
THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

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

If you have sold or transferred all your shares in Kunming Dianchi Water Treatment Co., Ltd., you should at once hand this circular and the proxy form and the reply slip for the Annual General Meeting to the purchaser or transferee or to the bank, stockbroker or other agent through whom the sale was effected for transmission to the purchaser or transferee.

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Kunming Dianchi Water Treatment Co., Ltd.

昆明滇池水务股份有限公司

(a joint stock company incorporated in the People's Republic of China with limited liability)

(Stock Code: 3768)

2018 ANNUAL GENERAL MEETING AND CONTINUING CONNECTED TRANSACTION UNDER THE NEW FRAMEWORK AGREEMENT

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



BAOQIAO PARTNERS CAPITAL LIMITED

A letter from the Board is set out on pages 4 to 24 of this circular. A letter from the Independent Board Committee containing its recommendation to the Independent Shareholders is set out on pages 25 to 26 of this circular. A letter from the Independent Financial Adviser, containing its advice to the Independent Board Committee and the Independent Shareholders, is set out on pages 27 to 51 of this circular.

The Annual General Meeting will be held at 2:30 p.m. on Friday, 21 June 2019 at the meeting room of the Company on the 1st floor at Wastewater Treatment Plant No. 7, Kunming Dianchi Tourist Resort, Yunnan Province, the PRC. The notice of AGM was despatched to the Shareholders on 6 May 2019.

If you intend to appoint a proxy to attend the AGM, you are required to complete and return the proxy form in accordance with the instructions printed thereon. For holders of H Shares, the proxy form should be returned to Tricor Investor Services Limited and for holders of Domestic Shares, the proxy form should be returned to the Company's registered office and headquarters in the PRC by personal delivery or by post not less than 24 hours before the time fixed for holding the AGM (i.e., before 2:30 p.m. on Thursday, 20 June 2019) or any adjourned meeting thereof. Completion and return of the proxy form will not preclude you from attending and voting in person at the AGM or at any other adjourned meeting should you so wish.

If you intend to attend the AGM in person or by proxy, you are required to complete and return the reply slip to Tricor Investor Services Limited (for holders of H Shares) or to the Company's registered office and headquarters in the PRC (for holders of Domestic Shares) on or before Friday, 31 May 2019 as set out in the AGM reply slip dispatched on 6 May 2019.

31 May 2019

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DEFINITIONS

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

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| “AGM” or “Annual General Meeting” | the 2018 annual general meeting of the Company to be held on Friday, 21 June 2019 at the meeting room of the Company on the 1st floor at Wastewater Treatment Plant No. 7, Kunming Dianchi Tourist Resort, Yunnan Province, the PRC |
| “Articles of Association” | the articles of association of the Company, as amended from time to time |
| “Board of Directors” or “Board” | the board of Directors of the Company |
| “Board of Supervisors” | the board of Supervisors of the Company |
| “Company” | Kunming Dianchi Water Treatment Co., Ltd. (昆明滇池水務股份有限公司), a joint stock company established in the PRC with limited liability on 23 December 2010, and its H Shares are listed on the Stock Exchange (stock code: 3768) |
| “connected person(s)” | has the meaning ascribed to it under the Listing Rules |
| “continuing connected transaction” | has the meaning ascribed to it under the Listing Rules |
| “controlling shareholder” | has the meaning ascribed to it under the Listing Rules |
| “Dianchi Investment Group” | Kunming Dianchi Investment and its subsidiaries, excluding the Group |
| “Director(s)” | director(s) of the Company |
| “Domestic Shares” | ordinary shares in the Company’s capital, with a nominal value of RMB1.00 each, which are subscribed for and paid up in RMB |
| “General Mandate” | a general mandate to be granted to the Board for exercising of the power of the Company to issue Domestic Shares and H Shares up to 20% of the total number of the Domestic Shares and H Shares of the Company, respectively, in issue on the date of passing the related resolution, subject to the conditions set out in the resolution proposed at the AGM for approving the general mandate |
| “Group” | the Company and its subsidiaries |

DEFINITIONS

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| “H Share(s)” | overseas listed foreign share(s) in the share capital of the Company with a nominal value of RMB1.00 each, which is listed on the Main Board of the Stock Exchange and traded in Hong Kong dollars |
| “HKD” or “HK\$” | Hong Kong dollar, the lawful currency of Hong Kong |
| “Hong Kong” | the Hong Kong Special Administrative Region of the People’s Republic of China |
| “Independent Board Committee” | an Independent Board Committee of the Company comprising all of the independent non-executive Directors (i.e. Mr. Yin Xiaobing, Mr. He Xifeng and Mr. Sin Lik Man) to advise the Independent Shareholders on the continuing connected transaction under the New Framework Agreement and the relevant proposed annual caps |
| “Independent Financial Adviser” or “BaoQiao Partners” | BaoQiao Partners Capital Limited, a licensed corporation to carry on Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities under the SFO, being the Independent Financial Adviser appointed by the Company to advise the Independent Board Committee and the Independent Shareholders on the continuing connected transaction under the New Framework Agreement and the relevant proposed annual caps |
| “Independent Shareholders” | the Shareholders other than Kunming Dianchi Investment and its associates |
| “Kunming Dianchi Investment” | Kunming Dianchi Investment Co., Ltd. (昆明滇池投資有限公司), a Company established in Yunnan Province, the PRC with limited liability on 13 October 2004, which is the controlling shareholder of the Company |
| “Latest Practicable Date” | 29 May 2019, being the latest practicable date prior to the printing of this circular for ascertaining certain information contained in this circular |
| “Listing” | the listing of the H Shares of the Company on the Stock Exchange on 6 April 2017 |
| “Listing Rules” | the Rules Governing the Listing of Securities on the Stock Exchange, as amended, supplemented and otherwise modified from time to time |

DEFINITIONS

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|-------------------------------------|---|
| “New Framework Agreement” | the entrusted operation and management framework agreement entered into by the Company and Kunming Dianchi Investment on 30 April 2019 |
| “Non-completion Agreement” | the non-competition agreement entered into between the Company and Kunming Dianchi Investment dated 25 April 2016 |
| “operation and management services” | the operation and management services provided by the Group to Dianchi Investment Group, including operation and management services for wastewater treatment facilities, reclaimed water supply facilities and running water supply facilities |
| “PRC” or “China” | the People’s Republic of China, excluding, for the purpose of this circular only, Hong Kong, Macau Special Administrative Region, and Taiwan region |
| “Previous Framework Agreement” | the entrusted operation and management framework agreement entered into by the Company and Kunming Dianchi Investment on 25 April 2016. For details, please refer to the Prospectus |
| “Prospectus” | the prospectus issued by the Company on 24 March 2017 for the purpose of Listing |
| “RMB” | Renminbi, the lawful currency of the PRC |
| “SFO” | the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong), as amended, supplemented or otherwise modified from time to time |
| “Share(s)” | share(s) in the share capital of the Company, with a nominal value of RMB1.00 each, comprising the Domestic Shares and H Shares |
| “Shareholder(s)” | holder(s) of the Share(s) |
| “Stock Exchange” | The Stock Exchange of Hong Kong Limited |
| “Subsidiary(ies)” | has the meaning ascribed to it in the Listing Rules |
| “Supervisor(s)” | supervisors of the Company |

LETTER FROM THE BOARD



Kunming Dianchi Water Treatment Co., Ltd. **昆明滇池水务股份有限公司**

(a joint stock company incorporated in the People's Republic of China with limited liability)

(Stock Code: 3768)

Board of Directors:

Executive Directors:

Ms. Guo Yumei (*Chairperson*)

Mr. Luo Yun

Non-executive Directors:

Ms. Ma Ce

Ms. Song Hong

Independent non-executive Directors:

Mr. Yin Xiaobing

Mr. He Xifeng

Mr. Sin Lik Man

*Registered office and headquarters
in the PRC:*

Wastewater Treatment Plant No. 7

Kunming Dianchi Tourist Resort

Yunnan Province

the PRC

Principal place of business

in Hong Kong:

Room 1901, 19/F, Lee Garden One

33 Hysan Avenue

Causeway Bay, Hong Kong

31 May 2019

To the Shareholders

Dear Sirs and Madams,

2018 ANNUAL GENERAL MEETING AND CONTINUING CONNECTED TRANSACTION UNDER THE NEW FRAMEWORK AGREEMENT

1. INTRODUCTION

On behalf of the Board of Directors, I invite you to attend the AGM to be held at 2:30 p.m. on Friday, 21 June 2019 at the meeting room of the Company on the 1st floor at Wastewater Treatment Plant No. 7, Kunming Dianchi Tourist Resort, Yunnan Province, the PRC.

The purpose of this circular is to provide you with the information reasonably necessary to enable you to make an informed decision on whether to vote for or against the proposed resolutions at the AGM.

LETTER FROM THE BOARD

2. BUSINESSES TO BE CONSIDERED AT THE AGM

The businesses to be considered at the AGM are described in more details in the notice of Annual General Meeting dated 6 May 2019.

Resolutions will be proposed at the AGM and passed as ordinary resolutions, which include:

- (a) the Report of the Board of Directors for 2018
- (b) the Report of the Board of Supervisors for 2018
- (c) the final accounts for 2018
- (d) the audited financial statements and independent auditors' report for the year ended 31 December 2018
- (e) the profit distribution plan for 2018
- (f) the financial budget plan for 2019
- (g) the authorization to the Board to determine the domestic and international auditors of the Company for the year 2019 and their remunerations
- (h) amendments to the "Implementation Rules for Audit Committee of the Board"
- (i) the election of Ms. Zhao Zhu as a non-executive Director

Resolutions will be proposed at the AGM and passed as special resolutions, which include:

- (j) the General Mandate to issue Shares

Meanwhile, a resolution will be proposed by the Independent Shareholders at the AGM and passed as an ordinary resolution, which includes:

- (k) to approve the New Framework Agreement and the continuing connected transaction thereunder

In order to enable you to have a better understanding of the resolutions to be proposed at the AGM and to make an informed decision in the circumstance where sufficient and necessary information is available, we have provided detailed information in this circular.

LETTER FROM THE BOARD

3. BUSINESSES OF THE AGM

3.1 Regular Businesses of the AGM

3.1.1 To consider and approve the Report of the Board of Directors of the Company for 2018

The text of the Report of the Board of Directors for 2018 is set out in the section headed “Report of the Board of Directors” in the Company’s 2018 annual report published on the website of the Stock Exchange on 26 April 2019.

3.1.2 To consider and approve the Report of the Board of Supervisors of the Company for 2018

The text of the Report of the Board of Supervisors for 2018 is set out in the section headed “Report of the Board of Supervisors” in the Company’s 2018 annual report published on the website of the Stock Exchange on 26 April 2019.

3.1.3 To consider and approve the final accounts of the Company for 2018

The auditors of the Company, PricewaterhouseCoopers Zhong Tian LLP (Special General Partnership) and PricewaterhouseCoopers, have audited the financial statements for 2018 based on the operations of the Company, and have issued standard unqualified opinions.

Summary of the final accounts of the Company for 2018 prepared in accordance with International Financial Reporting Standards is as follows: total assets amounted to approximately RMB7,444.02 million, total liabilities amounted to approximately RMB3,538.94 million, net assets amounted to approximately RMB3,905.08 million, revenues amounted to approximately RMB1,429.79 million and total profits amounted to approximately RMB415.22 million.

3.1.4 To consider and approve the audited financial statements of the Company and the independent auditors’ report for the year ended 31 December 2018

The audited financial statements and independent auditors’ report for the year ended 31 December 2018 are set out in the sections headed “Independent Auditors’ Report” and “Financial Statements” in the Company’s 2018 annual report published on the website of the Stock Exchange on 26 April 2019.

3.1.5 To consider and approve the profit distribution plan of the Company for 2018

The Board recommends the distribution of a final dividend of RMB0.1714 per share (tax inclusive) for the year ended 31 December 2018 to all Shareholders, totaling RMB176,389,625.40 (tax inclusive). In respect of distribution of the final dividend, the dividend for holders of Domestic Shares of the Company shall be declared and paid in RMB while the dividend for holders of H Shares of the Company shall be declared in RMB and paid in Hong Kong dollars. The actual amount of dividend distributed in Hong Kong dollars for H Shares shall be calculated using the average exchange rate published by the People’s Bank of China within one week prior to the date of the Annual General Meeting. Upon consideration for and passing of the profit distribution plan for 2018 of the Company at the AGM, the final dividend shall be distributed in cash on Thursday, 8 August 2019 to the holders of H Shares whose names appear on the H Shares register of members on Tuesday, 2 July 2019.

LETTER FROM THE BOARD

For the purpose of determining the list of shareholders who are entitled to the above final dividend, the Share register of members of the Company will be closed from Thursday, 27 June 2019 to Tuesday, 2 July 2019 (both days inclusive). In order to be qualified for the final dividend for the year ended 31 December 2018 (subject to approval of Shareholders), the holders of unregistered H Shares are required to submit the transfer documents to the Company's H Share Registrar, Tricor Investor Services Limited at Level 22, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 4:30 p.m. on Wednesday, 26 June 2019.

It is proposed to Shareholders at the AGM to authorise the Board and its authorized persons to implement the above profit distribution plan, and proposed for the Board to delegate its authority to the Company's management for implementing all relevant matters relating to the above profit distribution plan at the time when it obtains the above authority.

Pursuant to the Enterprise Income Tax Law of the PRC and its implementation rules, which came into force on 1 January 2008 and other relevant rules, where the Company distributes the proposed 2018 final dividend to non-resident enterprise Shareholders whose names appear on the register of members for H Shares of the Company, it is required to withhold and pay enterprise income tax at the rate of 10%. Any H Shares registered in the name of non-individual registered Shareholders, including HKSCC Nominees Limited, other nominees or trustees, or other organisations or groups, will be treated as shares being held by non-resident enterprise Shareholders, and consequently will be subject to the withholding of the enterprise income tax.

According to the requirements of the State Administration of Taxation (Guo Shui Han [2011] No. 348) and the relevant laws and regulations, if the individual holders of H shares are residents of Hong Kong or Macau or those countries which have entered into a tax treaty with the PRC stipulating a dividend tax rate of 10%, the Company will withhold and pay individual income tax at the rate of 10% on behalf of these Shareholders. If the individual holders of H shares are residents of those countries which have entered into a tax treaty with the PRC stipulating a dividend tax rate of less than 10%, the Company will assist them to make applications to seek entitlement of the relevant agreed preferential treatments pursuant to the relevant tax treaty. If the individual holders of H shares are residents of those countries which have entered into a tax treaty with the PRC stipulating a dividend tax rate of more than 10% but less than 20%, the Company will withhold and pay individual income tax at the actual tax rate stipulated in the relevant tax treaty. If the individual holders of H shares are residents of those countries which have entered into a tax treaty with the PRC stipulating a dividend tax rate of 20%, or those countries which have not entered into any tax treaties with the PRC, or under any other circumstances, the Company will withhold and pay individual income tax at the rate of 20% on behalf of these Shareholders.

LETTER FROM THE BOARD

The Company will determine the resident status of the individual holders of H Shares based on the registered address as recorded in the register of members of the Company on Tuesday, 2 July 2019 (the “**Registered Address**”). If the resident status of any individual holders of H Shares is not consistent with that indicated by the Registered Address, such individual holders of H Shares shall notify the Company’s H Share Registrar not later than 4:30 p.m. on Wednesday, 26 June 2019, and provide relevant supporting documents to the Company’s H Share Registrar, Tricor Investor Services Limited, at Level 22, Hopewell Centre, 183 Queen’s Road East, Hong Kong. Any individual holders of H Shares who fail to provide relevant supporting documents within the time period stated above, may either personally or appoint an agent to attend to the relevant procedures in accordance with the requirements under the tax treaty notice.

The Company assumes no responsibility and disclaims all liabilities whatsoever in relation to the tax status or tax treatment of the individual holders of H Shares and for any claims arising from any delay in or inaccurate determination of the tax status or tax treatment of the individual holders of H Shares or any disputes over the withholding mechanism or arrangements.

3.1.6 To consider and approve the annual financial budget plan of the Company for 2019

A resolution for approving the annual budget plan for 2019 shall be proposed at the Annual General Meeting. The specific details of the annual budget plan for 2019 are as follows:

In 2019, the Company plans to invest a total of approximately RMB3,570 million in markets, project construction, technology research and development and other areas, with estimated aggregate cash payments of approximately RMB1,300 million, including RMB630 million to be invested in engineering projects, approximately RMB600 million to be invested in markets, approximately RMB70 million to be invested in other items such as information, technology research and development, major and medium repairs, purchases of fixed assets.

3.1.7 To consider and approve the authorization to the Board to determine the domestic and international auditors of the Company for the year 2019 and their remunerations

In order to comply with the regulatory requirements of the State-owned Assets Supervision and Administration Commission of Kunming and the relevant provisions of the Stock Exchange and in accordance with the Law of the People’s Republic of China on Tenders and Bids and other relevant laws, regulations and normative documents, combined with the actual situation of the Company, the Board proposes to the AGM to consider, approve and authorize the Board to determine the Company’s domestic and international auditors in 2019 and determine their remuneration.

The Company has recently conducted bidding process, and Zhongshen Zhonghuan Certified Public Accountants (Special General Partnership) (“**ZSZH**”) and Mazars CPA Limited (“**Mazars**”) have respectively won the bid for the domestic and international auditors of the Company for the year 2019.

LETTER FROM THE BOARD

The proposed appointments of ZSZH and Mazars will be effective after the AGM approves the resolution authorizing the Board to determine the domestic and international auditors of the Company for the year 2019 and after the Company signs engagement letters with each of them.

The current domestic auditors of the Company, PricewaterhouseCoopers Zhong Tian LLP (Special General Partnership) (“**PwC Zhong Tian**”) and international auditors PricewaterhouseCoopers Certified Public Accountants (“**PwC**”) will retire as the Company’s domestic and international auditors, respectively, at the conclusion of the AGM. The Board of Directors confirmed that there is no matter relating to the proposed change of external auditors that needs to be brought to the attention of the Shareholders. The Board of Directors has also confirmed that there are no disagreements or outstanding matters between the Company and PwC Zhong Tian and PwC.

3.1.8 To consider and approve the amendment to the “Implementation Rules for Audit Committee of the Board”

In order to reflect the recent amendments to the Listing Rules of the Stock Exchange and the actual situation of the Company, the Board proposes to the AGM to approve corresponding amendments to the current “Implementation Rules for Audit Committee of the Board” of the Company. Details are as follows:

| Existing version | Amended version |
|---|--|
| Article 3 The Audit Committee shall comprise three Directors (including two independent Directors). The members shall include at least one independent Director who shall be a professional accountant with qualifications stipulated under Rule 3.10(2) of the Hong Kong Listing Rules. | Article 3 The Audit Committee shall comprise three Directors, <u>all of whom shall be non-executive Directors</u> (including <u>at least</u> two independent Directors). The members shall include at least one independent Director who shall be a professional accountant with qualifications stipulated under Rule 3.10(2) of the Hong Kong Listing Rules. |

LETTER FROM THE BOARD

| Existing version | Amended version |
|---|--|
| <p>Article 8 The former partner of the existing external auditor of the Company shall not act as a member of the Audit Committee within <u>one</u> year from the following dates (whichever is the latter):</p> <p>(1) the date of his/her ceasing to be a partner of this auditor; or</p> <p>(2) the date where he/she no longer has any financial interest in this auditor.</p> | <p>Article 8 The former partner of the existing external auditor of the Company shall not act as a member of the Audit Committee within <u>two</u> years from the following dates (whichever is the latter):</p> <p>(1) the date of his/her ceasing to be a partner of this auditor; or</p> <p>(2) the date where he/she no longer has any financial interest in this auditor.</p> |
| <p>Article 21 These Rules shall come into effect on the date of <u>the listing of the overseas-listed foreign shares (the H shares) of the Company on The Stock Exchange of Hong Kong Limited</u> upon approval at a general meeting.</p> | <p>Article 21 These Rules shall come into effect on the date of approval at a general meeting.</p> |

The revised “Implementation Rules for Audit Committee of the Board” will come into effect and will be implemented on the date of approval at the AGM.

3.1.9 Election of non-executive Director

Ms. Ma Ce (“**Ms. Ma**”), a non-executive Director of the Company, submitted a resignation letter to the Board on 22 March 2019, resigning her position as the non-executive Director due to work reallocation. Her resignation will come into effect on the day when the substitute non-executive Director is elected. As considered and approved at the 56th meeting of the first session of the Board held on 22 March 2019, Ms. Zhao Zhu (“**Ms. Zhao**”) was proposed to serve as a non-executive Director of the first session of the Board of the Company in place of Ms. Ma.

LETTER FROM THE BOARD

Biography of Ms. Zhao is as follows:

Ms. Zhao Zhu, aged 38, has been serving as the deputy general manager of the financial management department of Yunnan Investment Holding Group Co., Ltd.* (雲南省投資控股集團有限公司) (“**Yunnan Investment Group**”), a Shareholder of the Company, since June 2018. From November 2017 to June 2018, she served as the audit director of the financial management department of Yunnan Investment Group. She served as the senior assistant to the business manager of Yunnan Investment Group and the financial director of Yunnan Medical Investment Management Co., Ltd.* (雲南省醫療投資管理有限公司) (“**Yunnan Medical Investment**”) from December 2015 to November 2017. From July 2013 to December 2015, she served as the senior business director and assistant to the business manager of the financial management department of Yunnan Investment Group and the financial director of Yunnan Medical Investment. She served as the manager of the financial management department of Yunnan Investment Construction Co., Ltd.* (雲南雲投建設有限公司) from November 2009 to July 2013. From November 2004 to November 2009, she worked in the field of planning and finance for Yunnan Investment Group. Ms. Zhao graduated from the school of economics at Yunnan University with major in accounting and a bachelor’s degree in management in July 2004 and completed her postgraduate degree in statistics at Yunnan University in October 2014. Ms. Zhao is also a senior accountant in China.

The appointment of Ms. Zhao as a non-executive Director of the Company will come into effect after the Shareholders of the Company approve the resolution of her appointment at the AGM. The Company will then enter into a director service agreement with Ms. Zhao with a term from the day when the above resolution is considered and approved at the AGM to the day when the election of the next session of the Board is completed. Ms. Zhao will not obtain remuneration from the Company during her term as a non-executive Director of the Company.

To the best of knowledge of the Directors of the Company, Ms. Zhao does not hold any Directorship in public companies whose securities are listed in Hong Kong or any overseas securities markets in the past three years, nor is she connected to any Director, Supervisor, senior management, substantial or controlling Shareholder of the Company. Apart from serving as the non-executive Director of the Company, Ms. Zhao does not hold any other positions in the Company or any other member companies of the Group to which the Company belongs. As at the Latest Practicable Date, Ms. Zhao does not have any interests in the Shares of the Company or its associated corporations (as defined in Part XV of the Securities and Futures Ordinance of Hong Kong).

Save as disclosed above, there is nothing which needs to be disclosed pursuant to paragraphs (h) to (v) of Rule 13.51(2) of the Listing Rules, nor are there any other issues relating to Ms. Zhao which need to be brought to the attention of the Shareholders of the Company.

* For identification purpose only

LETTER FROM THE BOARD

3.1.10 General Mandate to issue Shares

In order to meet the capital requirements of the Company for its continuous business development, to utilize financing platforms effectively and flexibly and to take advantage of capital market windows in a timely manner, in accordance with the applicable laws and regulations of the PRC, the Listing Rules and the Articles of Association, the Company proposes to grant the General Mandate to the Board by way of resolution at the AGM to allot, issue or deal with additional Domestic Shares and H Shares not exceeding 20% of the total number of Domestic Shares and H Shares of the Company, respectively, in issue on the date of passing such resolution. As at the Latest Practicable Date, the issued share capital of the Company comprised 689,088,000 Domestic Shares and 340,023,000 H Shares. Subject to the passing of the resolution related to the granting of the General Mandate and on the basis that no further Shares will be issued before the AGM, the Company will be allowed to issue a maximum of 137,817,600 Domestic Shares and 68,004,600 H Shares in accordance with the General Mandate.

(A) Specific plans on the General Mandate to issue Shares:

- (a) Subject to the conditions set out in (b) below, the Board is hereby authorized to approve, allot, issue, grant and/or otherwise deal with Shares (Domestic Shares and/or H Shares), securities convertible into Shares, and options, warrants to subscribe for or convertible into Shares or other securities with rights to subscribe for or convert into Shares, separately or at the same time during the Relevant Period (as defined below).

Notwithstanding the fulfillment of the conditions set out in (b) below, if the allotment of voting shares will result in a de facto change of control of the Company, the Board of the Company shall separately obtain authorization by way of a special resolution in advance before making such an allotment.

- (b) The number of Shares (Domestic Shares and/or H Shares), securities convertible into Shares, or options, warrants to subscribe for or convertible into Shares or other securities with rights to subscribe for or convert to Shares (which shall be calculated on the basis of the number of Domestic Shares and/or H Shares that such securities can be converted into/be allotted) proposed to be approved, allotted, issued, granted and/or otherwise dealt with by the Board shall not exceed 20% of each class of the Domestic Shares and H Shares issued of the Company as at the date on which this resolution is passed at the AGM.

- (c) For the purposes of this resolution:

“Relevant Period” means the period from the date on which this special resolution is passed at the general meeting until the earliest of: 1. the conclusion of the next annual general meeting of the Company following the date of passing of this resolution; 2. the expiration of twelve months following the date of passing of this resolution at a general meeting; 3. the date on which the authority granted to the Board under this resolution is revoked or varied by a special resolution of the Shareholders of the Company at a general meeting.

LETTER FROM THE BOARD

- (d) The Board is hereby authorized to determine the details of the issuance plan, including but not limited to: 1. the class and number of Shares proposed to be issued; 2. the pricing basis and/or the offer price (including the price range); 3. the date of opening and closing of the issuance; 4. the specific use of the proceeds raised; 5. the recommendation, agreement and share options to be made or granted for the exercise of the said power; 6. other content to be included in the detailed issuance plan as required by the relevant laws and regulations and other regulatory documents, the relevant regulatory authorities and the local stock exchange.

- (e) The Board is hereby authorized to implement the issuance plan and deal with the matters related to an increase in the registered capital of the Company so as to reflect the Shares authorized to be issued by the Company under this resolution, and to make such amendments as it deems appropriate and necessary to the provisions related to the issuance of Shares and registered capital in the Articles of Association, and to adopt and complete any other actions and procedures that are necessary for the implementation of the issuance plan and the completion of the increase in the registered capital of the Company.

(B) Relevant mandate

In order to enhance the efficiency of decision-making, reduce internal approval procedures and grasp market opportunities, in respect of the general mandate to issue Shares, it is proposed to the Board, which in turn proposed to the general meeting to approve the authorization of the Board and any persons authorized by the Board to deal with the matters in connection with the general mandate to issue Shares. The specific details of the mandate given to the authorized persons will be separately determined upon the exercise of the general mandate by the Board under this resolution.

3.2 The New Framework Agreement and the Continuing Connected Transaction thereunder

3.2.1 Overview

References are made to the Prospectus and the announcement published by the Company on 30 April 2019 in relation to the continuing connected transaction in which the Group provided operation and management services to Dianchi Investment Group. As disclosed in the Prospectus, the Company entered into the Previous Framework Agreement with Kunming Dianchi Investment on 25 April 2016, pursuant to which the Group provided certain operation and management services to Dianchi Investment Group in relation to wastewater treatment plants, reclaimed water supply facilities and running water facilities owned by Dianchi Investment Group for a period from 25 April 2016 to 31 December 2018. Such operation and management service, depending on the development stage of the project, typically includes operating, testing and adjusting the equipment and facilities, arranging operating personnel and experts to maintain the daily operation of such plants and ensure the effluent quality meets the relevant discharge standard, setting up management policies and operation guidelines, chemicals purchase, and sludge transportation and disposal.

LETTER FROM THE BOARD

As further disclosed in the Prospectus, the Company has obtained approval for annual caps of the transaction under the Previous Framework Agreement covering a period of three years until 31 December 2019. As at the Latest Practicable Date, 8 individual agreements are still effective between the Group and Dianchi Investment Group. These individual agreements are in line with various agreed principles within the Previous Framework Agreement. Despite the expiration of the Previous Framework Agreement on 31 December 2018, all transactions occurred in 2019 under the relevant individual agreements between the Group and Dianchi Investment Group are governed by effective individual agreements and are within the scope of the pre-approved annual cap for the year ending 31 December 2019.

With the view that the Group will continue to provide operation and management services to Dianchi Investment Group upon expiration of the existing individual agreements, and to further regulate the terms and conditions under which the Group will provide such operation and management services to Dianchi Investment Group during the three years ending 31 December 2021, the Company and Kunming Dianchi Investment commenced friendly negotiation since December 2018 and the Company also commenced the bidding process for engagements of independent financial adviser and Legal adviser in relation to the proposed continuing connected transaction. Parties entered into the New Framework Agreement on 30 April 2019, pursuant to which the Group will continue to provide operation and management services to Dianchi Investment Group for three years until 31 December 2021.

3.2.2. New Framework Agreement

(a) Parties

- (i) Kunming Dianchi Investment; and
- (ii) the Company.

(b) Date of signature, effective date and term of the agreement

The New Framework Agreement was entered into on 30 April 2019 with both parties' signatures and seals. It will take effect upon approval by the Company's general meeting. The term of the agreement is from the date of approval of the New Framework Agreement and the continuing connected transaction thereunder by the Company's general meeting to 31 December 2021.

The term of the individual agreements entered into by the Group and Dianchi Investment Group under the New Framework Agreement shall not exceed the term of the New Framework Agreement.

LETTER FROM THE BOARD

(c) ***Principal terms***

Scope of the operation and management services

The operation and management services provided by the Group to Dianchi Investment Group include operation and management services for wastewater treatment facilities, reclaimed water supply facilities, and running water supply facilities.

Principles of transaction

- (i) The parties agree that entering into the New Framework Agreement does not preclude the parties (or their respective subsidiaries) from freely choosing counterparties or entering into transactions with third parties.
- (ii) Kunming Dianchi Investment agrees that Dianchi Investment Group shall give priority to the operation and management services provided by the Group when the service terms offered and fees quoted by third parties are the same.
- (iii) Dianchi Investment Group has the right to obtain services from third parties if the Group cannot meet the requirements of Dianchi Investment Group for the operation and management services or if the terms provided by third parties are more favorable.
- (iv) The Company will provide an annual estimate of the operation and management services fees required for the next year to Kunming Dianchi Investment.
- (v) Subject to the principles of the New Framework Agreement, it is expected that the Group will enter into individual agreements with Dianchi Investment Group as required from time to time. The Group reserves the right to amend these individual agreements in order to comply with the Listing Rules.

Operation and management fees

Each party will agree on relevant management fees for the entrusted operation according to the types of individual operation and management services, which will be reflected in individual agreements (please refer to the relevant terms under “Operation mode” below).

LETTER FROM THE BOARD

The price of the operation and management services under the New Framework Agreement shall be determined according to the following principles:

- (i) if there is a market price, it shall be executed at market price; and
- (ii) if the above transaction principle cannot be applied in actual transactions, the agreed price shall be adopted.

The above “market price” refers to the price determined in the following sequence: (1) the price charged by third parties that provide such products and services under normal commercial transactions at the place where such services are provided or in its vicinity; or (2) the price charged by a third party providing such services under normal commercial transactions. When determining the market price, the purchasing department of the Company will collect service fee quotations at the places where the operation and management services are provided or in their vicinity and the price charged by the Group for providing similar services to independent third parties during the same period to reach specific charges. The final price will be reported to the chairperson of the Company for approval.

The above “agreed price” refers to the price determined according to “reasonable costs + reasonable profit (no more than 10%)”, of which:

- (i) the “reasonable costs” refers to the costs mutually agreed through negotiation between both parties for actual expenses incurred for provision of such products or services by the Group to Dianchi Investment Group or the costs mutually agreed through negotiation between both parties (including taxes and fees). In determining “reasonable costs”, an estimate of expenses to be incurred will be provided by the Group to Dianchi Investment Group, which is determined with reference to historical costs for provision of such products or services and adjustments made to such historical costs. In making the relevant adjustments to historical costs, the Group will mainly consider the expected increase or decrease in costs such as sludge treatment and other costs including electricity costs. This estimate of expenses is subject to agreement by both parties. The Group may also outsource the provision of certain products or services to third parties. Under this situation, “reasonable costs” is determined with reference to the actual service fee charged by the relevant third party and the Group’s expenses allocated to the relevant product or service, which is subject to negotiation and agreement by both parties.
- (ii) the “reasonable profit” was fixed at no more than 10% as agreed between the Company and Dianchi Investment Group. On the one hand, the Company considers that it is commercially reasonable to adopt an overall margin for different types of projects to be transacted under the New Framework Agreement, which will allow the Company to have more flexibility to negotiate with Dianchi Investment Group regarding the pricing for individual projects. On the other hand, the Company will ensure that the overall profit margin for the transactions under the New Framework Agreement will not be lower than 8%. When determining the price and specific terms of an individual agreement, the Company will strictly follow its internal control measures as set out in section 3.2.4 below, to ensure that the price is fair and reasonable and the terms of individual agreement conforms with the principles stipulated under the New Framework Agreement.

LETTER FROM THE BOARD

Operation Mode

For all service transactions under the New Framework Agreement, parties to the transactions will enter into individual agreements in accordance with the scope and principles specified in the New Framework Agreement. Such individual agreements shall not violate the agreed provisions under the New Framework Agreement.

The parties shall ensure and procure their respective subsidiaries to enter into individual agreements in accordance with the principles and provisions of the New Framework Agreement and the service plans agreed by both parties. Kunming Dianchi Investment is committed to use its best endeavor to procure its associates other than its subsidiaries to enter into individual agreements in accordance with the principles and provisions of the New Framework Agreement and the service plans agreed by both parties.

During the process of implementing the New Framework Agreement, if necessary and as agreed by both parties of the agreement, the individual agreements may be adjusted.

Obligation of the parties

The main obligations of Dianchi Investment Group and the Group under the New Framework Agreement include:

- (i) Dianchi Investment Group
 - a. to coordinate on matters relating to implementation of each individual agreement;
 - b. to designate or establish a special department for liaison, file preparation, planning and arrangement, supervision, assessment, coordination of the implementation of the agreements in relation to the relevant transactions under the New Framework Agreement, and dispute resolutions; and
 - c. to pay relevant service fees in accordance with the requirements under the individual agreements and to guarantee compensation for the losses caused to the Group due to violation of the New Framework Agreement or any terms of the individual agreements.
- (ii) The Group
 - a. to provide and procure its member companies to provide corresponding services to Dianchi Investment Group in accordance with the New Framework Agreement and to coordinate matters in relation to various individual agreements;
 - b. to regularly submit data and information on relevant work status according to the requirements of Dianchi Investment Group, as well as promptly and effectively organize, resolve and rectify problems in the maintenance and operation of the entrusted subjects, and accept supervision, assessment and relevant evaluation of Dianchi Investment Group and third parties assigned by it;

LETTER FROM THE BOARD

- c. to compensate for the losses caused to Dianchi Investment Group due to violation of any terms of the individual agreements under the New Framework Agreement in accordance with the requirements of the individual agreements; and
- d. to ensure safe and stable operation of the entrusted subjects and bear environmental protection responsibility caused due to improper operation and management by the Group.

3.2.3 Historical Data and Annual Caps

The historical transaction data of the operation and management services provided by the Group to Dianchi Investment Group under the individual agreements for the years ended 31 December 2016, 2017 and 2018, respectively and for the three months ended 31 March 2019:

| | For the year ended 31 December | | | For the three months ended |
|---------------------------|--------------------------------|-----------|-----------|-------------------------------|
| | 2016 | 2017 | 2018 | 31 March 2019 |
| | (RMB'000) | (RMB'000) | (RMB'000) | (RMB'000) |
| Annual Cap | – | 115,800 | 130,000 | 140,000 ^{Note} |
| Actual transaction amount | 73,439 | 82,373 | 67,999 | 16,303 |

Note: Annual cap for the year ending 31 December 2019 of the transactions under the Previous Framework Agreement and as disclosed in the Prospectus.

The Directors of the Company have estimated that the annual caps for the transactions under the New Framework Agreement, which include all costs and expenses payable by the Group in relation to the operation and management of the various wastewater treatment plants, and the service fees the Group may charge pursuant to the New Framework Agreement, for each of the years ending 31 December 2019, 2020 and 2021 would be as follows:

| | For the year ending 31 December | | |
|---|---------------------------------|-----------|-----------|
| | 2019 | 2020 | 2021 |
| | (RMB'000) | (RMB'000) | (RMB'000) |
| Service fees and reimbursable costs (after tax) to be paid by Kunming Dianchi Investment to the Company ^{Note} | 123,170 | 193,440 | 252,800 |

Note: The annual cap for each of the three years was adjusted as compared to those disclosed in the announcement dated 30 April 2019, for the reasons that (1) the Company was informed that Dianchi Investment Group will reduce one project from the service scope, and (2) the Company rectifies the calculation of the annual caps with the accurate effective tax rates.

LETTER FROM THE BOARD

For the purposes of determining the proposed annual caps for the transactions under the New Framework Agreement for each of the years ending 31 December 2019, 2020 and 2021, the Directors have considered the following factors:

- (i) the historical transaction amount and existing costs of services of operation and management services;
- (ii) the expected increase in service volume for the three years ending 31 December 2021. Our operation and management services mainly include three types of projects, namely the first-class A standard project, the over-limit phosphorus removal project and the DF water quality improvement project. It is expected that our production capacity for each of these projects will increase in the three years ending 31 December 2021;

| | 2018 | 2019 | 2020 | 2021 |
|---------------------------------------|------------|------------|------------|------------|
| | (tons/day) | (tons/day) | (tons/day) | (tons/day) |
| First-class A standard project | 154,000 | 199,500 | 225,000 | 337,000 |
| Over-limit phosphorus removal project | 134,000 | 246,500 | 624,000 | 774,000 |
| DF water quality improvement project | 5,500 | 5,500 | 5,500 | 5,500 |

- (iii) estimated increase in costs of the first-class A standard projects of approximately 21%, 24% and 27% in 2019, 2020 and 2021, respectively, as compared to the costs of the first-class A standard projects in 2018, mainly due to increase of costs for sludge treatment as required under relevant environmental policies; and
- (iv) level of profit under the New Framework Agreement.

When determining the proposed annual cap of the above-mentioned transaction for the year ending 31 December 2019, the Directors have considered the used and unused quota for the annual cap of the transaction under the Previous Framework Agreement for that year and the additional services that may be required by Dianchi Investment Group.

3.2.4 Internal Control Measures

To ensure that the proposed annual caps will not be exceeded and the individual transactions will be conducted in accordance to the New Framework Agreement, the Group has adopted the below internal control measures:

- (a) the Company has formulated the Connected Transactions Management Policies (《關聯交易管理辦法》) (the “Policies”), to ensure that all connected transactions, including those under the New Framework Agreement, are properly controlled and monitored. In particular, the Policies require that continuing connected transactions are subject to annual review by auditors and independent board committee of the Company;

LETTER FROM THE BOARD

- (b) the Finance Department of the Company has formed a price-determination team (including members from the Finance Department and other relevant departments of the Company) to collect and record service fee quotations for similar operation and management services provided by third parties on a regular basis to keep up with the latest market conditions. Before entering into an individual agreement, the price-determination team will review proposed transaction price and the terms under a draft individual agreement, to ensure that they are in line with the general principles under the New Framework Agreement and entering into such transaction will not result in lowering the overall profit margin for the transactions under the New Framework Agreement to below 8%. The price-determination team will then report their review result to the chairperson of the Company and the chairperson will consider and approve the signing of such individual agreement;
- (c) each year, the Finance Department of the Company will prepare an annual plan and annual estimate of the operation and management services fees required for the next year, which is subject to review and approval by the Board. Both the management and the Board shall ensure that the overall profit margin under the New Framework Agreement will not be lower than 8%;
- (d) the Finance Department of the Company will prepare accounts of all individual transactions occurred on a monthly and quarterly basis, and such accounts will be submitted to the Securities Department of the Company and further reported to the president of the Company on a monthly basis and to the president of the Company and the Board on a quarterly basis; and
- (e) the Finance Department and Business Department of the Company will monitor the implementation of each individual agreement on a continuous basis, and report to Securities Department of the Company for any deviation or possible deviation from the relevant individual agreement or the New Framework Agreement. The Securities Department of the Company will further report any serious deviation to the president and the Board.

3.2.5 Reasons for and benefits of entering into the New Framework Agreement

Dianchi Investment Group reserves certain wastewater treatment plants. According to the concession agreement between the Company and the Kunming Municipal Government, the Company has the exclusive right to operate wastewater treatment facilities in Kunming. Therefore, Dianchi Investment Group shall rely on or entrust the Company to operate and manage the wastewater treatment facilities in Kunming.

The Company considers that through collection of service fees from Kunming Dianchi Investment and taking advantage of the Company's resources and expertise, provision of operation and management services enables the Company to operate wastewater treatment facilities, thereby obtaining maximum benefits from such water plants.

LETTER FROM THE BOARD

In addition, the Company entered into the Non-competition Agreement with Kunming Dianchi Investment to regulate the relationship and potential business competition between the Group and Dianchi Investment Group upon the Listing. Pursuant to the Non-competition Agreement, for those wastewater treatment plants the Company is entrusted to operate, the Company has (i) the right to request Kunming Dianchi Investment to sell; (ii) the right to acquire at their respective commencement of commercial operation; and (iii) the right of first offer to acquire any or all of them. Entering into the New Framework Agreement will facilitate the Group to continue to operate and control these assets and track the situation and performance of the wastewater treatment plants. It will also enable the Company to better assess whether and when to exercise its right to acquire such assets in accordance with the Non-competition Agreement.

Based on the above, the Directors (excluding the independent non-executive Directors) are of the view that the New Framework Agreement and the continuing connected transaction thereunder are entered into in the ordinary and usual course of business of the Company and on normal commercial terms, and the terms of the continuing connected transaction under the New Framework Agreement and the proposed annual caps are fair and reasonable so far as the Independent Shareholders are concerned, and are in the interests of the Company and the shareholders as a whole.

3.2.6 Implication under the Listing Rules

Kunming Dianchi Investment is the controlling shareholder of the Company and holds approximately 64.16% equity interest of the Company as at the Latest Practicable Date, and is therefore a connected person of the Company. Accordingly, provision of entrusted operation and management services by the Group to Dianchi Investment Group under the New Framework Agreement constitutes a continuing connected transaction of the Company under Chapter 14A of the Listing Rules.

Pursuant to the Listing Rules, as one or more percentage ratios applicable to the relevant annual caps of the above continuing connected transaction are higher than 5%, the continuing connected transaction contemplated under the New Framework Agreement is subject to reporting, annual review, announcement, circular and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

The Directors of the Company, Ms. Guo Yumei and Ms. Song Hong, serve in Kunming Dianchi Investment and, therefore, they are considered to have a material interest in the continuing connected transaction under the New Framework Agreement. Accordingly, they are required to abstain from voting in the Board resolution approving the continuing connected transaction under the New Framework Agreement. Save as disclosed above, as no other Directors have a material interest in the continuing connected transaction under the New Framework Agreement, no other Directors are required to abstain from voting in relation to the relevant Board resolution.

LETTER FROM THE BOARD

3.2.7 General information

The Company

The Company is a leading municipal wastewater treatment and reclaimed water supply services provider in Yunnan Province, the PRC, an integrated water-related services (including running water supply service) provider and a core enterprise implementing the PRC's strategic goal to treat pollutants at Dianchi Lake.

Kunming Dianchi Investment

Kunming Dianchi Investment is a state-owned enterprise established on 13 October 2004 and wholly owned by the State-owned Assets Supervision and Administration Commission of the Kunming People's Government (昆明市人民政府國有資產監督管理委員會). As at the Latest Practicable Date, Kunming Dianchi Investment holds 64.16% of the issued share capital of the Company. It engages in investment, construction, operation and management of projects confirmed by the Kunming Municipal People's Government in Yunnan Province of the PRC; investment and construction of wastewater treatment plants and investment, operation and management of assets in relation to infrastructure, technology and other industries.

4. THE AGM

The business to be considered at the AGM is described in the notice of AGM issued on 6 May 2019. The proxy form and the reply slip of the AGM were despatched to the Shareholders together with the notice of AGM.

If you intend to appoint a proxy to attend the AGM, you are required to complete and return the form of proxy in accordance with the instructions printed thereon. For holders of H Shares, the form of proxy should be returned to Tricor Investor Services Limited and for holders of Domestic Shares, the form of proxy should be returned to the Company's registered office and headquarters in the PRC by personal delivery or by post not less than 24 hours before the time fixed for holding the AGM (i.e. before 2:30 p.m. on Thursday, 20 June 2019) or any adjourned meeting thereof. Completion and return of the form of proxy will not preclude you from attending and voting in person at the AGM or at any other adjourned meeting should you so wish.

If you intend to attend the AGM in person or by proxy, you are required to complete and return the reply slip to (for holders of H Shares) Tricor Investor Services Limited or (for holders of Domestic Shares) to the Company's registered office and headquarters in the PRC on or before Friday, 31 May 2019 as set out in the AGM reply slip dispatched on 6 May 2019.

LETTER FROM THE BOARD

5. VOTING BY POLL

According to Rule 13.39(4) of the Listing Rules, any vote of Shareholders at a general meeting must be taken by poll. Accordingly, the Chairman of the AGM will exercise his power under the Articles of Association to demand a poll in relation to all the proposed resolutions at the AGM.

In view of Kunming Dianchi Investment's interests in the continuing connected transaction under the New Framework Agreement, Kunming Dianchi Investment (holding approximately 64.16% of the Company's equity interest) and its associates are required to abstain and shall abstain from voting on the ordinary resolution to be proposed at the AGM to approve the continuing connected transaction under the New Framework Agreement.

To the best of the Directors' knowledge, information and belief, having made all reasonable enquiries, save as disclosed above, no connected person of the Company, the Shareholder or their respective associates with a material interest in the resolution to be proposed at AGM is required to abstain from voting at the AGM.

To the best knowledge, information and belief of the Directors, having made all reasonable enquiries, there is (i) no voting trust or other agreement or arrangement or understanding entered into by or binding upon any Shareholder; and (ii) no obligation or entitlement of any Shareholder as at the Latest Practicable Date, whereby it has or may have temporarily or permanently transferred control over the exercise of the voting right in respect of its Shares to a third party, either generally or on a case-by-case basis. Accordingly, to the best knowledge, information and belief of the Directors, there exists no discrepancy between any Shareholder's beneficial Shareholding interest in the Company and the number of Shares in the Company in respect of which such Shareholder will control or will be entitled to exercise control over the voting right at the AGM.

6. RECOMMENDATIONS

The Board considers that the resolutions proposed at the AGM are in the interests of the Company and its Shareholders as a whole. Accordingly, the Board recommends the Shareholders to vote in favour of those proposed resolutions at the AGM.

The Independent Board Committee comprising all independent non-executive Directors has been established to advise the Independent Shareholders in respect of the continuing connected transaction under the New Framework Agreement. BaoQiao Partners has been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in such respect.

The Directors (excluding the independent non-executive Directors) are of the view that the New Framework Agreement and the continuing connected transactions thereunder are entered into in the ordinary and usual course of business of the Company and on normal commercial terms, and the terms of the continuing connected transaction under the New Framework Agreement and the proposed annual caps are fair and reasonable so far as the Independent Shareholders are concerned, and are in the interests of the Company and the Shareholders as a whole. Therefore, the Directors (excluding the independent non-executive Directors) recommend the Independent Shareholders to vote in favor of the resolution on the continuing connected transaction under the New Framework Agreement to be proposed at the AGM.

LETTER FROM THE BOARD

The Independent Board Committee, having taking into account of the terms of the New Framework Agreement and the advice of the Independent Financial Adviser, considers that the New Framework Agreement and the continuing connected transactions thereunder are entered into in the ordinary and usual course of business of the Company and on normal commercial terms, and the terms of the continuing connected transaction under the New Framework Agreement and the proposed annual caps are fair and reasonable so far as the Independent Shareholders are concerned, and are in the interests of the Company and the Shareholders as a whole. Therefore, the Independent Board Committee recommends the Independent Shareholders to vote in favor of the resolution to be proposed at the AGM to approve the continuing connected transaction under the New Framework Agreement.

Your attention is drawn to (i) the letter from the Independent Board Committee set out on pages 25 to 26 of this circular containing the recommendation of the Independent Board Committee to the Independent Shareholders in respect of the continuing connected transaction under the New Framework Agreement; and (ii) the letter from the Independent Financial Adviser set out on pages 27 to 51 of this circular containing the advice of the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders as well as the principal factors and reasons considered in respect of the continuing connected transaction under the New Framework Agreement.

Yours faithfully,
Guo Yumei
Chairperson

LETTER FROM THE INDEPENDENT BOARD COMMITTEE



Kunming Dianchi Water Treatment Co., Ltd. **昆明滇池水务股份有限公司**

(a joint stock company incorporated in the People's Republic of China with limited liability)

(Stock Code: 3768)

31 May 2019

To the Independent Shareholders:

Dear Sir or Madam,

CONTINUING CONNECTED TRANSACTION UNDER THE NEW FRAMEWORK AGREEMENT

We refer to the circular dated 31 May 2019 (the “**Circular**”) to the Shareholders by the Company, of which this letter forms part. Unless specified otherwise, capitalized terms used in this letter shall have the same meaning as those defined in the Circular.

In accordance with the requirements under the Listing Rules, we have been appointed to consider and advise the Independent Shareholders as to whether the New framework agreement and the continuing connected transactions thereunder (including the proposed annual caps) are entered into in the ordinary and usual course of business of the Company, are on normal commercial terms, are fair and reasonable so far as the Independent Shareholders are concerned and are in the interests of the Company and the Shareholders as a whole. For such purpose, BaoQiao Partners has been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in this regard. Details of the continuing connected transaction under the New Framework Agreement and the reasons for transactions are contained in the letter from the Board set out on pages 4 to 24 in the Circular.

We have also discussed with the management of the Company regarding the terms of the New framework agreement and the basis upon which the proposed annual caps of the transactions during the term of the New Framework Agreement are determined. Having considered (i) the terms of the New Framework Agreement, (ii) the discussions with the management of the Company about the background to and nature of the New Framework Agreement and (iii) the advice of BaoQiao Partners to Independent Board Committee and the Independent Shareholders, we consider that the New Framework Agreement and the continuing connected transactions thereunder (including the proposed annual caps) are entered into in the ordinary and usual course of business of the Company, on normal commercial terms, and the agreement terms and the proposed annual caps are fair and reasonable so far as the Independent Shareholders are concerned and are in the interests of the Company and the Shareholders as a whole.

LETTER FROM THE INDEPENDENT BOARD COMMITTEE

We therefore recommend the Independent Shareholders to vote in favor of the ordinary resolution to be proposed at the AGM to approve the continuing connected transaction under the New Framework Agreement.

Yours faithfully,
Independent Board Committee of
Kunming Dianchi Water Treatment Co., Ltd.
Yin Xiaobing
He Xifeng
Sin Lik Man
Independent Non-executive Directors

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

The following is the full text of the letter of advice from BaoQiao Partners Capital Limited to the Independent Board Committee and the Independent Shareholders in relation to the Transactions, which has been prepared for the purpose of inclusion in this circular.



BAOQIAO PARTNERS CAPITAL LIMITED

Unit 601, 6/F, Tower 1, Admiralty Centre,
18 Harcourt Road, Admiralty, Hong Kong

31 May 2019

*To the Independent Board Committee and the Independent Shareholders of
Kunming Dianchi Water Treatment Co., Ltd.*

Dear Sir or Madam,

CONTINUING CONNECTED TRANSACTION UNDER THE NEW FRAMEWORK AGREEMENT

INTRODUCTION

We refer to our engagement as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the New Framework Agreement and the continuing connected transaction thereunder (the “**Continuing Connected Transaction**”), details of which are set out in the letter from the Board (“**Letter from the Board**”) contained in the circular of the Company to the Shareholders dated 31 May 2019 (the “**Circular**”), of which this letter forms part. Capitalised terms used in this letter shall have the same meanings ascribed to them in the Circular unless the context otherwise requires.

On 30 April 2019, the Company and Kunming Dianchi Investment have entered into the New Framework Agreement through friendly negotiation, pursuant to which the Group will continue to provide operation and management services to Dianchi Investment Group for three years until 31 December 2021, including operation and management services for wastewater treatment facilities, reclaimed water supply facilities, and running water supply facilities.

Kunming Dianchi Investment is the controlling shareholder of the Company and holds approximately 64.16% equity interest of the Company as at the Latest Practicable Date, and is therefore a connected person of the Company. Accordingly, provision of entrusted operation and management services by the Group to Dianchi Investment Group under the New Framework Agreement constitutes a continuing connected transaction of the Company under Chapter 14A of the Listing Rules.

Pursuant to the Listing Rules, as one or more percentage ratios applicable to the relevant annual caps of the above continuing connected transaction are higher than 5%, the continuing connected transaction contemplated under the New Framework Agreement is subject to reporting, annual review, announcement, circular and Independent Shareholders’ approval requirements under Chapter 14A of the Listing Rules.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

The Directors of the Company, Ms. Guo Yumei and Ms. Song Hong, serve in Kunming Dianchi Investment and, therefore, they are considered to have a material interest in the continuing connected transaction under the New Framework Agreement. Accordingly, they are required to abstain from voting in the Board resolution approving the continuing connected transaction under the New Framework Agreement. Save as disclosed above, as no other Directors have a material interest in the continuing connected transaction under the New Framework Agreement, no other Directors are required to abstain from voting in relation to the relevant Board resolution.

The Independent Board Committee comprising all independent non-executive Directors, namely Mr. Yin Xiaobing, Mr. He Xifeng and Mr. Sin Lik Man, has been established to advise the Independent Shareholders as to whether the New Framework Agreement and the continuing connected transactions contemplated thereunder are entered into in the ordinary and usual course of business of the Group and on normal commercial terms, and the terms of the continuing connected transaction under the New Framework Agreement and the proposed annual caps are fair and reasonable so far as the Independent Shareholders are concerned, and are in the interests of the Company and the Shareholders as a whole. We, BaoQiao Partners Capital Limited, have been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in such respect.

OUR INDEPENDENCE

In the last two years, prior to the Latest Practicable Date, we have not acted in any capacity in relation to any transactions of the Company. As at the Latest Practicable Date, we do not have any relationship with, or have any interest in, the Company and its respective subsidiaries and associates that could reasonably be regarded as relevant to our independence. Apart from the normal professional fees payable to us in connection with this appointment as the Independent Financial Adviser in relation to the New Framework Agreement and transactions contemplated thereunder, no other arrangement exists whereby we had received or will receive any fees or benefits from the Company or any other parties that could reasonably be regarded as relevant to our independence as defined under Rules 13.84 of the Listing Rules.

BASIS OF OUR OPINION

In formulating our opinion to the Independent Board Committee and the Independent Shareholders, we have relied on the accuracy of the statements, information, opinions and representations contained or referred to in the Circular and the information and representations provided to us by the Company, the Directors and the management of the Company (the “**Management**”). We have assumed that all information and representations that have been provided by the Directors and the Management, for which they are solely and wholly responsible, are true, accurate and complete in all material respects and not misleading or deceptive at the time when they were made and continue to be so as up to the date of the Circular. We have also assumed that all statements of belief, opinions, expectations, representations and intentions made by the Directors and the Management in the Circular and/or discussed with/provided to us were reasonably made after due enquiries and careful consideration. We have no reason to suspect that any material facts or information have been withheld or to doubt the truth, accuracy and completeness of the information and facts contained in the Circular, or the reasonableness of the opinions expressed by the Company, its advisers, the Directors and/or the Management, which have been provided to us.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

All Directors collectively and individually accept full responsibility for the purpose of giving information with regard to the Group in the Circular and, having made all reasonable enquiries, confirm that to the best of their knowledge and belief, the information contained in the Circular is accurate and complete in all material respects and not misleading or deceptive, and there are no other facts not contained in the Circular, the omission of which would make any statement in the Circular misleading.

We consider that we have been provided with sufficient information to reach an informed view and to provide a reasonable basis for our opinion. We have not, however, conducted any independent in-depth investigation into the business and affairs, financial condition and future prospects of the Company, its subsidiaries or associates, nor have we considered the taxation implication on the Group or the Shareholders as a result of the entering into of the New Framework Agreement and the continuing connected transaction thereunder. Our opinion is necessarily based on financial, economic, market and other conditions in effect, and the facts, information, representations and opinions made available to us, at the Latest Practicable Date.

This letter is issued for the information for the Independent Board Committee and the Independent Shareholders solely in connection with their consideration of approving the New Framework Agreement and the continuing connected transaction thereunder, and this letter, except for its inclusion in the Circular and for inspection as required under the Listing Rules, is not to be quoted or referred to, in whole or in part, nor shall this letter be used for any other purposes, without our prior written consent.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion to advise the Independent Board Committee and the Independent Shareholders regarding the New Framework Agreement and the continuing connected transaction thereunder, we have taken into consideration the following principal factors and reasons:

1. Information of the Group

The Company and its subsidiaries are principally engaged in the provision of municipal wastewater treatment and reclaimed water supply services in Yunnan Province, the PRC. The Group is an integrated water-related services (including running water supply service) provider and a core enterprise implementing the PRC's strategic goal to treat pollutants at Dianchi Lake. The Group's business falls into the following segments:

- (i) Wastewater treatment: This segment of business includes design, construction and/or operation of wastewater treatment facilities under concession arrangements;
- (ii) Other water-related service (a) Reclaimed water supply: This segment of business includes provision to commercial, industrial and governmental customers of reclaimed water generated from treated water from certain of our wastewater treatment facilities; (b) Running water supply: This segment of business includes provision to residential, commercial, industrial customers of running water generated from our running water facilities; and

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- (iii) Others: This segment of business mainly involves the provision of Entrusted Operation and Management Services (as defined below) to Kunming Dianchi Investment for management of treatment facilities it owns, in addition to transportation and other miscellaneous businesses.

The Company has the exclusive right to operate wastewater treatment facilities in Kunming according to the concession agreement between the Company and the Kunming Municipal People's Government.

2. Information of Kunming Dianchi Investment

Kunming Dianchi Investment is a state-owned enterprise established on 13 October 2004 and wholly-owned by the State-owned Assets Supervision and Administration Commission of the Kunming People's Government (昆明市人民政府國有資產監督管理委員會). As at the Latest Practicable Date, Kunming Dianchi Investment holds 64.16% of the issued share capital of the Company. It engages in investment, construction, operation and management of projects confirmed by the Kunming Municipal People's Government in Yunnan Province of the PRC as well as investment and construction of wastewater treatment plants and investment, operation and management of assets in relation to infrastructure, technology and other industries.

3. Information of the Entrusted Operation and Management Services

The entrusted operation and management services (the “**Entrusted Operation and Management Services**”) provided by the Group to Dianchi Investment Group under both of the Previous Framework Agreement and the New Framework Agreement are wastewater treatment services for the wastewater processing plants/facilities owned by Kunming Dianchi Investment, which mainly include three types of projects, namely the first-class A standard project (“**Project A**”), the over-limit phosphorus removal project (“**Project PR**”) and the DF water quality improvement project (“**Project DF**”) (collectively, the “**Projects**”), and each Project involves different processing requirements. For the two years ended 31 December 2016 (“**FY2016**”) and 2017 (“**FY2017**”), the Group's Entrusted Operation and Management Services covered Project A only while the other two projects were commenced in the year ended 31 December 2018 (“**FY2018**”). As at 31 December 2018, the Group provided operation and management services to a total of 9 wastewater treatment plants/facilities owned by Dianchi Investment Group with total designed wastewater processing capacity of 505,000 tons/day¹. A brief description of the Projects is as below:

(a) **Project A**

Project A uses several wastewater processing technologies (e.g. MBR (membrane bio-reactor), AAO (anaerobic-anoxic-toxic), CASS (Cyclic Activated Sludge System) and/or ultraviolet disinfection) to purify the wastewater to reach first class A standard, the highest quality standard as defined in the Discharge Standard of Pollutants for Municipal Wastewater Treatment Plant (城鎮污水處理廠污染物排放標準) of the PRC. For FY2018, there were 6 wastewater treatment plants/facilities of Dianchi Investment Group under this project with total designed wastewater processing capacity and actual average daily processing volume of approximately 345,000 tons/day and 154,000 tons/day respectively.

¹ Since the density of water is around 1 ton per cubic metres, the Company has used tons and cubic metres interchangeably in practice.

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As informed by the Management, two new wastewater treatment plants designed for Project A owned by Kunming Dianchi Investment, namely Kunming No. 13 Water Purification Plant and Kunming No. 14 Water Purification Plant are expected to commence operation in mid-2019 and year 2021 respectively.

On 9 May 2019, Kunming Dianchi Investment announced on its website (www.kmdctz.com) that the wastewater processing capacity of the first phase of its newly built Kunming No. 13 Water Purification Plant is 60,000 tons/day (total designed capacity: 120,000 tons/day). The Management expects this plant will commence operation in June 2019. The construction of Kunming No. 14 Water Purification Plant with designed wastewater processing capacity of 100,000 tons/day is expected to complete and commence trial operation in September 2021 based on our review of the environmental report approved by Kunming Bureau of Ecological Environment (昆明市生態環境局).

As informed by the Management, it is expected that Project A will cover a total of 8 plants/facilities under the New Framework Agreement.

(b) Project PR

Project PR is a wastewater treatment process to further purify the processed water of Project A to reach TP (Total Phosphorus) level at less than 0.05mg/L. This project commenced trial operation since May 2018 and there were 2 wastewater treatment plants under this project with total designed wastewater processing capacity and actual daily processing volume of approximately 135,000 tons/day and 134,000 tons/day respectively for FY2018. The Company has outsourced the day to day management of this project to an independent third party since August 2018 but it will bear the costs of labour, utility, repair and maintenance as well as quality control of Project PR in accordance with the terms and conditions of the outsourcing agreement with the independent third party.

According to the Management, there will be four new wastewater treatment plants/facilities designed for Project PR with total designed wastewater processing capacity of 640,000 tons/day to be built and commence operation during the three years ending 31 December 2021. These four new wastewater treatment plants/facilities were approved by Kunming or Yunnan government authorities based on our review of the relevant approval documents.

Based on our discussion with the Management, it is expected that the Company will continue the outsourcing arrangement for the operation of the six existing and new wastewater treatment plants/facilities of Project PR under the New Framework Agreement.

(c) Project DF

Project DF is a new wastewater treatment process by utilizing “MBR (membrane bio-reactor) + Ultra-low Pressure and Highly Selective Membrane (DF)” to purify the processed water of Project A in order to further improve the water quality to reach standard II as defined in the Environmental Quality Standards For Surface Water (地表水環境質量標準) of the PRC.

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There is only one plant designed for Project DF and is for experimental purpose as required by the Kunming government authorities. It's designed wastewater processing capacity and actual average daily processing volume are approximately 25,000 tons/day and 5,500 tons/day respectively, which is relatively small comparing to the other Projects.

Project DF commenced operation since mid-2018 and the Company has outsourced the day to day management of this project to an independent third party but it will bear the costs of labour, utility, repair and maintenance as well as quality control of Project DF in accordance with the terms and conditions of the outsourcing agreement with the independent third party.

Based on our discussion with the Management, it is expected that the Company will continue the outsourcing arrangement of Project DF under the New Framework Agreement.

4. Reasons for and benefits of entering into the New Framework Agreement

As disclosed in the prospectus of the Company dated 24 March 2017 (the “**Prospectus**”), Kunming Dianchi Investment reserves certain wastewater treatment plants in Kunming and the Company entered into an entrusted operation and management framework agreement (the “**Previous Framework Agreement**”) on 25 April 2016 with Kunming Dianchi Investment for the period from 25 April 2016 to 31 December 2018 to regulate the terms and conditions under which the Company would provide such Entrusted Operation and Management Services to Kunming Dianchi Investment after Listing.

The Company has obtained approval for annual caps of the transactions under the Previous Framework Agreement covering a period of three years until 31 December 2019. The Previous Framework Agreement was expired on 31 December 2018 and as disclosed in the Letter from the Board and the section headed “Information of the Entrusted Operation and Management Services” in this Letter, 8 individual agreements entered into between the Group and Dianchi Investment Group under the Previous Framework Agreement are still effective and there are certain new wastewater treatment plants/facilities of Kunming Dianchi Investment to be completed and commenced operation in the coming few years. As such, Kunming Dianchi Investment shall continue relying on or entrust the Company to operate and manage the expanded capacities of the existing and new wastewater treatment plants/facilities in Kunming.

In addition, the Company entered into the Non-competition Agreement with Kunming Dianchi Investment to regulate the relationship and potential business competition between the Group and Kunming Dianchi Investment upon the Listing. Pursuant to the Non-competition Agreement, for those wastewater treatment plants the Company is entrusted to operate, the Company has (i) the right to request Kunming Dianchi Investment to sell; (ii) the right to acquire at their respective commencement of commercial operation; and (iii) the right of first offer to acquire any or all of them. Entering into the New Framework Agreement will facilitate the Group to continue to operate and control these assets and track the situation and performance of the wastewater treatment plants. It will also enable the Company to better assess whether and when to exercise its right to acquire such assets in accordance with the Non-competition Agreement. In addition, the Company considers that the continuing business with Kunming Dianchi Investment will enhance the income flow of the Group.

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Based on the above, the Directors (including the independent non-executive Directors) are of the view that the New Framework Agreement and the Continuing Connected Transaction thereunder are entered into in the ordinary and usual course of business of the Company and on normal commercial terms, and the terms of the Continuing Connected Transaction under the New Framework Agreement and the proposed annual caps are fair and reasonable so far as the Independent Shareholders are concerned, and are in the interests of the Company and the Shareholders as a whole.

5. The New Framework Agreement

As disclosed in the Letter from the Board, since the operation and management services for wastewater treatment facilities, reclaimed water supply facilities, and running water supply facilities will be continuously provided by the Group to Dianchi Investment Group, on 30 April 2019, the New Framework Agreement was entered into between the Company and Kunming Dianchi Investment to set out such services to be provided. Set out below are the principal terms of the New Framework Agreement:

| | |
|--|---|
| Parties | (i) Kunming Dianchi Investment; and (ii) the Company |
| Date of signature, effective date and term of the agreement | <p>The New Framework Agreement was entered into on 30 April 2019 with both parties' signatures and seals. It will take effect upon approval by the Company's general meeting. The term of the agreement is from the date of approval of the New Framework Agreement and the continuing connected transaction thereunder by the Company's general meeting to 31 December 2021.</p> <p>The term of the individual agreements entered into by the Group and Dianchi Investment Group under the New Framework Agreement shall not exceed the term of the New Framework Agreement.</p> |
| Scope of the operation and management services | The operation and management services provided by the Group to Dianchi Investment Group include operation and management services for wastewater treatment facilities, reclaimed water supply facilities, etc. and running water supply facilities. |
| Principles of transaction | (i) The parties agree that entering into the New Framework Agreement does not affect the parties' (or their respective subsidiaries) independent choice of transaction objects or transactions with third parties; |

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- (ii) Kunming Dianchi Investment agrees that for the entrusted operation and management services provided by the Group, Dianchi Investment Group shall give priority to the Group's entrusted operation and management services when the service conditions offered and fees quoted by third parties are the same;
- (iii) Dianchi Investment Group has the right to obtain services from third parties if the Group cannot meet the requirements of Dianchi Investment Group for the operation and management services or if the conditions provided by third parties are more favorable;
- (iv) The Company will provide an annual estimate of the operation and management services required for the next year to Kunming Dianchi Investment; and
- (v) Subject to compliance with the principles of the New Framework Agreement, it is expected that the Group will enter into individual service agreements with Dianchi Investment Group from time to time as required. The Group reserves the right to amend these individual service agreements as required in order to comply with the Listing Rules.

Operation and management fees

Each party will agree on relevant management fees for the entrusted operation according to the types of individual operation and management services, which will be reflected in individual agreements (please refer to the relevant terms under "Operation mode" in the Letter from the Board and below).

The price of the operation and management services under the New Framework Agreement shall be determined according to the following principles:

- (i) if there is a market price, it shall be executed at market price; and
- (ii) if the above transaction principle cannot be applied in actual transactions, the agreed price shall be adopted.

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The above “market price” refers to the price determined in the following sequence: (1) the price charged by third parties that provide such products and services under normal commercial transactions at the place where such services are provided or in its vicinity; or (2) the price charged by a third party providing such services under normal commercial transactions. When determining the market price, the purchasing department of the Company will collect service fee quotations at the places where the operation and management services are provided or in their vicinity and the price charged by the Group for providing similar services to independent third parties during the same period to reach specific charges. The final price will be reported to the chairperson of the Company for approval.

The above “agreed price” refers to the price determined according to “reasonable costs + reasonable profit (no more than 10%)”, of which:

- (i) the “reasonable costs” refers to the costs mutually agreed through negotiation between both parties for actual expenses incurred for provision of such products or services by the Group to Dianchi Investment Group or the costs mutually agreed through negotiation between both parties (including taxes and fees). In determining “reasonable costs”, an estimate of expenses to be incurred will be provided by the Group to Dianchi Investment Group, which is determined with reference to historical costs for provision of such products or services and adjustments made to such historical costs. In making the relevant adjustments to historical costs, the Group will mainly consider the expected increase or decrease in costs such as sludge treatment and other costs including electricity costs. This estimate of expenses is subject to agreement by both parties. The Group may also outsource the provision of certain products or services to third parties. Under this situation, “reasonable costs” is determined with reference to the actual service fee charged by the relevant third party and the Group’s expenses allocated to the relevant product or service, which is subject to negotiation and agreement by both parties.

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- (ii) the “reasonable profit” was fixed at no more than 10% as agreed between the Company and Dianchi Investment Group. On the one hand, the Company considers that it is commercially reasonable to adopt an overall margin for different types of projects to be transacted under the New Framework Agreement, which will allow the Company to have more flexibility to negotiate with Dianchi Investment Group regarding the pricing for individual projects. On the other hand, the Company will ensure that the overall profit margin for the transactions under the New Framework Agreement will not be lower than 8%. When determining the price and specific terms of an individual agreement, the Company will strictly follow its internal control measures as set out in section 3.2.4 below, to ensure that the price is fair and reasonable and the terms of individual agreement conforms with the principles stipulated under the New Framework Agreement.

Operation mode

For all service transactions under the New Framework Agreement, parties to the transactions will enter into individual agreements in accordance with the scope and principles specified in the New Framework Agreement. Such individual agreements shall not violate the agreed provisions under the New Framework Agreement.

The parties of this agreement shall ensure and procure their respective subsidiaries to enter into individual agreements in accordance with the principles and provisions of the New Framework Agreement and the service plans agreed by both parties. Kunming Dianchi Investment is committed to use its best endeavor to procure its associates other than its subsidiaries to enter into individual agreements in accordance with the principles and provisions of the New Framework Agreement and the service plans agreed by both parties.

During the process of implementing the New Framework Agreement, if necessary and as agreed by both parties of the agreement, the individual agreements may be adjusted.

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Obligation of the parties

The main obligations of Dianchi Investment Group and the Group under the New Framework Agreement include:

- (i) Dianchi Investment Group
 - a) to coordinate on matters relating to implementation of each individual agreement;
 - b) to designate or establish a special department for liaison, file preparation, planning and arrangement, supervision, assessment, coordination of the implementation of the agreements in relation to the relevant transactions under the New Framework Agreement, and dispute resolutions; and
 - c) to pay relevant service fees in accordance with the requirements under the individual agreements and to guarantee compensation for the losses caused to the Group due to violation of the New Framework Agreement or any terms of the individual agreements.
- (ii) The Group
 - a) to provide and procure its member companies to provide corresponding services to Dianchi Investment Group in accordance with the New Framework Agreement and to coordinate matters in relation to various individual agreements;
 - b) to regularly submit data and information on relevant work status according to the requirements of Dianchi Investment Group, as well as promptly and effectively organize, resolve and rectify problems in the maintenance and operation of the entrusted subjects, and accept supervision, assessment and relevant evaluation of Dianchi Investment Group and third parties assigned by it;

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- c) to compensate for the losses caused to Dianchi Investment Group due to violation of any terms of the individual agreements under the New Framework Agreement in accordance with the requirements of the individual agreements; and
- d) to ensure safe and stable operation of the entrusted subjects and bear environmental protection responsibility caused due to improper operation and management by the Group.

We have reviewed and compared the principal terms of the New Framework Agreement with those of the Previous Framework Agreement, and noted that save for the determination method of the “agreed price” under operation and management fees, there is no material difference in comparison with the Previous Framework Agreement. The “agreed price” under the Previous Framework Agreement refers to the price, determined according to “reasonable costs + reasonable profit (10%)” while the “agreed price” under the New Framework Agreement refers to the price, determined according to “reasonable costs + reasonable profit (no more than 10%)”.

In terms of the historical Entrusted Operation and Management Services (the “**Historical CCTs**”) provided by the Group to Dianchi Investment Group under the Previous Framework Agreement, we have obtained and reviewed, the historical transaction summary (the “**Historical Transaction Summary**”) and the relevant sample transactions documents with Dianchi Investment Group, including individual contracts, volume data and stamped payment applications (collectively, the “**Transaction Documents**”) for various plant(s)/facility(ies) under the Projects from the Management. We have reviewed the Transaction Documents of the plants/facilities which in aggregate contributed over 90% of the total revenue under the Projects for FY2018. We consider these transactions are exhaustive list of samples based on the selection criteria and are fair and representative samples.

As advised by the Management, the agreed price of Project A under the Previous Framework Agreement was a fixed price based on arm’s length negotiation on the cost estimated by the Management with reference to the historical costs plus profit margin. Project PR and Project DF were newly commenced in 2018 and there were no historical costs that could be used for reference. We noted that the agreed price will be charged at a temporary price of RMB0.36 per cubic meters and RMB1.176 per cubic meters for Project PR and Project DF respectively, which would be adjusted by the audited actual cost of each Project by an independent auditor engaged by Kunming Dianchi Investment and the Company, plus net profit margin. We have reviewed the audited costs accounts of Project PR for FY2018 provided by the Management and noted that the agreed price was adjusted to RMB0.47 per cubic metres. As confirmed with the Management, Kunming Dianchi Investment and the Company have currently engaged an auditor to audit the actual cost of the Project DF.

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Based on our discussion with the Management and our further analysis under section headed “6. Historical Data and Annual Caps”, a fixed agreed price was applied when entering into the individual agreements for Project A under the Previous Framework Agreement and the resulted profit margin for the Historical CCTs were substantially higher than the agreed profit margin of 10% under the Previous Framework Agreement. Both the Company and Kunming Dianchi Investment considered that consistent basis (i.e. 10% profit margin) should be applied for the New Framework Agreement. In addition, despite the nature of the Projects are the same (i.e. wastewater treatment), negative margins are expected for Project DF as compared to both Project A and Project PR, mainly due to the limited scale of operations and experimental nature of Project DF. Based on the above and in order to maintain a reasonable margin for the benefits of both the Company and Kunming Dianchi Investment, the Company and Kunming Dianchi Investment agreed that it is commercially reasonable to adopt an overall margin for the Projects. It was agreed that such margin shall not be over 10% and/or result in lowering the overall profit margin for the transactions under the New Framework Agreement to below 8%.

It is noted from the Transaction Documents and as confirmed by the Management that the historical pricings of the transactions under the Previous Framework Agreement were determined based on the agreed price. As confirmed by the Management, since there was neither fees as prescribed by the PRC government for Entrusted Operation and Management Services nor any other similar transactions with independent third parties (save for the Four Facilities mentioned below, which we consider are not meaningful in comparison for value and will not be applied for comparison purpose) which prevailing market price(s) and practices were available for reference during the term of the Previous Framework Agreement (i.e. from 25 April 2016 to 31 December 2018), the agreed price was adopted.

As advised by the Management, there were four small-scale water purification facilities (“**Four Facilities**”), which were classified as connected parties under Dianchi Investment Group in FY2016 and transferred (the “**Transfer**”) to other government entities in years 2017 and 2018. The Group continues to provide the wastewater treatment management services to the Four Facilities after the Transfer. Based on our review of the sales-cost summary, the wastewater processing capacity and the sample transaction documents of the transactions with these Four Facilities, we noted (i) the aggregated designed wastewater processing capacity of these four plants were 4,500 tons/day as compared to the total designed wastewater processing capacity of 505,000 tons/day of the 9 wastewater treatment plants owned by Kunming Dianchi Investment for FY2018; and (ii) the Group recorded net loss for these four plants in FY2018 despite higher fees have been charged to these four plants, mainly due to the lack of economies of scale in operating these Four Facilities. For the avoidance of doubt, the Group’s transactions with these Four Facilities were not and will not be treated as continuing connected transactions of the Group after the Transfer.

Based on our review of the Historical CCTs under the Previous Framework Agreement and the Entrusted Operation and Management Services to be provided by the Group under the New Framework Agreement, we are of the opinion that the Entrusted Operation and Management Services to be provided by the Group under the New Framework Agreement are in line with the principal business of the Group and that the New Framework Agreement will be entered into in the ordinary and usual course of business of the Group. In addition, based on our review of the Historical CCTs, we concur with the view of Directors that the adoption of the agreed price and the pricing policy for the Historical CCTs are reasonable.

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6. Historical Data and Proposed Annual Caps

Historical Data

As disclosed in the Letter from the Board and as provided by the Management, set out below is the historical transaction data (the “**Historical Transaction Data**”) of the Entrusted Operation and Management Services provided by the Group to Dianchi Investment Group under the individual agreements for the years ended 31 December 2016, 2017 and 2018, respectively and for the three months ended 31 March 2019:

| | For the year ended 31 December | | | For the three months ended 31 March |
|----------------------------|--------------------------------|------------------|------------------|--|
| | 2016 | 2017 | 2018 | 2019 |
| | <i>(RMB'000)</i> | <i>(RMB'000)</i> | <i>(RMB'000)</i> | <i>(RMB'000)</i> |
| Annual Cap | – | 115,800 | 130,000 | 140,000 <i>(Note)</i> |
| Actual transaction amounts | 73,439 | 82,373 | 67,999 | 16,303 |
| – Project A | 73,439.0 | 82,373.0 | 53,358.3 | 11,468 |
| – Project PR | – | – | 12,494.0 | 4,207 |
| – Project DF | – | – | 2,146.7 | 627 |

Note:

1. Annual cap for the year ending 31 December 2019 of the transactions under the Previous Framework Agreement and as disclosed in the Prospectus.

As shown in the Historical Transaction Data, the actual transaction amounts of Project A for the three years ended 31 December 2018 were approximately RMB73.4 million, RMB82.4 million and RMB53.4 million respectively, representing 100%, 100% and approximately 78.5% of the corresponding total actual transaction amounts for respective years. The decrease in the share of Project A’s transactions in FY2018 was because of the commencement of new Projects, namely Project PR and Project DF with Dianchi Investment Group in mid-2018. The actual transaction amounts of Project PR and Project DF for FY2018 were approximately RMB12.5 million and RMB2.1 million respectively.

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Despite the provision of new services by the Group under Project PR and Project DF in FY2018, the overall utilization rate of the annual caps decreased from 71.1% for FY2017 to 52.3% for FY2018, mainly due to the acquisition of Kunming No. 10 Water Purification Plant (“**No. 10 Plant**”) by the Group from Dianchi Investment Group during FY2018 and the relevant transactions ceased to be regarded as connected transactions. The transaction amount of No. 10 Plant accounted for approximately 47.4% and 42.3% of the total transactions of Project A for FY2016 and FY2017 respectively.

Based on our review of the calculation of the profit margins of the Historical CCTs and as discussed with the Management, the reasonable costs of the Historical CCTs included cost of sales (which consists of direct materials, labour and overhead cost and sludge disposal cost), sales and administration expenses, finance cost and tax expenses. We noted that the overall profit margin of the Historical CCTs was approximately 20.3% and 20.7% for both FY2016 and FY2017 respectively and it dropped to around 16.0% for FY2018. As discussed with the Management, the decrease in profit margin for FY2018 was mainly due to (i) the disproportionate increase in sludge disposal cost for FY2018 as compared to FY2017, which accounted for approximately 6.2% of the total revenue of Project A for FY2018 as compared to 4.9% of the total revenue of Project A for FY2017; and (ii) the commencement of Project PR and Project DF, for which lower/negative margins were reported.

As mentioned in the section headed “Information of the Entrusted Operation and Management Services” in this letter, each of Project PR and Project DF involves an additional process to improve water quality and the day to day operations of Project PR and Project DF have been outsourced to independent third parties. Based on our review of the outsourcing agreements of these two Projects, the profit margins (excluding the additional costs to be borne by the Group and the share of sales and administrative costs of wastewater treatment management services) under the outsourcing agreements for Project PR and Project DF are approximately 55% and 20% respectively. In view of the limited scale of operations of both Projects in FY2018, lower/negative margins for FY2018 after absorption of all relevant costs of services provided by the Group were therefore reported.

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Proposed Annual Caps

Pursuant to the Letter from the Board and as provided by the Management, the Directors have estimated that the annual caps (the “**Proposed Annual Caps**”) for the transactions under the New Framework Agreement, which include all costs and expenses payable by the Group in relation to the operation and management of the various wastewater treatment plants, and the service fees the Group may charge pursuant to the New Framework Agreement, for each of the years ending 31 December 2019, 2020 and 2021 would be as follows:

| | For the year ending 31 December | | |
|---|---------------------------------|----------------|----------------|
| | 2019 | 2020 | 2021 |
| | (RMB'000) | (RMB'000) | (RMB'000) |
| Service fees and reimbursable costs (after tax) to be paid by Kunming Dianchi Investment to the Company^{Note} | 123,170 | 193,440 | 252,800 |
| – Project A | 74,526 | 84,957 | 117,681 |
| – Project PR | 34,903 | 88,355 | 109,594 |
| – Project DF | 2,544 | 2,544 | 2,544 |
| – 10% buffer | 11,197 | 17,584 | 22,981 |

Note: The annual cap for each of the three years was adjusted as compared to those disclosed in the announcement dated 30 April 2019, for the reasons that (1) the Company was informed that Dianchi Investment Group will reduce one project from the service scope, and (2) the Company rectifies the calculation of the annual caps with the accurate effective tax rates. We have reviewed the revised calculation of the annual caps, which reflected the change of service scope under the applicable effective tax rates provided by the Management.

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As stated in the Letter from the Board, for the purposes of determining the Proposed Annual Caps for the transactions under the New Framework Agreement for each of the years ending 31 December 2019, 2020 and 2021, the Directors have considered the following factors:

- (i) historical transaction amount and existing costs of services of operation and management services;
- (ii) the expected increase in service volume for the three years ending 31 December 2021. The Company's operation and management services mainly include three types of projects, namely the Project A, Project PR and Project DF. It is expected that production capacity of the Company for each of these projects will increase in the three years ending 31 December 2021:

| | 2018 | 2019 | 2020 | 2021 |
|------------|-------------------|-------------------|-------------------|-------------------|
| | <i>(tons/day)</i> | <i>(tons/day)</i> | <i>(tons/day)</i> | <i>(tons/day)</i> |
| Project A | 154,000 | 199,500 | 225,000 | 337,000 |
| Project PR | 134,000 | 246,500 | 624,000 | 774,000 |
| Project DF | 5,500 | 5,500 | 5,500 | 5,500 |

- (iii) estimated increase in costs of the Project A of approximately 21%, 24% and 27% in 2019, 2020 and 2021 respectively as compared to the costs of the Project A in 2018, mainly due to increase of costs for sludge treatment as required under relevant environmental policies; and
- (iv) level of profit under the New Framework Agreement.

When determining the proposed annual cap of the above-mentioned transaction for the year ending 31 December 2019, the Directors have considered the used and unused quota for the annual cap of the transaction under the Previous Framework Agreement for that year and the additional services that may be required by Dianchi Investment Group.

In order to assess the fairness and reasonableness of the Proposed Annual Caps under the New Framework Agreement, we have performed certain works and discussed with the Management on the basis and assumptions underlying the determination of the Proposed Annual Caps.

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We have obtained and reviewed the projection tables (the “**Caps Projection Tables**”) for the determination of the Proposed Annual Caps for the three years ending 31 December 2021 prepared by the Management, showing (i) the names of each wastewater treatment plant/facility of the Dianchi Investment Group under the Projects; (ii) the designed and expected wastewater treatment capacity of each plant/facility of the Dianchi Investment Group; (iii) progress of the construction of new wastewater treatment plants/facilities; and (iv) the expected price. The proposed annual caps for the three years ending 31 December 2021 under the New Framework Agreement were calculated based on the expected wastewater treatment volume multiplied by the expected price for each plant/facility.

We have further obtained and reviewed the relevant government approval documents issued by various government authorities including Development and Reform Commission of Yunnan Province (雲南省發展和改革委員會), Housing and Urban-Rural Development Department of Yunnan Province (雲南省住房和城鄉建設廳) and Kunming Municipal People’s Government (昆明市人民政府), publications by Kunming Municipal People’s Government (昆明市人民政府) and the project design documents issued by qualified engineering design institutions) from the Management or from public open domain regarding the designed capacity of each wastewater treatment plant/facility, and noted that the expected actual capacity of each wastewater treatment plant/facility used in the Caps Projection Tables are all within the designed capacity.

For assessment purpose, we have obtained and reviewed the projection tables (the “**Price-Cost Projection Tables**”) for the sales and the breakdown of the costs by each plant/facility for each of the three years ending 31 December 2021 prepared by the Management, showing (i) the names of each plant/facility of the Dianchi Investment Group under the Projects; and (ii) the projected sales and the breakdown of the costs. As advised by the Management, since there was neither fees as prescribed by the PRC government nor any other similar transactions with independent third parties, which prevailing market prices or practices are available for reference, for the above-mentioned operation and management services during the term of the Previous Framework Agreement, the agreed price will be adopted for the Continuing Connected Transaction based on the estimated cost plus agreed net profit margin, which is consistent with that in the Previous Framework Agreement. The profit margins of the Projects for the three years ending 31 December 2021 in the Price-Cost Projection Tables as well as the overall profit margin of the Projects for FY2018 are summarised as below.

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| Projects | Approximate historical overall profit margin (%) for the year ended December 2018 | Approximate expected overall profit margin (%) for the year ending 31 December | | |
|-----------------|--|---|-------------|-------------|
| | | 2019 | 2020 | 2021 |
| – Project A | 18.6 | 8.4 | 7.7 | 7.2 |
| – Project PR | 10.7 | 10.8 | 11.4 | 11.9 |
| – Project DF | -17.8 | -18.1 | -17.5 | -17.0 |
| Overall | 16.0 | 8.6 | 9.2 | 9.1 |

Profit Margin and Pricing

As noted from the Price-Cost Projection Tables and as advised by the Management, the expected price used in the Caps Projection Tables are either historical prices or prices higher than the historical prices (i.e. approximately in a range of RMB0.45-1.47 per cubic metres depending on the type of the project) after considering the overall expected profit margin. The cost components of the reasonable costs adopted for calculation of the profit margin are consistent with the Historical CCTs. The overall profit margin of the Continuing Connected Transaction under the Projects will maintain at around 8.6% – 9.2% for the three years ending 31 December 2021, based on the pricing policy of “reasonable costs + reasonable profit (no more than 10%)” under the New Framework Agreement. In addition, such margin shall not result in lowering the overall profit margin for the transactions under the New Framework Agreement to below 8%.

Project A

We noted that the overall profit margins of the Projects for the coming three years are lower than that of FY2018, mainly due to the increase in sludge disposal cost for Project A.

Based on the information provided by the Management, the average sludge disposal cost per ton of wastewater would be increased from approximately RMB0.6 for FY2018 to RMB0.17, RMB0.17 and RMB0.17 for the three years ending 31 December 2019, 2020 and 2021 respectively, representing approximately 6.2%, 16.9%, 16.7 % and 15.6% of the total revenue for FY2018 and for the three years ending 31 December 2019, 2020 and 2021 respectively. We have enquired the reasons for such increase and we were told by the Management that due to the stricter environmental requirement imposed by the government, the sludge disposal cost has increased sharply in recent years. The Management estimated that the average sludge disposal cost per ton remained the same for the three years ending 31 December 2021 for prudence sake.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

We have obtained and reviewed the Group's sludge disposal agreements over the past three years and noted that the year on year increase of the sludge processing fee for 2019 and 2018 was approximately 100% and 125% respectively.

Project PR and Project DF

It is expected that the profit margin of Project PR will maintain at around 11% for three years ending 31 December 2019, 2020 and 2021, similar to that of FY2018.

As above-mentioned, Project DF is for experimental purpose and will continue to be operated by one plant only, and the daily processing volume of which will be approximately 5,500 tons for the coming three years. The Company expects that Project DF will continue to operate in loss due to the lack of economies of scale.

In the view that (i) the agreed price based on "reasonable costs + reasonable profit (no more than 10%)" is adopted as there is neither fees as prescribed by the PRC government nor any prevailing market prices or practices are available for reference; (ii) the overall margin of the Continuing Connected Transaction under the Projects will maintain at around 8.6%–9.2% for the three years ending 31 December 2021 based on the calculation provided by the Management; and (iii) the existence of the internal control policy adopted by the Company as disclosed under the section headed "Internal Control Measures" in the Letter from the Board, especially, (a) before entering into an individual agreement, the price-determination team will review proposed transaction price and the terms under a draft individual agreement, to ensure that they are in line with the general principles under the New Framework Agreement and entering into such transaction will not result in lowering the overall profit margin for the transactions under the New Framework Agreement to below 8%; and (b) both the management and the Board shall ensure that the overall profit margin under the New Framework Agreement will not be lower than 8%, we consider the pricing policy of "reasonable costs + reasonable profit (no more than 10%)" under the New Framework Agreement are on normal commercial terms, fair and reasonable as far as the Independent Shareholders are considered.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

Processing Volume

Project A

Based on the Caps Projection Tables, the Proposed Annual Caps for the Project A for each of the three years ending 31 December 2021 are approximately RMB74.5 million, RMB85.0 million and RMB117.7 million respectively. As noted in the Caps Projection Tables and as advised by the Management, the increase in the Proposed Annual Caps is mainly due to the expected increase in wastewater processing capacity in the coming three years by approximately 183,000 tons/day to approximately 337,000 tons/per day from the average of approximately 154,000 tons/day for FY2018. The expected increase in the processing capacity was because (i) there are two new plants (i.e. Kunming No. 13 Water Purification Plant and Kunming No. 14 Water Purification Plant with wastewater processing capacity of 60,000 tons/day (first phase) and 100,000 tons/day respectively) expected to commence operation in mid-2019 and 2021 respectively as discussed under the section headed “3. Information of the Entrusted Operation and Management Services” above, and each is expected to generate revenue of approximately RMB19.6 million and RMB32.7 million per annum for the Group; and (ii) the expected increase of approximately 23,000 tons/day or 15% in wastewater processing volume for the existing plants from approximately 154,000 tons/day as at 31 December 2018 to an approximate average of 177,000 tons/day for the coming three years. We have obtained and reviewed the relevant government/project documents in relation to the designed wastewater processing capacity of the above plants and noted that the expected volume used in the Caps Projection Tables are all within the designed capacity.

As noted in the Historical Transaction Summary, the wastewater processing volume for the existing plants/facilities for FY2018 increased at a compound annual growth rate of approximately 22% from FY2016.

According to the Thirteenth Five-Year Plan on Protection and Treatment of Water Environment in Dianchi Basin (2016-2020) (Hearing Version) (《滇池流域水環境保護治理「十三五」規劃》(2016-2020年)(聽證稿)) (the “**Thirteenth Five Year Plan (2016-2020)**”) published by Kunming Municipal People’s Government in 2016, in view of the continuous deterioration in emission of pollutants in Dianchi area, it is planned that the urban wastewater processing capacity will increase by 250,000 cubic metres/day under the Thirteenth Five Year Plan (2016-2020).

Project PR

As noted in the Caps Projection Tables, the proposed annual caps for Project PR for each of the three years ending 31 December 2021 are approximately RMB34.9 million, RMB88.4 million and RMB109.6 million respectively.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

Based on the Caps Projection Tables and as advised by the Management, the increase in the Proposed Annual Caps are mainly attributable to (i) the additional four wastewater processing plants/facilities with total expected wastewater processing capacity of 640,000 tons/day to be built and commence operation during the three years ending 31 December 2021; and (ii) the existing plants operated for Project PR only commenced operation since mid-2018. Based on our discussion with the Management regarding the four new wastewater processing plants/facilities, the Management confirmed that one with designed capacity of 150,000 tons/day has commenced trial operation in 2019, and the Management expects that the other two with aggregated designed capacity of 190,000 tons/day are expected to commence operation in early 2020, and the remaining one with designed capacity of 300,000 tons/day is expected to commence operation in mid-2020. As discussed under the section headed “3. Information of the Entrusted Operation and Management Service” above, these four new wastewater treatment plants/facilities were approved by Kunming or Yunnan government authorities. The Management estimates that the new plants/facilities to be built and commence operation during the three years ending 31 December 2021 will run at a level close to full capacity. We also noted from the Historical Transaction Summary that the actual wastewater processing volume of the existing plants/facilities under Project PR were 134,000 tons/day, operating at a level close to full capacity of approximately 135,000 tons/day throughout the period since the commencement of Project PR since mid-2018.

Project DF

We noted from the Caps Projection Tables that the Proposed Annual Caps for Project DF are approximately RMB2.5 million for each of the three years ending 31 December 2021. This project consists of one plant, namely, Luolonghe Wastewater Treatment Plant, which is designed for experimental purpose as required by the Kunming government authorities. As advised by the Management, since the Luolonghe Wastewater Treatment Plant commenced the water quality upgrade and renovation testing operation under the Project DF since mid-2018, the actual processing volume of this project was approximately 1,690,000 tons and the actual amount of transactions of the Project DF amounted to approximately RMB2.1 million for FY2018. The Management expects the annual processing volume of this project for each of the three years ending 31 December 2021 will proportionately increase to approximately 2,000,000 tons and thus the expected annual caps are approximately RMB2.5 million for the corresponding years.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

10% buffer in the Proposed Annual Caps

We noted that the Management has added a 10% buffer on top of the Proposed Annual Caps for the transactions under the New Framework Agreements. In view of the fact that the 10% buffer will give the Group flexibility to generate more revenue through price/volume increment, we are of the view that such 10% buffer is reasonable.

Having considered the above factors, especially, (i) the expected processing capacity of each plant/facility are all within the designed capacity; (ii) the expected increase in the processing capacity in the existing and new plants/facilities are fair and reasonable; (iii) the expected price used in the Caps Projection Tables and the overall profit margins of the Continuing Connected Transaction are based on pricing policy under the New Framework Agreement and reference to the historical prices and the overall profit margin of the Historical CCTs for FY2018; and (iv) consistence basis, including the cost components, are adopted in calculating the profit margins for the Proposed Annual Caps, we are of the review that the Proposed Annual Caps are fair and reasonable.

7. Internal Control

We have discussed with the management of the Company and reviewed the internal control measures in place of the Continuing Connected Transaction.

To ensure that the Proposed Annual Caps will not be exceeded and the individual transactions will be conducted in accordance to the New Framework Agreement, the Group has adopted the below internal control measures:

- (a) the Company has formulated the Connected Transactions Management Policies (《關聯交易管理辦法》) (the “**Policies**”) to ensure that all connected transactions, including those under the New Framework Agreement, are properly controlled and monitored, and we have been provided with a copy of the Policies. In particular, the Policies require that continuing connected transactions are subject to annual review by auditors and independent board committee of the Company;
- (b) the Finance Department of the Company has formed a price-determination team (including members from the Finance Department and other relevant departments of the Company) to collect and record service fee quotations for similar operation and management services provided by third parties on a regular basis to keep up with the latest market conditions. Before entering into an individual agreement, the price-determination team will review proposed transaction price and the terms under a draft individual agreement, to ensure that they are in line with the general principles under the New Framework Agreement and entering into such transaction will not result in lowering the overall profit margin for the transactions under the New Framework Agreement to below 8%. The price-determination team will then report their review result to the chairperson of the Company and the chairperson will consider and approve the signing of such individual agreement;

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

- (c) each year, the Finance Department of the Company will prepare an annual plan and annual estimate of the operation and management services fees required for the next year, which is subject to review and approval by the Board. Both the management and the Board shall ensure that the overall profit margin under the New Framework Agreement will not be lower than 8%;
- (d) the Finance Department of the Company will prepare accounts of all individual transactions occurred on a monthly and quarterly basis, and such accounts will be submitted to the Securities Department of the Company and further reported to the president of the Company on a monthly basis and to the president of the Company and the Board on a quarterly basis; and
- (e) the Finance Department and Business Department of the Company will monitor the implementation of each individual agreement on a continuous basis, and report to Securities Department of the Company for any deviation or possible deviation from the relevant individual agreement or the New Framework Agreement. The Securities Department of the Company will further report any serious deviation to the president and the Board of the Company.

In view of the existence of the Policies and above internal control policies adopted by the Company, especially (i) the proposed transaction price and the draft individual agreement will be subject to review by the chairperson of the Company to ensure that they are in line with the general principles under the New Framework Agreement; and (ii) the Finance Department and Business Department of the Company will monitor the implementation of each individual agreement on a continuous basis, and report to Securities Department of the Company for any deviation or possible deviation from the relevant individual agreement or the New Framework Agreement, we are of the view that internal control policies adopted by the Company are appropriate to ensure that (i) the proposed annual caps will not be exceeded; and (ii) the terms of the Continuing Connected Transaction are on normal commercial terms, fair and reasonable and are in the interest of the Company and its Shareholders as a whole.

LISTING RULES IMPLICATION

Pursuant to Rules 14A.55 to 14A.59 of the Listing Rules, Continuing Connected Transaction is subject to the following annual review requirements:

- (a) each year, the independent non-executive Directors must review the Continuing Connected Transaction and confirm in the annual report whether the Continuing Connected Transaction has been entered into:
 - 1. in the ordinary and usual course of business of the Group;
 - 2. on normal commercial terms or better; and
 - 3. according to the agreement governing it on terms that are fair and reasonable and in the interests of the Company and the Shareholders as a whole;

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

- (b) each year, the auditors of the Company must provide a letter to the Board (with a copy provided to the Stock Exchange at least 10 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 Continuing Connected Transaction:
1. have not been approved by the Board;
 2. were not, in all material aspects, in accordance with the pricing policies of the Group if the transactions involve the provision of goods or services by the Group;
 3. were not entered into, in all material aspects, in accordance with the relevant agreements governing the Continuing Connected Transaction; and
 4. have exceeded the annual caps;
- (c) the Company must allow, and ensure that the counterparties to the Continuing Connected Transaction allow, the Company's auditors sufficient access to their records for the purpose of reporting on the Continuing Connected Transaction as set out in paragraph (B). The Board must state in the annual report whether the Company's auditors have confirmed the matters set out in Listing Rule 14A.56; and
- (d) the Company shall promptly notify the Stock Exchange and publish an announcement if the independent non-executive Directors and/or the auditors of the Company cannot confirm the matters set out in paragraphs (a) and/or (b) respectively.

In light of the reporting requirements for the Continuing Connected Transaction, in particular, (i) the restriction of the values of the Continuing Connected Transaction by way of the annual caps; and (ii) the requirements under the Listing Rules for ongoing review by the independent non-executive Directors and the auditors of the Company of the terms of the Continuing Connected Transaction and the annual caps, we are of the view that there exist appropriate measures to govern the conduct of the Continuing Connected Transaction and to safeguard the interests of the Independent Shareholders.

RECOMMENDATION

Having taken into account the principal factors and reasons set out in our letter, we are of the opinion that (i) the New Framework Agreement is entered into in the ordinary and usual course of business of the Group and the terms of the Continuing Connected Transaction are on normal commercial terms and the Proposed Annual Caps are fair and reasonable so far as the Independent Shareholders are concerned; and (ii) the entering into New Framework Agreement is in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Board Committee to advise the Independent Shareholders to vote in favour of the resolution(s) to be proposed at the EGM to approve the New Framework Agreement and the transactions contemplated thereunder and we recommend the Independent Shareholders to vote in favour of the resolution(s) in this regard.

Yours faithfully,
BaoQiao Partners Capital Limited

GENERAL INFORMATION

1. RESPONSIBILITY STATEMENT

This circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Group. The Directors, 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, nor are there any matters the omission of which would make this circular or any statement herein misleading.

2. DISCLOSURE OF INTERESTS

(a) Interests and Short Positions of Directors, Supervisors and Senior Management in the Shares, Underlying Shares and Debentures

As at the Latest Practicable Date, none of the Directors, Supervisors or senior management of the Company had any interests or short positions in the Shares, underlying Shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which would have to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they were taken or deemed to have under such provisions of the SFO), or which were required, pursuant to Section 352 of the SFO, to be recorded in the register referred to therein, or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers set out in Appendix 10 of the Listing Rules.

(b) Competing and Other Interests of Directors

As at the Latest Practicable Date, none of the Directors or, so far as is known to them, any of their respective associates was interested in any business (apart from the Group's business) which competes or is likely to compete either directly or indirectly with the Group's business (as would be required to be disclosed under Rule 8.10 of the Listing Rules if each of them were a controlling shareholder).

(c) Material Interests of the Directors in the Transactions

The Directors of the Company, Ms. Guo Yumei and Ms. Song Hong, serve in Kunming Dianchi Investment and, therefore, they are considered to have a material interest in the continuing connected transaction under the New Framework Agreement. Accordingly, they are required to abstain from voting in the Board resolution approving the continuing connected transaction under the New Framework Agreement. Save as disclosed above, as no other Directors have a material interest in the continuing connected transaction under the New Framework Agreement, no other Directors are required to abstain from voting in relation to the relevant Board resolution.

GENERAL INFORMATION

3. POSITIONS HELD BY THE DIRECTORS IN KUNMING DIANCHI INVESTMENT

The following table sets out the positions held by the Directors in Kunming Dianchi Investment, the controlling shareholder of the Company that has an interest or short position in the Shares and underlying Shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, as at the Latest Practicable Date:

| Name of Director | Position(s) held in the Company | Position(s) held in Kunming Dianchi Investment |
|------------------|---|--|
| Ms. Guo Yumei | Chairperson, executive Director and president | Vice chairperson of the investment board |
| Ms. Song Hong | Non-executive Director | Director and financial director |

4. INTERESTS HELD BY THE DIRECTORS IN THE GROUP'S ASSETS OR CONTRACTS OR ARRANGEMENTS SIGNIFICANT TO THE GROUP

So far as the Company and Directors are aware after making reasonable enquiries, as at the Latest Practicable Date, none of the Directors or Supervisors had any interest, either directly or indirectly, in any assets which have been, since 31 December 2018 (being the deadline to which the latest published audited accounts of the Company were made up), acquired or disposed of or leased by any member of the Group, or are proposed to be acquired or disposed of or leased by any member of the Group.

So far as the Company and Directors are aware after making reasonable enquiries, as at the Latest Practicable Date, none of the Directors or Supervisors was materially interested, either directly or indirectly, in any significant contract or arrangement entered into by the Group that is relevant to the business of the Group and is still valid as at the Latest Practicable Date.

5. SERVICE CONTRACTS OF DIRECTORS AND SUPERVISORS

As at the Latest Practicable Date, none of the Directors or Supervisors has or is proposed to have any service contract with any member of the Group that is not determinable within one year without payment of compensation (other than statutory compensation).

6. MATERIAL ADVERSE CHANGE

As at the Latest Practicable Date, the Directors were not aware of any material adverse change in the financial or trading position of the Group since 31 December 2018 (being the deadline to which the latest published audited accounts of the Group were made up).

GENERAL INFORMATION

7. EXPERT AND CONSENT

The following is the qualification of the expert who has been named in this circular or has given its opinion or advice which is contained in this circular:

| Name | Qualification |
|------------------|---|
| BaoQiao Partners | a corporation licensed to carry on Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities under the SFO |

BaoQiao Partners has confirmed that:

- (a) it has given and has not withdrawn its written consent to the issue of this circular with the inclusion of its letter dated 31 May 2019 and the reference to its name in the form and context in which it appears;
- (b) as at the Latest Practicable Date, it did not have any shareholding in any member of the Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group; and
- (c) as at the Latest Practicable Date, it did not have any direct or indirect interest in any assets which have been, since 31 December 2018 (being the date to which the latest published audited accounts of the Company were made up), acquired or disposed of by or leased to each member of the Group, or are proposed to be acquired or disposed of by or leased to each member of the Group.

8. GENERAL

- (a) The joint company secretaries of the Company are Mr. Yang Yang and Mr. Chiu Ming King, FCIS, FCS.
- (b) The Company's registered office and headquarters in the PRC is located at Wastewater Treatment Plant No. 7, Kunming Dianchi Tourist Resort, Yunnan Province, PRC and its principal place of business in Hong Kong is located at Room 1901, 19/F, Lee Garden One, 33 Hysan Avenue, Causeway Bay, Hong Kong.
- (c) The Company's H Share Registrar is Tricor Investor Services Limited which is located at Level 22, Hopewell Centre, 183 Queen's Road East, Hong Kong.

GENERAL INFORMATION

9. DOCUMENTS FOR INSPECTION

Copies of the following documents are available for inspection during 9:00 a.m. to 5:00 p.m. at the Company's principal place of business in Hong Kong at Room 1901, 19/F, Lee Garden One, 33 Hysan Avenue, Causeway Bay, Hong Kong within 14 days from the date of this circular (excluding Saturdays, Sundays and public holidays):

- (a) the New Framework Agreement;
- (b) the letter of recommendation from the Independent Board Committee in relation to the continuing connected transaction under the New Framework Agreement, the text of which is set out on pages 25 to 26 of this circular;
- (c) the letter from the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders in relation to the continuing connected transaction under the New Framework Agreement, the text of which is set out on pages 27 to 51 of this circular;
- (d) written consent of BaoQiao Partners as mentioned in the paragraph 7 in this Appendix; and
- (e) this circular.