



红日资本有限公司

RED SUN CAPITAL LIMITED

27 May 2025

*To: The Independent Board Committee and the Independent Shareholders of
Luzhou Xinglu Water (Group) Co., Ltd.*

Dear Sirs,

CONTINUING CONNECTED TRANSACTIONS SLUDGE DISPOSAL SERVICES

I. INTRODUCTION

We refer to our engagement as the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders in respect of the Service Contract and the transactions contemplated thereunder (the **"Continuing Connected Transactions"**) (including the proposed annual caps for the years ending 31 December 2025 and 2026 (the **"Proposed Annual Caps"**)), details of which are contained in the letter from the Board (the **"Letter from the Board"**) as set out in the circular to the Shareholders dated 27 May 2025 (the **"Circular"**), of which this letter forms part. This letter contains our advice to the Independent Board Committee and the Independent Shareholders in respect of the Continuing Connected Transactions and the Proposed Annual Caps. Unless otherwise stated, terms defined in the Circular have the same meanings in this letter.

Reference is made to the announcement dated 7 May 2025, in relation to the Service Contract and the transactions contemplated thereunder. On 7 May 2025 (after trading hours), Xinglu Wastewater Treatment, a non-wholly owned subsidiary of the Company, entered into the Sludge Disposal Service Contract with Xinglu Environmental Protection, pursuant to which, Xinglu Environmental Protection agreed to provide sludge disposal services to Xinglu Wastewater Treatment.

As at the Latest Practicable Date, Xinglu Environmental Protection is 100% owned by Xinglu Environment, which in turn is directly held as to 38.35% by Xinglu Investment, the beneficial owner of Xinglu Assets, the Controlling Shareholder of the Company and indirectly held as to 36.65% through Tianhong Partnership. Tianhong Partnership is owned as to 99.5% by Xinglu Assets and as to 0.5% by Xinglu Equity Fund. Xinglu Equity Fund is 100% owned by Xinglu Assets, which is 100% owned by Xinglu Investment. Therefore, the ultimate beneficiary of Tianhong Partnership is Xinglu

Investment. The remaining interests of Xinglu Environment are directly held as to 5% by Chongqing Derun Environment and as to 20% by Chongqing Sanfeng Environment, respectively (Chongqing Derun Environment directly holds 43.86% of the interest in Chongqing Sanfeng Environment, therefore Chongqing Derun Environment indirectly holds approximately 8.8% of the interest in Xinglu Environment through Chongqing Sanfeng Environment). Chongqing Derun Environment is owned as to 54.9% by Chongqing Water & Environment Holdings. Chongqing Sanfeng Environment is owned as to 43.86% by Chongqing Derun Environment and as to 32.99% by Chongqing Water & Environment Holdings, respectively. Chongqing Water & Environment Holdings is 100% owned by Chongqing SASAC. Therefore, the ultimate beneficiary of Chongqing Derun Environment and Chongqing Sanfeng Environment is Chongqing SASAC. Accordingly, Xinglu Environmental Protection is a connected person of the Company and the transactions contemplated under the Service Contract constitute continuing connected transactions for the Company pursuant to Chapter 14A of the Listing Rules.

As the applicable percentage ratios in respect of the transactions contemplated under the Service Contract (other than profit ratio) are more than 5% but less than 25%, and the absolute amount exceeds HK\$10 million, the transactions thereunder are subject to the reporting, announcement, annual review, circular and independent shareholders' approval requirements pursuant to Chapter 14A of the Listing Rules.

II. THE INDEPENDENT BOARD COMMITTEE

The Independent Board Committee comprising all the independent non-executive Directors, namely Ms. Ma Hua, Mr. Fu Ji and Mr. Liang Youguo has been established to advise the Independent Shareholders in relation to the Service Contract and the transactions contemplated thereunder (including the Proposed Annual Caps). Red Sun Capital Limited has been appointed by the Board with the approval of the Independent Board Committee as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in the same regard.

Our appointment has been approved by the Independent Board Committee. Our role as the independent financial adviser is to give our recommendation to the Independent Board Committee and the Independent Shareholders in respect of the Service Contract and the transactions contemplated thereunder, including the Proposed Annual Caps, as to whether (i) the terms thereunder are on normal commercial terms and fair and reasonable; and (ii) the transactions contemplated thereunder are conducted in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole, and how the Independent Shareholders should vote in respect of the relevant resolution to approve the transactions contemplated under the Service Contract, including the Proposed Annual Caps, at the AGM.

III. OUR INDEPENDENCE

As at the Latest Practicable Date, we were independent from and not connected with the Company, Xinglu Environmental Protection and their respective shareholders, directors or chief executives, or any of their respective associates. Accordingly, we are qualified to give independent advice to the Independent Board Committee and the Independent Shareholders regarding the transactions contemplated under the Service Contract.

Save for this appointment and our appointment as the independent financial adviser in respect of the continuing connected transactions in relation to sludge disposal services, details of which are set out in the circular of the Company dated 7 June 2024, Red Sun Capital has not acted as an independent financial adviser to the Company under the Listing Rules in the past two years.

Apart from normal professional fees paid or payable to us in connection with this appointment as the Independent Financial Adviser, no arrangements exist whereby we have received or will receive any fees or benefits from the Group or any other parties that could reasonably be regarded as relevant to our independence. Accordingly, we consider that we are independent from the Group pursuant to Rule 13.84 of the Listing Rules.

IV. BASIS OF OUR ADVICE

In formulating our advice, we have relied solely on the statements, information, opinions, beliefs and representations for matters relating to the Group, the connected parties and their respective shareholders and management contained in the Circular and the information and representations provided to us by the Group and/or its senior management (the “Management”) and/or the Directors.

We have assumed that all such statements, information, opinions, beliefs and representations contained or referred to in the Circular (including this letter) or otherwise provided or made or given by the Group and/or the Management and/or the Directors and for which it is/they are solely and wholly responsible, were true and accurate, and valid and complete in all material respects at the time they were made and given and continue to be so as at the Latest Practicable Date.

We have assumed that all the opinions, beliefs and representations for matters relating to the Group and Xinglu Environmental Protection made or provided by the Management and/or the Directors contained in the Circular have been reasonably made after due and careful enquiry. The Company and/or the Management and/or the Directors confirmed that no material facts have been omitted from the information provided and referred to in the Circular.

We consider that we have been provided with sufficient information and documents to enable us to reach an informed view and the Company has assured us no material information has been withheld from us to allow us to reasonably rely on the information provided so as to provide a reasonable basis for our advice. We have no reason to doubt the truth, accuracy and completeness of the statements, information, opinions, beliefs and representations provided to us by the Group and/or the Management and/or the Directors and their respective advisers or to believe that material information has been withheld or omitted from the information provided to us or referred to in the aforesaid documents.

We have not, however, carried out any independent verification nor have we conducted any independent investigation into information provided by the Directors and the Management, background, business or affairs or future prospects of the Group, Xinglu Environmental Protection and, where applicable, their respective shareholder(s) and subsidiaries or affiliates, and their respective history, experience and track records, or the prospects of the markets in which they respectively operate.

This letter is issued for the information of the Independent Board Committee and the Independent Shareholders solely in connection with their consideration of the Service Contract and the transactions contemplated thereunder, and, except for its inclusion in the Circular, 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. In the event of inconsistency, the English text of this letter shall prevail over the Chinese translation of this letter.

V. PRINCIPAL FACTORS AND REASONS CONSIDERED

In formulating our opinion to the Independent Board Committee and the Independent Shareholders, we have taken into consideration the following principal factors and reasons:

1. Information of the Group

1.1 Background information of the Group

The Group is principally engaged in tap water supply and wastewater treatment.

1.2 Overview of the historical financial information of the Group

With a view to provide background information on the historical financial performance of the Group, we set out the following financial information of the Group as extracted and summarised from the annual results announcement and annual report of the Group for the year ended 31 December 2024 (the “2024 Annual Report”).

Summary of the Group’s consolidated balance sheet

	As at 31 December	
	2024	2023
	RMB'000	RMB'000
Current assets	1,444,270	1,304,524
– Monetary funds	447,179	390,505
– Accounts receivable	697,661	563,915
Non-current assets	5,743,806	5,750,262
– Fixed assets	3,738,536	3,334,920
– Intangible assets	1,512,274	1,537,620
Current liabilities	1,521,227	1,500,662
– Accounts payable	430,247	417,137
– Non-current liabilities due within one year	504,327	569,614
Non-current liabilities	2,518,366	2,541,491
– Long-term borrowings	1,410,549	1,465,304
Total shareholders’ equity attributable to the parent company	2,929,363	2,798,549

Note: for the avoidance of doubt, only selected major asset and liability balances are disclosed in the table above

Financial position as at 31 December 2024 compared to 31 December 2023

We noted from the 2024 Annual Report that as at 31 December 2024, the Group's total assets amounted to approximately RMB7,188.1 million, representing an increase of approximately RMB133.3 million as compared to approximately RMB7,054.8 million as at 31 December 2023, which mainly comprised (i) fixed assets of approximately RMB3,738.5 million; (ii) intangible assets of approximately RMB1,512.3 million; (iii) accounts receivable of approximately RMB697.7 million; and (iv) monetary funds of approximately RMB447.2 million.

The Group's total liabilities amounted to approximately RMB4,039.6 million as at 31 December 2024, representing a decrease of approximately RMB2.6 million as compared to approximately RMB4,042.2 million as at 31 December 2023, which mainly comprised (i) long-term borrowings of approximately RMB1,410.5 million; (ii) non-current liabilities due within one year of approximately RMB504.3 million; and (iii) accounts payable of approximately RMB430.2 million.

As at 31 December 2024, the total shareholders' equity attributable to the parent company amounted to approximately RMB2,929.4 million, as compared to approximately RMB2,798.5 million as at 31 December 2023.

Summary of the Group's consolidated income statement

	Year ended	
	31 December	
	2024	2023
	<i>RMB'000</i>	<i>RMB'000</i>
Total operating revenue	1,330,267	1,286,434
– Water supply business	414,131	384,719
– Wastewater treatment business	660,047	607,255
– Engineering business	238,850	256,823
– Others	17,239	37,636
Total operating costs	1,118,733	1,075,970
Operating profit	226,227	268,577
Profit before tax	227,865	262,521
Income tax expense	37,930	38,608
Net Profit after tax	189,935	223,913

Financial performance for the years ended 31 December 2024 (“FY2024”) and 31 December 2023 (“FY2023”)

As set out in the 2024 Annual Report, the Group recorded total operating revenue of approximately RMB1,330.3 million for FY2024, representing an increase of approximately RMB43.9 million or approximately 3.4% compared to approximately RMB1,286.4 million for FY2023. The increase was mainly due to the increase in the

revenue from tap water and wastewater treatment. The total operating revenue of the Group was mainly generated from (i) water supply business amounted to approximately RMB414.1 million, representing an increase of approximately RMB29.4 million or approximately 7.6% compared to approximately RMB384.7 million for FY2023 which was mainly due to the increase in water sales volume; (ii) wastewater treatment business amounted to approximately RMB660.0 million, representing an increase of approximately RMB52.7 million or approximately 8.7% compared to approximately RMB607.3 million for FY2023 which was mainly due to the increase in wastewater charge volume; and (iii) engineering business amounted to approximately RMB238.9 million for FY2024, representing a decrease of approximately RMB17.9 million or approximately 7.0% compared to approximately RMB256.8 million for FY2023, which was mainly due to the downward adjustment of tariff policy and the decrease in engineering installation projects.

The total operating costs of the Group increased by approximately 4.0% from approximately RMB1,076.0 million for FY2023 to approximately RMB1,118.7 million for FY2024 and the operating profit of the Group decreased by approximately 15.8% from approximately RMB268.6 million for FY2023 to approximately RMB226.2 million for FY2024.

The Group recorded profit before tax and net profit after tax of approximately RMB227.9 million and approximately RMB189.9 million for FY2024, respectively.

2. Information about the parties

2.1 *Xinglu Wastewater Treatment*

Xinglu Wastewater Treatment is a limited liability company established in the PRC on 11 December 2000 and a non-wholly owned subsidiary of the Company, which is principally engaged in sewage treatment and related infrastructure construction services.

2.2 *Xinglu Environmental Protection*

Xinglu Environmental Protection is a limited liability company established in the PRC on 7 November 2012 and is principally engaged in the business of ecological protection and environmental governance (solid waste and hazardous waste treatment), and Xinglu Investment, its ultimate beneficial owner, is principally engaged in investment and asset management, project management and investment and financial consulting business.

3. Reasons for and benefits of the Service Contract

As set out in the Letter from the Board, Xinglu Environmental Protection is currently the only organisation in the Luzhou region that can implement incineration method for sludge disposal. According to the relevant requirements of Luzhou City on the implementation of the ecological environment protection in Sichuan Province, Xinglu Wastewater Treatment's entrustment of

sludge disposal to Xinglu Environmental Protection will more effectively manage the safety and environmental protection risks of Xinglu Wastewater Treatment in the production and operation process.

Having considered the Company's reasons for and benefits of the Service Contract as set out above together with factors, including, among others,

- (i) the principal business activities of the Group, namely, tap water supply and wastewater treatment;
- (ii) Xinglu Wastewater Treatment is principally engaged in sewage treatment and related infrastructure construction services;
- (iii) Xinglu Environmental Protection is currently the only organisation in the Luzhou region that can implement incineration method for sludge disposal; and
- (iv) the Service Contract, if approved, will facilitate the sludge disposal services to be carried out in an efficient and effective manner without the need for the Company to seek Independent Shareholders' approval on a transaction-by-transaction basis,

we concur with the Directors' view that the Service Contract are entered into in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole.

4. Principal terms of the Service Contract

Set out below is a summary of the principal terms of the Service Contract based on the Letter from the Board.

Date:	7 May 2025 (after trading hours)
Parties:	(1) Xinglu Wastewater Treatment; and (2) Xinglu Environmental Protection.
Subject Matter:	Provision of disposal services by Xinglu Environmental Protection for the sludge generated during the production process for Xinglu Wastewater Treatment.
Term and Service Fee:	1 year from the date of the Service Contract signing and becoming effective, effective from the date of approval at the AGM (i.e. from 28 June to 31 December 2025 and 1 January to 27 June 2026).

The disposal service fee under the Service Contract shall not exceed RMB33,000,000 per annum (tax inclusive), which was determined by both parties based on the agreed unit price of the sludge disposal service fee and the volume of sludge disposed.

Payment Method:

Xinglu Environmental Protection shall provide to Xinglu Wastewater Treatment each quarter a statement of the sludge disposal service fee for the previous quarter (including but not limited to payment instructions, daily accounts for sludge disposal and official invoices), and Xinglu Wastewater Treatment shall make payment within 25 working days upon receipt of the payment information by way of bank transfer.

Pricing Policy:

When determining the service fee under the Service Contract, Xinglu Environmental Protection calculated based on the actual quantity of sludge disposed per quarter and the agreed unit price for the disposal, and in the ordinary and usual course of business and on normal commercial terms according to a pre-determined formula, and such terms and conditions were negotiated on an arm's length basis.

When determining the unit price of sludge disposal service fees, such is calculated based on the unit price range of similar services provided by independent third-party service providers from 1 January 2024 to 31 December 2024 (i.e. RMB325.3 to RMB358 per tonne), and the unit price of sludge disposal service fee was determined to be RMB343 per tonne after arm's length negotiation. The Directors are of the view that the unit price per tonne agreed under the Service Contract is within the 2024 Service Fee Range and is therefore no less favourable to the historical transaction unit price charged by independent third-party service providers as far as the Company is concerned. It is fair and reasonable and is in the interests of all Shareholders as a whole.

For other principal terms of the Service Contract, please refer to the Letter from the Board.

5. **Our analysis on the principal terms of the Service Contract and work performed on the internal control procedures**

With a view to assess the fairness and reasonableness of the principal terms of the Service Contract, we have carried out the following work and analysis.

5.1 Our analysis on the pricing policy for the Service Contract

We noted from the pricing policy under the Service Contract that the service fee was calculated based on the actual quantity of sludge disposed per quarter and the agreed unit price for the disposal, and such terms and conditions were negotiated on an arm's length basis.

With a view to assess the reasonableness of the sludge disposal service charge per tonnage charged by the connected person under the existing Service Contract of RMB343 per tonne, we have reviewed the sludge disposal service charge per tonnage charged by independent third party service providers. To identify comparable historical transactions, we have obtained and reviewed the sludge disposal services contract which covered the full cycle disposal procedures in one service contract. However, only one such service contract was identified. In order to expand our sample size, we have expanded our selection criteria to include sludge disposal services contract which would not use the landfill approach to dispose the sludge, which is in line with the latest PRC government policy directives with a total contract amount of not less than RMB5 million. Based on the aforesaid, we have identified two set of contracts by independent third party service providers (together the "Comparable Transactions"), the disposal service charge of which ranged from approximately RMB325.3 per tonne to RMB358 per tonne (the "Service Fee Range").

Based on our review of the Service Contract, we noted that the agreed unit price per tonne of RMB343 for the provision of disposal services by Xinglu Environmental Protection under the Service Contract is within the range of the Service Fee Range of the Comparable Transactions. On this basis, the agreed unit price per tonne under the Service Contract is not less favourable to the Company than the historical comparable transacted unit price per tonne charged by independent third party service providers, and is therefore considered to be fair and reasonable.

5.2 Our analysis on the payment terms for the Service Contract

For our assessment on the reasonableness of the payment terms, we have obtained and reviewed transactions in relation to the provision of disposal services by independent third party service providers under the Comparable Transactions for the Group during the year ended 31 December 2024 and noted that the payment terms of such services ranged from one week in advance to 30 business days from the relevant invoice date/ payment notice which was billed each month.

We noted that (i) the service fee under the Service Contract calculated based on the actual quantity of sludge disposed per quarter; and (ii) the payment terms offered by the Xinglu Environmental Protection to Xinglu Wastewater Treatment is 25 business days upon receipt of the payment notice. On this basis, the payment terms under the Service Contract is not less favourable than those payments terms with independent third parties for similar services.

5.3 *Our work performed on the internal control procedures for the Service Contract*

We noted that the Group has adopted the following internal control measures to ensure that the terms of the continuing connected transactions under the Service Contract are fair and reasonable:

- (i) prior to the signing of the Service Contract, Xinglu Wastewater Treatment shall approve the Service Contract in accordance with the provisions of the relevant contract management system of the Company. The legal department of the Company shall assess and analyse whether the Service Contract constitutes a connected transaction in accordance with the relevant provisions of the Listing Rules and, after confirming that it is a continuing connected transaction, Xinglu Wastewater Treatment shall submit the Service Contract to the Board of Directors for consideration and approval. The Directors believe the unit price per tonne under the Service Contract is the same with that of the last year and is no less favourable to the historical transaction unit price charged by independent third-party service providers as far as the Company is concerned to ensure that it is fair and reasonable and is in the interests of all Shareholders as a whole. Accordingly, the Board shall consider and approve the Service Contract and recommend the same for the approval by the Shareholders at the general meeting;
- (ii) the legal department and finance department of the Company will closely monitor the transactions under the Service Contract, which will be specifically responsible by the legal department to arrange specialized personnel to establish related transaction management accounts, and track and monitor the performance of transactions during the effective period of the contract, including quarterly sludge treatment volume, fee amount and payment, etc., so as to ensure that the transaction amounts will not exceed the annual caps for the Service Contract;
- (iii) if the estimated transaction amount is expected to exceed the annual cap, the legal department of the Company will discuss with the Company's management to consider whether it is necessary to amend the annual cap based on the estimated transaction amount, and any such amendment will be subject to the approval of the Board and Independent Shareholders (if any adjustment is made to the annual cap, the Company will re-comply with the relevant requirements of Rule 14A.54 of the Listing Rules);

- (iv) the legal department of the Company will conduct regular checks to review and assess whether the transactions contemplated under the Service Contract are conducted on normal commercial terms, in accordance with the terms set out in the Service Contract, and whether the service fees and relevant contract terms are in the interest of the Company and the Shareholders as a whole;
- (v) the Company's external auditors will conduct an annual review of the transactions under the Service Contract to ensure that the transaction amounts are within the annual caps and the transactions are in accordance with the terms set out in the Service Contract; and
- (vi) the independent non-executive Directors will conduct regular reviews of the status of the transactions under the Service Contract to ensure that the Company has complied with its internal approval process, the terms of the Service Contract and the relevant requirements under the Listing Rules.

In this connection, we have conducted the following work, including,

- (i) obtained and reviewed the relevant documents and approval record by authorised personnel, including of the relevant department, the general manager and the chairman of the board of Xinglu Wastewater Treatment for the procurement of services in relation to the Service Contract;
- (ii) obtained and reviewed the approval record by the executive Directors of the Company for the Service Contract;
- (iii) obtained the relevant internal policies, including, the management of connected transactions guidelines* (關聯交易管理工作實施細則) adopted by the Company setting out that the legal department and finance department of the Company will monitor the connected transactions to ensure that the transaction amounts will not exceed the respective annual caps;
- (iv) reviewed the report prepared by the Company's external auditors setting out that they have conducted an annual review of the continuing connected transactions for the year ended 31 December 2024 to ensure that the transaction amounts are within the respective annual caps and the transactions are in accordance with the terms set out in the respective agreement(s); and
- (v) reviewed the supporting documents and the 2024 Annual Report and noted that the Company's independent non-executive Directors have reviewed the relevant historical continuing connected transactions and did not note that there were any material deviations or non-compliance of the terms of the relevant agreement governing the continuing connected transactions.

Based on the documents reviewed and as confirmed by the Management, we are of the view that the abovementioned relevant internal control procedures are in place and have been carried out by the Company and that the effective implementation of such internal control procedures shall ensure the reasonableness of the relevant transactions.

5.4 Our findings

Having considered the work performed by us as set out above, in particular, our work performed on the principal terms of the Service Contract, including our analysis on the pricing policies, payment terms and internal control procedures in connection with the Continuing Connected Transactions, we considered that the terms of the Service Contract, which are subject to the relevant internal control procedures, to be fair and reasonable and in the interests of the Shareholders as a whole.

6. Basis and rationale for determining the Proposed Annual Caps

As set out in the Letter from the Board, the Proposed Annual Caps for the transactions under the Service Contract are calculated based on the expected maximum sludge treatment volume determined by the aforementioned pricing policy.

Our analysis on the Proposed Annual Caps

The Proposed Annual Caps under the Service Contract for the two years ending 31 December 2025 and 2026 is set out as follows:

	For the year ending 31 December	
	2025	2026
	<i>RMB'000</i>	<i>RMB'000</i>
Proposed Annual Caps		
Service Contract (<i>Note</i>)	16,500	16,500
	(the “2025 Annual Cap”)	(the “2026 Annual Cap”)
Annual cap under previous service contracts	16,500	
Combined annual cap	33,000	16,500

Note: The existing annual cap of RMB16.5 million for the year ending 31 December 2025 and the Proposed Annual Cap of RMB16.5 million for the year ending 31 December 2026 are intended to cover transactions for a period of approximately six months, respectively.

As set out in the Letter from the Board, in view of the fact that the Service Contract will take effect upon approval by the relevant Shareholders at the AGM, the 2025 annual cap is required to cover the transactions under previous service contracts from 1 January to 27 June 2025, as well as transactions under this signed service contract from 28 June to 31 December 2025, and the 2026 annual cap will cover transactions from 1 January to 27 June 2026.

With a view to assess the fairness and reasonableness of the basis of the Proposed Annual Caps, we have obtained and reviewed a schedule prepared by the Management setting out the basis of the Proposed Annual Caps which was mainly attributable to, among others, (i) the wastewater treatment plants operated by the Group in Luzhou (the “**Wastewater Treatment Plants**”) of which would require the disposal services under the Service Contract; (ii) the estimated tonnage of sludge to be produced by each of the Wastewater Treatment Plants that would require the disposal services under the Service Contract during the term of the Service Contract; and (iii) the estimated transaction amount by taking into account the agreed unit price per tonne and the tonnage of sludge under (ii) above.

Utilisation of the historical annual caps

We noted from the Letter from the Board that the historical transaction amount for the year ended 31 December 2024 and the three months ended 31 March 2025 (“**2025Q1**”) was approximately RMB10.97 million and RMB7.2 million, representing an utilisation rate of approximately 66.5% and 43.6% to the respective annual caps, respectively. Having discussed with the Management and reviewed the documents provided by the Management, we noted that the annual cap for the year ended 31 December 2024 of RMB16.5 million was determined based on most of the required sludge disposal services being provided by the connected person. However, as certain of the sludge disposal services were provided by independent third party service providers, which totalled to approximately RMB15.59 million for the year ended 31 December 2024. Thus, the historical utilisation rate was at approximately 66.5%. However, such utilisation rate would be higher if the connected person was engaged to provide more of the sludge disposal services as required by the Group at the relevant time.

As for the annual cap under the previous service contract for the six months ended 30 June 2025 of RMB16.5 million, the historical transaction amount of approximately RMB7.2 million was only for 2025Q1, being a period of three months instead of six months under the relevant cap. On this basis, barring unforeseen circumstances, the annual cap for the six months ended 30 June 2025 will have a notably higher utilisation rate than the calculated 43.6%, as it was only based on 2025Q1 transaction amount.

Our analysis on the 2025 Annual Cap and 2026 Annual Cap

We have considered that (i) the Service Contract shall become effective after the relevant Independent Shareholders’ approval has been obtained, on this basis, the 2025 Annual Cap shall cover transactions for a period of around six months. In this connection, the 2026 Annual Cap shall also cover transactions for a period of around six months given the term of the Service Contract is one year; (ii) the aggregate sludge tonnage of the Group that required disposal services was in excess of 27,000 tonnes for 2025Q1. Based on our review of historical information on sludge produced for the three years ended 31 December 2024 provided by the Management, the first quarter of the respective years produced in the region of approximately 23.8% to 28.8%, with an average of approximately 26.9%, of the total annual sludge. On this basis, we extrapolated the historical tonnage of 27,000 tonnes for 2025Q1 (included sludge disposal services from connected and independent third party service providers) and calculated the full year estimated total sludge to be produced and treated, based on the average for the

first quarter of approximately 26.9% as calculated above, and arrived at approximately 100,000 tonnes. Based on the rate of service fee per tonne of RMB343, the total transaction amount for a calendar year would amount to approximately RMB34.3 million which is broadly in line with the combined annual cap for 2025 of RMB33 million, which is considered to be reasonable as part of the sludge disposal services was provided by independent third party service providers; and (iii) based on our review of historical information on sludge produced for the three years ended 31 December 2024 provided by the Management, the first quarter produced in the region of approximately 45.1% to 52.7%, with an average of approximately 49.1%, of the total sludge for the first half of the subject calendar year. On this basis, we extrapolated the historical tonnage of 27,000 tonnes for 2025Q1 (included sludge disposal services from connected and independent third party service providers) and calculated the estimated total sludge for the first half of the year to be produced and treated at approximately 55,000 tonnes. Based on the rate of service fee per tonne of RMB343, the total transaction amount for the first half of the calendar year would amount to approximately RMB18.9 million which is slightly higher but broadly in line with the 2026 Annual Cap of RMB16.5 million, which is considered to be reasonable as part of the sludge disposal services was provided by independent third party service providers. On this basis, including, among others, our analysis of the 2025 Annual Cap and 2026 Annual Cap as well as our analysis on the historical utilisation rate and the reasons thereof, we are of the view that the basis of the 2025 Annual Cap and 2026 Annual Cap is reasonable, respectively.

VI. RECOMMENDATION

Having considered the factors as set out in this letter above, in particular,

- (i) the reasons for and benefits of the Service Contract;
- (ii) the transactions contemplated under the Service Contract shall be conducted in the ordinary and usual course of business of the Group and on normal commercial terms, to be governed by the relevant internal control procedures and in accordance with the pricing policies; and
- (iii) the basis for determining the Proposed Annual Caps under the Service Contract is reasonable, details of which are set out under the section headed “6. Basis and rationale for determining the Proposed Annual Caps” in connection with the Service Contract in this letter above,

we are of the view that the transactions contemplated under the Service Contract, are in the ordinary and usual course of business of the Group, on normal commercial terms and in the interests of the Company and the Shareholders as a whole, and the terms of the Service Contract, including the Proposed Annual Caps, are fair and reasonable so far as the Shareholders are concerned. Accordingly,

we advise the Independent Board Committee to recommend, and we ourselves recommend, that the Independent Shareholders to vote in favour of the relevant ordinary resolution to approve the Service Contract (including the Proposed Annual Caps) at the AGM.

Yours faithfully
For and on behalf of
Red Sun Capital Limited



Lewis Lai
Managing Director

Mr. Lewis Lai is a licensed person registered with the SFC and a responsible officer of Red Sun Capital Limited to carry out type 1 (dealing in securities) and type 6 (advising on corporate finance) regulated activities under the SFO and has over 18 years of experience in the corporate finance industry.

* *For identification purpose only*