which proposed that the production capacity of crude steel (including the steel billets) shall not further increase (the “**Production Limitation**”). As disclosed in the 2021 Annual Report, the Group’s actual production volume of steel billets was approximately 7.1 million tonnes for the year ended 31 December 2021. Although the Group’s maximum production volume of steel billets for the year ending 31 December 2022 and 2023 could be approximately 10 million tonnes and 11 million tonnes respectively, the planned production volume of steel billets would remain at approximately 7.1 million tonnes per year, which was the same as the actual production volume for the year ended 31 December 2021, due to the Production Limitation. This would result in idle capacity for the production of steel billets which creates inefficiency. Furthermore, although steel products are not subject to Production Limitation, the Production Limitation on steel billets would also have adverse impact on the Group’s production volume of steel products, as steel products are produced by further processing steel billets. The Group could not produce steel products in full capacity due to shortage of steel billets, resulting in idle capacity for the production of steel products.

The Supplemental Service and Supply Agreement and the Transactions could help utilize the idle capacity and solve the inefficiency by (i) allowing the Group to provide commissioned processing services to China Baowu Group, in which the Group would use the idle capacity to produce steel billets for China Baowu Group and the production amounts under this service are not subject to the Production Limitation; and (ii) allowing the Group to procure additional steel billets from China Baowu Group as raw materials so as to fully utilize the production capacity of steel products.

In addition, one of the business plans of the Group is to improve the procurement system so as to lower the procurement costs. As advised by the management of the Group, the Group is gradually shifting from fragmented third-party procurement to collective procurement through China Baowu Group. Given China Baowu Group is a leading iron and steel manufacturer with high credit standing in the PRC, it is familiar with the procurement of relevant materials and has stronger bargaining power than the Group. Leverage on China Baowu's brand, channels and resources, the Group would be able to enjoy not only stable supply of materials but also favorable pricing and payment terms.

As advised by the management of the Group, in order to improve the efficiency and achieve low-carbon emission, the Group has developed new strategic investment plans which include, among others, construction projects related to upgrading the production facilities. The Group plans to procure relevant services including construction, software development and labour services from China Baowu Group and the transaction amounts would increase accordingly.

After taking into account the factors above, we consider that the entering into of the Supplemental Service and Supply Agreement and the Transactions are conducted in the ordinary and usual course of business of the Group and are in the interests of the Company and the Shareholders as a whole.

3. Principal Terms of the Supplemental Service and Supply Agreement

The Supplemental Service and Supply Agreement was entered into on 8 July 2022 between the Company and China Baowu. Details of the terms of the Supplemental Service and Supply Agreement are set out in the Letter from the Board, which are summarised as follows:

Term : From the effective date of the agreement to 31 December 2023

Subject Matter : (i) China Baowu agreed to (by itself and/or China Baowu Group) provide the Group with the products, materials and services as follows:

- (a) raw materials such as iron ore, scrap steel, refractory materials, accessories (including dolomite, limestone, etc.), steel billets, coal, etc.;
- (b) production materials such as chemical materials, equipment and spare parts, water, etc.; and
- (c) technical services (including construction, software development and labour services, etc.), road transportation services and sanitation and greening services, etc.

- (ii) The Company (by itself and/or the Group) agreed to provide China Baowu Group with the materials and services as follows:
 - (a) production materials such as water, electricity, natural gas, steel billets, steel products, pig iron, solid waste, etc.;
 - (b) other services (including processing, quality control and technical consultation and other technical services), etc.

Pricing basis : In accordance with the prevailing pricing standards, the basis of price for each of the transactions under the Service and Supply Agreement, as supplemented by the Supplemental Service and Supply Agreement, is as follows:

Type	Pricing principle
Products and materials provided by China Baowu Group to the Group	<ul style="list-style-type: none"> (a) Marketing pricing for raw materials and production materials; and (b) State pricing for water (the price is determined by the Development and Reform Commission of Changshou District, Chongqing City by public notice from time to time (please refer to fzggw.cq.gov.cn for details); the current price of water was published in 2016)
Services provided by China Baowu Group to the Group	Market pricing
Products provided by the Group to China Baowu Group	<ul style="list-style-type: none"> (a) State pricing for water, electricity, natural gas, etc. (the price is determined by the Development and Reform Commission of Changshou District, Chongqing City by public notice from time to time (please refer to fzggw.cq.gov.cn for details); the current price of water was published in 2016 and the current price of electricity and natural gas was published in 2020); and (b) Market pricing for steel billets, steel products, pig iron, solid waste, etc.

Services provided by the Market pricing
Group to China Baowu
Group

Payment terms : The price for the provision of services or materials may be settled by one-off payment or installments. The time of payment shall be determined by the parties based on the nature of the services or materials and the usual business practice of the provision of the services or materials.

Conditions precedent : The Supplemental Service and Supply Agreement is conditional upon the passing of the resolution(s) approving the Supplemental Service and Supply Agreement and the transactions contemplated thereunder (including the Proposed Caps) by the Independent Shareholders at the EGM to be convened.

We have compared the Supplemental Service and Supply Agreement with the Service and Supply Agreement and noted that there are three newly added items under the Supplemental Service and Supply Agreement which are (i) steel billets procured from China Baowu Group as semi-finished products for the production of steel products of the Group; (ii) solid waste sold by the Group to China Baowu Group; and (iii) other services provided by the Group to China Baowu Group.

The pricing standards under the Service and Supply Agreement would still apply under the Supplemental Service and Supply Agreement. The transactions contemplated under the Service and Supply Agreement were approved by the then independent Shareholders at the 2020 annual general meeting of the Company held on 29 June 2021, details of which are set out in the circular of the Company dated 28 May 2021. The pricing basis of the three newly added items under the Supplemental Service and Supply Agreement are all market pricing, indicating that the prices shall be generally consistent with the market prices and shall be no less favorable to the Group than those received from or provided to other independent third parties.

In assessing whether there are internal control procedures to ensure the market pricing standard stated above, we have discussed with the management of the Group and understood the following:

In relation to the provision of products, materials and services by China Baowu Group to the Group, the finance department of the Company will carry out the pricing management and will lead the relevant department to conduct research on relevant market prices. For the procurement of steel billets from China Baowu Group, before entering into the final procurement agreements, the Group would compare the prices provided by China Baowu Group with the prevailing market prices available from industry websites such as www.mysteel.com and www.steelhome.cn (the “**Relevant Websites**”).

For the provision of materials and services by the Group to China Baowu Group, the Company will also conduct the pricing management and the price shall not be lower than the price of the same type of products provided by the Group to independent third parties. For the provision of solid waste and other services to China Baowu Group, the selling prices of the Group's materials or services shall be determined with reference to the market price information gathered by (i) the internal database maintained by the operation departments of the Company based on the recent invoices issued to independent third parties; or (ii) the industry website such as www.baiinfo.com.

On the above bases, we consider that the terms of the Supplemental Service and Supply Agreement are on normal commercial terms which are fair and reasonable.

4. The Proposed Annual Caps for the Transactions

The Proposed Caps for the transactions under the Supplemental Service and Supply Agreement for the two years ending 31 December 2023 ("FY2022" and "FY2023", respectively) are set out below:

	FY2022	FY2023
	<i>(RMB million)</i>	<i>(RMB million)</i>
Procurement of products, materials and services from China Baowu Group		
(i) Products and materials		
– Raw materials such as iron ore, scrap steel, refractory materials, accessories (including dolomite, limestone, etc.), steel billets, coal, etc.	40,446	46,682
– Production materials such as chemical materials, equipment and spare parts, water, etc.	2,574	2,585
(ii) Services		
– Technical services (including construction, software development and labour services, etc.), road transportation services and sanitation and greening services, etc.	4,753	4,316
Supply of materials and services to China Baowu Group		
– Production materials such as water, electricity, natural gas, steel billets, steel products, pig iron, solid waste, etc.	16,706	20,051
– Other services (including processing, quality control and technical consultation and other technical services), etc.	7,150	7,975

In assessing the fairness and reasonableness of the Proposed Caps, we have compared the original annual caps under the Service and Supply Agreement with the Proposed Caps and understood the difference between them, details of which are set out below:

(i) Procurement of products, materials and services from China Baowu Group

(a) Raw materials

As illustrated in the table below, the annual cap for procurement of raw materials from China Baowu Group is proposed to increase by approximately RMB12.1 billion and RMB16.2 billion for FY2022 and FY2023, respectively.

	FY2022	FY2023
	<i>(RMB million)</i>	<i>(RMB million)</i>
The proposed caps for raw materials (A)	40,446	46,682
Original caps for raw materials (B)	28,382	30,458
Difference (A-B)	12,064	16,224
Shortage of steel billets (million tonnes) (C)	2.9	3.9
Average purchase price (RMB per tonne) (D)	4,160	4,160
Transactions amount (C × D)	12,064	16,224

We have discussed with the management of the Company and understood that such increase is mainly due to the new demand on procurement of steel billets for the production and sales of steel products of the Group.

As stated in the section headed “2. Reasons for entering into the Supplemental Service and Supply Agreement” above, steel billets are semi-finished products that require further processing to become steel products. As disclosed in the 2021 Annual Report, the Group has the capacity to produce over 10 million tonnes of steel. However, due to the Production Limitation, the Group’s planned production amount of steel billets would be limited to approximately 7.1 million tonnes per year, representing shortfall of approximately 2.9 million tonnes and 3.9 million tonnes as compared to the maximum production volume of approximately 10.0 million tonnes and 11.0 million tonnes for FY2022 and FY2023, respectively. In order to have sufficient steel billets to fully utilize the production capacity of steel products (i.e. the end products), the Group plans to procure steel billets of approximately 2.9 million tonnes and 3.9 million tonnes for FY2022 and FY2023, respectively, from China Baowu Group to fill the shortfall.

The estimated purchase price of RMB4,160 per tonne is determined with reference to the historical market price of steel billets. We have reviewed the historical market price of steel billets in the PRC from the Relevant Websites and noted that the average market price of steel billets for the year ended 31 December 2021 amounted to approximately RMB4,747 per tonne (i.e. approximately RMB4,200 per tonne, tax exclusive), which is generally consistent with the estimated purchase price. The steel billets price further increased to approximately RMB4,800 per tonne (tax inclusive) in April 2022 and then decreased to approximately RMB4,000 per tonne (tax inclusive) by the end of June 2022 as a result of the latest outbreak of COVID-19 in the PRC. We consider it is reasonable to refer to the pre-epidemic prices as the outbreak shall eventually be contained.

After taking into account (1) the additional amounts on the annual caps are mainly for the procurement of steel billets; (2) the procurement amounts of steel billets are determined with reference to the Group's production capacity; and (3) the average purchase price is determined with reference to the historical market price of steel billets and generally consistent with the average market price for the year ended 31 December 2021, we consider the proposed annual caps for procurement of raw materials are fair and reasonable.

(b) *Production materials*

As illustrated in the table below, the annual cap for procurement of production materials from China Baowu Group is proposed to increase by approximately RMB1.62 billion and RMB1.58 billion for FY2022 and FY2023, respectively.

	FY2022	FY2023
	<i>(RMB million)</i>	<i>(RMB million)</i>
The proposed caps for production materials (A)	2,574	2,585
Original caps for production materials (B)	957	1,001
Difference (A-B)	1,617	1,584

We have discussed with the management of the Company and understood that such increase is mainly due to that (1) the Group is gradually shifting from fragmented third-party procurement to collective procurement through China Baowu Group, meaning the purchase amount of production materials from China Baowu Group will be increased by the amount the Group used to purchase from third party suppliers; and (2) the Group has additional demand on production materials for the increase in production volume and additional maintenance needs associated with the increasing production volume.

As advised by the management of the Company, the total procurement amount of production materials for the year ended 31 December 2021 amounted to approximately RMB1.63 billion. As compared to such historical procurement amount, the proposed caps for production materials of approximately RMB2.57 billion and RMB2.59 billion for FY2022 and FY2023 represent increase of approximately 57.7% and 58.8%, respectively, which is primarily attributable to that (1) the total production volume of steel billets is estimated to increase by approximately 40.8% and 54.9% from approximately 7.1 million for the year ended 31 December 2021 to approximately 10.0 million tonnes and 11.0 million tonnes for the year ended 31 December 2022 and 2023, respectively. The increase in production volume would accordingly increase the demand for production materials including chemical materials and water; and (2) maintenance works associated with the production volume would be increased. These maintenance works would in turn generate additional demand for production materials such as spare parts.

After taking into account proposed annual caps for production materials are determined with reference to (1) the total procurement amount for the year ended 31 December 2021 as the Group is gradually shifting its procurement to collective procurement through China Baowu Group; and (2) the additional demands for production materials due to the increasing production volume and additional maintenance needs, we consider the proposed annual caps for production materials are fair and reasonable.

(c) *Technical services*

As illustrated in the table below, the annual cap for procurement of technical services from China Baowu Group is proposed to increase by approximately RMB1.81 billion and RMB1.72 billion for FY2022 and FY2023, respectively.

	FY2022	FY2023
	<i>(RMB million)</i>	<i>(RMB million)</i>
The proposed caps for technical services (A)	4,753	4,316
Original caps for technical services (B)	2,943	2,597
Difference (A-B)	1,810	1,719
New construction projects	966	1,115
Completion of existing projects	786	416
Others	58	188
	<u>58</u>	<u>188</u>
Total	<u>1,810</u>	<u>1,719</u>

We have discussed with the management of the Company and understood that such increase is mainly due to (1) new construction projects to be implemented according to the latest investment plans; and (2) completion of existing projects.

We have reviewed the Group's latest investment plans for the next few years and compared the latest planned investment amounts with the original investment amounts under the Service and Supply Agreement. We noted that (1) the planned investment amount in relation to construction projects amounts to approximately RMB2,844 million for FY2022, representing an increase of approximately RMB966 million as compared to the original investment amount of approximately RMB1,878 million; (2) the planned investment amount in relation to construction projects amounts to approximately RMB2,625 million for FY2023, representing an increase of approximately RMB1,115 million as compared to the original investment amount of approximately RMB1,510 million. Based on the latest investment plans and discussion with the management of the Group, we understood that such additional investment is mainly for, among others, upgrading facilities to achieve higher production volume and lower carbon emission.

In addition, we have discussed with the management of the Group and understood that China Baowu Group is working on some construction projects for the Company and there have been some delays in the progress of these projects, of which the completion has been delayed to the next few years. According to the internal estimates of the Group, the Group expects to incur cost of approximately RMB786 million and RMB416 million for settlement of these existing projects for FY2022 and FY2023, respectively.

Others mainly comprise of service fees to be paid to China Baowu Group for the procurement and processing services provided by China Baowu Group. We have reviewed the draft procurement agreement and the services proposals and noted that the proposed caps are mainly determined with reference to (1) the procurement needs and production volume of the Group and (2) the fee proposed by China Baowu Group in the procurement agreement or services proposals.

After taking into account the proposed annual caps for technical services are mainly determined with reference to (1) the planned investment amount under the latest investment plans; and (2) the settlement needs for the ongoing projects, we consider the proposed annual caps for technical services are fair and reasonable.

(ii) **Provision of materials and services to China Baowu Group**

(a) *Production materials*

As illustrated in the table below, the annual cap for the provision of production materials to China Baowu Group would remain unchanged.

	FY2022	FY2023
	<i>(RMB million)</i>	<i>(RMB million)</i>
The proposed caps for production materials	16,706	20,051
Original caps for production materials	16,706	20,051

The Supplemental Service and Supply Agreement allows the Group to sell solid waste to China Baowu Group which was not covered by the Service and Supply Agreement. The original caps for production materials were sufficient to cover the additional sales of solid waste and hence were not revised.

(b) *Other services*

As illustrated in the table below, the annual caps for provision of other services to China Baowu Group amount to approximately RMB7.15 billion and RMB7.98 billion for FY2022 and FY2023, respectively.

	FY2022	FY2023
	<i>(RMB million)</i>	<i>(RMB million)</i>
The proposed caps for other services	7,150	7,975
Estimated production amount <i>(million tonnes)</i> (A)	2.6	2.9
Service fee <i>(RMB per tonne)</i> (B)	2,750	2,750
Transactions amount <i>(A × B)</i>	7,150	7,975

We have discussed with the management of the Company and understood that other services mainly related to commissioned processing services for steel billets to be provided by the Group. As stated in the section headed “2. Reasons for entering into the Supplemental Service and Supply Agreement” above, although the maximum production volume of steel billets for the year ending 31 December 2022 and 2023 could be approximately 10 million tonnes and 11 million tonnes respectively, the planned production volume of steel billets remain at approximately 7.1 million tonnes per year, which was the same as the actual production volume for the year ended 31 December 2021, due to the Production Limitation. As such, there would be idle capacity for the production of steel billets which amount to approximately 2.9 million tonnes and 3.9 million tonnes for FY2022 and FY2023.

The Supplemental Service and Supply Agreement allows the Group to provide commissioned processing services for steel billets to China Baowu Group, in which the Group would use the idle capacity to produce steel billets for China Baowu Group and the production volume under this service are not subject to the Production Limitation. After communicating with China Baowu Group, it is expected that they would require processing service for approximately 2.6 million tonnes and 2.9 million tonnes in 2022 and 2023, respectively. As such, the Group plans to produce steel billets of approximately 2.6 million tonnes and 2.9 million tonnes for China Baowu Group through commissioned processing services for FY2022 and FY2023, respectively.

As for the service fee of approximately RMB2,750 per tonne, it is mainly determined with reference to the difference between the historical market price of steel billets and the Group’s purchasing cost of raw materials (mainly iron ore) in April 2022. The numbers used in calculation of service fee are consistent with the data available from Relevant Websites and internal records provided by the Group.

After taking into the account proposed annual caps for other services are determined with reference to (1) the Group’s idle capacity for the production of steel billets and China Baowu Group’s demand for steel billets; and (2) the service fee which was estimated primarily based on the difference between the market price of steel billets and the cost of raw materials, we consider the proposed annual caps for other services are fair and reasonable.

Based on the factors and reasons stated above, we consider that the Proposed Caps for the Transactions are fair and reasonable.

5. Reporting Requirements and Conditions of the Continuing Connected Transactions

Pursuant to Rules 14A.55 to 14A.59 of the Listing Rules, the Transactions are subject to the following annual review requirements:

- (i) the independent non-executive Directors must review the Transactions and confirm in the annual report and accounts that the Transactions have been entered into:
 - (a) in the ordinary and usual course of business of the Group;
 - (b) on normal commercial terms or better; and
 - (c) according to the agreement governing them on terms that are fair and reasonable and in the interests of the Shareholders as a whole;
- (ii) the Company must engage its auditors to report on the Transactions every year. The Company's auditors must provide a letter to the Board (with a copy to be provided to the Stock Exchange at least ten business days before the bulk printing of the Company's annual report) confirming whether anything has come to their attention that causes them to believe that the Transactions:
 - (a) have not been approved by the Board;
 - (b) were not, in all material respects, in accordance with the pricing policies of the Group if the Transactions involve the provision of goods or services by the Group;
 - (c) were not entered into, in all material respects, in accordance with the relevant agreement governing the Transactions; and
 - (d) have exceeded the Proposed Caps;
- (iii) the Company must allow, and ensure that the counter-parties to the Transactions allow, the Company's auditors sufficient access to their records for the purpose of the reporting on the Transactions as set out in paragraph (ii); and
- (iv) the Company must promptly notify the Stock Exchange and publish an announcement if the independent non-executive Directors and/or auditors of the Company cannot confirm the matters as required.

In light of the reporting requirements attached to the Transactions, in particular, (i) the restriction of the value of the Transactions by way of the Proposed Caps; and (ii) the ongoing review by the independent non-executive Directors, the auditors of the Company and the CCT Management Committee of the terms of the Transactions and the Proposed Caps not being exceeded, we are of the view that appropriate measures have been in place to monitor the conduct of the Transactions and assist in safeguarding the interests of the Independent Shareholders.

OPINION AND RECOMMENDATION

Having taken into account the above principal factors and reasons, we consider that the continuing connected transactions contemplated under the Supplemental Service and Supply Agreement (including the Proposed Caps) are conducted in the ordinary and usual course of business of the Group and on normal commercial terms which are fair and reasonable so far as the Independent Shareholders are concerned and in the interests of the Company and the Shareholders as a whole. Accordingly, we advise the Independent Board Committee to recommend, and we ourselves recommend, the Independent Shareholders to vote in favour of the ordinary resolution to be proposed at the EGM to approve the continuing connected transactions contemplated under the Supplemental Service and Supply Agreement (including the Proposed Caps).

Yours faithfully,
For and on behalf of
Rainbow Capital (HK) Limited


Larry Choi
Managing Director

Mr. Larry Choi is a licensed person and a responsible officer of Rainbow Capital (HK) Limited registered with the Securities and Futures Commission to carry out type 1 (dealing in securities) and type 6 (advising on corporate finance) regulated activities under the SFO. He has over ten years of experience in the corporate finance industry.