



SOMERLEY CAPITAL LIMITED

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30 September 2019

To: *the Independent Board Committee*

Dear Sirs,

**MANDATORY CONDITIONAL CASH OFFER BY
CHINA INTERNATIONAL CAPITAL CORPORATION HONG KONG
SECURITIES LIMITED ON BEHALF OF
BAOSTEEL HONG KONG INVESTMENT COMPANY LIMITED
寶鋼香港投資有限公司 TO ACQUIRE ALL THE ISSUED H SHARES IN
MAANSHAN IRON & STEEL COMPANY LIMITED
(OTHER THAN THOSE ALREADY OWNED
OR AGREED TO BE ACQUIRED BY
BAOSTEEL HONG KONG INVESTMENT COMPANY LIMITED
寶鋼香港投資有限公司 AND PARTIES ACTING IN CONCERT WITH IT)**

INTRODUCTION

We refer to our appointment to advise the Independent Board Committee in relation to the mandatory conditional cash offer by CICC on behalf of Baosteel to acquire all the issued H Shares, other than those already owned or agreed to be acquired by Baosteel and parties acting in concert with it. Details of the Offer are set out in the Composite Document dated 30 September 2019, of which this letter forms part. Terms used in this letter shall have the same meanings as those defined in the Composite Document unless the context otherwise requires.



As set out in the Joint Announcement, on 31 May 2019, Anhui SASAC and China Baowu have entered into the Equity Transfer Agreement, pursuant to which Anhui SASAC agreed to transfer 51% of the equity interest held by it in Magang Group to China Baowu at nil consideration. Further details of the Equity Transfer Agreement are set out in the Joint Announcement. Completion of the Equity Transfer Agreement took place on 19 September 2019. Immediately after Completion and as at the Latest Practicable Date, China Baowu held 51% of the equity interest in Magang Group, and had, through Magang Group, obtained indirect control of the A Shares held by Magang Group, representing approximately 45.54% of the total issued shares of the Company. Pursuant to Rule 26.1 of the Takeovers Code, China Baowu is required to extend a mandatory conditional cash offer for all the outstanding H Shares (other than those H Shares which are already owned or agreed to be acquired by Baosteel and parties acting in concert with it). Accordingly, China Baowu had procured its direct wholly-owned subsidiary, Baosteel, to extend the Offer to the Offer Shareholders.

The Independent Board Committee comprising Mr. Ren Tianbao, non-executive Director, and all three independent non-executive Directors, namely Ms. Zhang Chunxia, Ms. Zhu Shaofang and Mr. Wang Xianzhu has been established to advise the Offer Shareholders on whether the terms of the Offer are fair and reasonable and as to their acceptance of the Offer. The Independent Board Committee has approved our appointment as the Independent Financial Adviser to advise the Independent Board Committee in relation to the Offer.

During the past two years, Somerley Capital Limited has acted as the independent financial adviser to the independent board committee and the independent shareholders of the Company in relation to continuing connected transactions and connected transactions as detailed in the Company's circular dated 23 October 2018. The aforesaid past engagement was limited to providing independent advisory service to the independent board committee and the independent shareholders of the Company pursuant to the Listing Rules, for which Somerley Capital Limited received normal professional fees. Accordingly, we do not consider the past engagement gives rise to any conflict of interest for Somerley Capital Limited in acting as the Independent Financial Adviser.

We are not associated with the Company, China Baowu, Baosteel or any party acting, or presumed to be acting, in concert with any of them and, accordingly, are considered eligible to give independent advice on the Offer. Apart from normal professional fees payable to us in connection with this appointment, and except as disclosed above, no arrangement exists whereby we will receive any fees or benefits from the Company, China Baowu, Baosteel or any party acting, or presumed to be acting, in concert with any of them.



BASIS OF OUR OPINION

In formulating our opinion, we have reviewed, among other things, (i) the Composite Document; (ii) the annual report of the Company for the year ended 31 December 2018, the first quarterly report of the Company for the three months ended 31 March 2019 and the interim report of the Company for the six months ended 30 June 2019; (iii) the announcements published by the Company on the website of the Stock Exchange since 1 January 2017; and (iv) the material change statement set out in Appendix II to the Composite Document. We have sought and received confirmation from the Directors that no material facts have been omitted from the information supplied and opinions expressed by them. We consider that the information we have received is sufficient for us to reach our opinion and recommendation as set out in this letter. We have no reason to doubt the truth and accuracy of the information provided to us or to believe that any material facts have been omitted or withheld. We have, however, not conducted any independent investigation into the business and affairs of the Group, China Baowu or Baosteel, nor have we carried out any independent verification of the information supplied. We have also assumed that all representations contained or referred to in the Composite Document are true as at the Latest Practicable Date, and that the Offer Shareholders will be notified of any material changes to the Composite Document as soon as reasonably practicable during the Offer Period.

We have not considered the tax and regulatory implications on the Offer Shareholders of acceptance or non-acceptance of the Offer since these depend on their individual circumstances. In particular, the Offer Shareholders who are resident overseas or subject to overseas taxes or Hong Kong taxation on securities dealings should consider their own tax position and, if in any doubt, consult their own professional advisers.

PRINCIPAL TERMS OF THE OFFER

CICC are making the Offer for and on behalf of Baosteel on the following basis:

For each H Share. HK\$2.97 in cash

Pursuant to the Panel Decision, the Takeovers Panel had ruled that the offer price for the Offer shall be set at the volume weighted average price of the H Shares in the Company on the last trading day prior to the publication of the Rule 3.7 Announcement (i.e. 31 May 2019). In arriving at the offer price for the Offer, an “ex-dividend” adjustment was made by deducting a sum equal to the final dividend of the Company for the financial year ended 31 December 2018 (i.e. HK\$0.35278 (including tax)), which was paid to the Company’s shareholders on 12 July 2019. The H Shares are being acquired under the terms of the Offer “ex” such dividend. The Offer Price has been rounded up to the nearest cent.



Based on the issued share capital of the Company as at the Latest Practicable Date, there are 1,732,930,000 H Shares subject to the Offer, representing approximately 22.5% of the total issued share capital of the Company.

Magang Group currently controls approximately 45.54% of the voting rights of the Company. The Offer is conditional on valid acceptances of the Offer having been received (and not, where permissible, withdrawn) and acquisitions of Shares having been made or agreed to be made by Baosteel and parties acting in concert with it in respect of a minimum of 343,873,138 H Shares. Such Shares, together with the Shares already owned by Baosteel and parties acting in concert with it (except Hwabao Fund Management) and acquired or agreed to be acquired before or during the Offer Period, will result in Baosteel and parties acting in concert with it (except Hwabao Fund Management) holding in aggregate more than 50% of the voting rights of the Company, by 4:00 p.m. on or prior to the Closing Date (or such later time and/or date as Baosteel may determine and the Executive may approve).

Offer Shareholders should note that the Offer will be subject to the satisfaction of the Acceptance Condition. Accordingly, the Offer may or may not become unconditional.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In formulating our opinion and recommendations with regard to the Offer, we have taken into account the following principal factors and reasons:

1. Background of the Offer

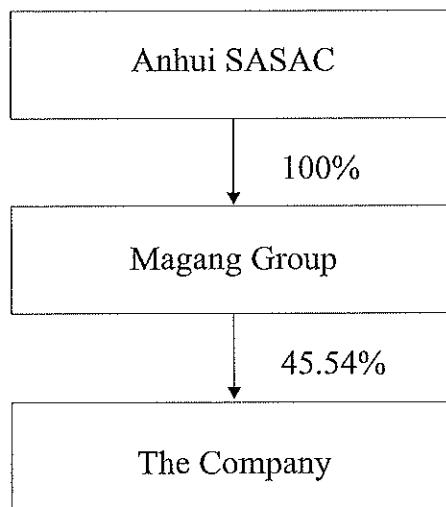
On 31 May 2019, Anhui SASAC and China Baowu have entered into the Equity Transfer Agreement, pursuant to which Anhui SASAC agreed to transfer 51% of the equity interest held by it in Magang Group to China Baowu at nil consideration. As set out in the section headed “Reasons of the Offer and China Baowu’s and Baosteel’s intention in relation to the Company” in the “Letter from CICC” of the Composite Document, the Equity Transfer represented part of the initiative consistent with the policy of the PRC government to promote the development of the iron and steel industry and to implement a structural reform of the industry, by way of consolidating and reorganising iron and steel producers to create globally competitive conglomerates. The consolidation of business operations between China Baowu and the Company, as two of the leading market participants in the iron and steel industry of the PRC, will increase the degree of market concentration within the iron and steel industry in the PRC. Further details with respect to the reasons and background of the Offer are set out in the same section of the Composite Document as mentioned above.

On 19 September 2019, Baosteel and the Company jointly announced that Completion took place on the same day. Immediately after Completion and as at the Latest Practicable Date, China Baowu held 51% of the equity interest in Magang Group, while Anhui SASAC held the remaining 49% of the equity interest in Magang Group. China Baowu is wholly-owned by SASAC, and Baosteel

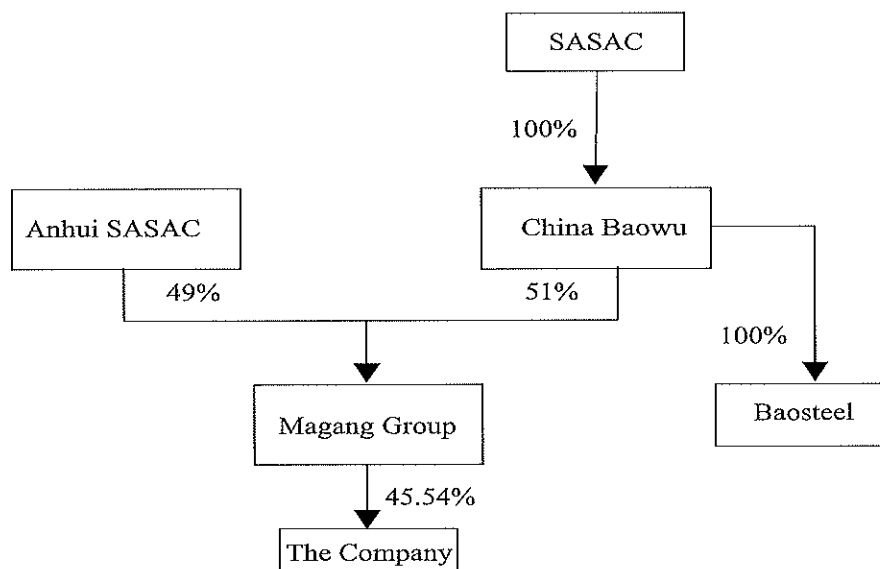


is wholly- owned by China Baowu. Immediately upon the Completion of the Equity Transfer, as Magang Group continues to hold 3,506,467,456 A Shares (representing approximately 45.54% of the total issued share capital of the Company), China Baowu indirectly holds a controlling interest in the A Shares representing approximately 45.54% of the total issued share capital of the Company through Magang Group. The shareholding and control between the Company, Magang Group, China Baowu, Anhui SASAC, Baosteel and SASAC as at the date of the Joint Announcement and immediately upon Completion is illustrated as follows:

(i) As at the date of the Joint Announcement



(ii) Immediately upon Completion



It should be noted that the equity interest held by Anhui SASAC in Magang Group decreased from 100% to 49%. The direct controlling shareholder of the Company remained unchanged (being Magang Group).



2. Information and prospects of the Group

(a) Background and financial information of the Group

The Company is a joint stock limited company incorporated in the PRC. The H Shares of the Company are listed on the Stock Exchange and the A Shares of the Company are listed on the Shanghai Stock Exchange. The Group is principally engaged in the manufacture and sale of iron and steel products and related by-products, with main business operations in the PRC.

(i) Financial performance

The steel industry is in general subject to cyclical factors, such as sales demand and raw materials supply. In particular, the supply of iron ore of the required quantity has been restricted by weather conditions in Australia and the failure of a tailings dam in Brazil. This has contributed to high iron ore prices in 2019, which have not been fully passed through to sales of the Group's finished products. Meanwhile, the industry requirement for fixed assets is high, which may make production adjustments difficult. These factors are likely to result in earnings volatility as evidenced by good 2018 results but declining 2019 first half results period-to-period, as set out further below.

The following is an extract of the financial results of the Group for (a) the two years ended 31 December 2017 and 2018 (both the 2017 and 2018 annual results having been extracted from the Company's 2018 annual report); and (b) the six months ended 30 June 2018 and 2019 (both of 2018 and 2019 interim results having been extracted from the Company's 2019 interim report).

	For the six months ended 30 June		For the year ended 31 December	
	2019	2018	2018	2017
	RMB	RMB	RMB	RMB
	(unaudited)	(unaudited)	(audited)	(audited)
Revenue	37,026,693,821	40,063,041,443	81,951,813,488	73,228,029,624
Less: Cost of sales	33,672,424,605	34,002,350,727	69,794,982,119	63,556,258,449
Taxes and surcharges	281,198,990	399,818,296	810,322,306	741,194,307
Selling expenses	431,513,432	465,095,326	959,718,246	865,396,451
General and administrative expenses	711,335,104	698,585,993	1,379,991,907	1,164,112,101
R&D expenses	354,535,705	381,791,868	801,240,784	255,023,306
Financial expenses	390,006,931	574,785,327	960,457,412	998,780,259
including: interest expense	415,505,618	476,375,706	879,897,330	920,767,866
interest income	51,850,462	17,490,196	54,228,185	34,412,987



	For the six months ended 30 June		For the year ended 31 December	
	2019	2018	2018	2017
	RMB	RMB	RMB	RMB
	(unaudited)	(unaudited)	(audited)	(audited)
Impairment losses	241,775,610	57,950,358	754,443,431	746,374,994
Credit impairment losses	43,977,242	22,658,394	41,876,945	–
Add: Other income	48,434,334	44,152,109	185,350,836	238,868,248
Investment income	410,893,019	560,777,607	1,090,099,779	676,516,349
including: share of				
profits of				
associates				
and joint				
ventures	311,705,507	298,820,874	657,410,287	490,410,552
(Loss)/gain on the				
changes in fair value	26,280,702	(8,960,465)	(10,213,369)	10,145,756
Gain/(loss) from disposal				
of non-current assets	(936,915)	52,603,426	371,280,264	(176,952,368)
Operating profit	1,384,597,342	4,108,577,831	8,085,297,848	5,649,467,742
Add: Non-operating income	274,306,453	96,622,262	160,098,567	176,123,978
Less: Non-operating expenses	1,610,123	2,915,034	6,472,487	16,625,157
Profit before tax	1,657,293,672	4,202,285,059	8,238,923,928	5,808,966,563
Less: Income tax expense	239,613,971	346,039,776	1,180,935,234	736,728,434
Net profit	1,417,679,701	3,856,245,283	7,057,988,694	5,072,238,129
Categorized by operation continuity:				
Net profit from continuing				
operations	1,417,679,701	3,856,245,283	7,057,988,694	5,072,238,129
Categorized by ownership:				
Net profit attribute to owners of the				
parent	1,144,660,011	3,428,518,933	5,943,286,585	4,128,939,861



	For the six months ended 30 June		For the year ended 31 December	
	2019	2018	2018	2017
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
	(unaudited)	(unaudited)	(audited)	(audited)
Net profit attribute to non-controlling interests	<u>273,019,690</u>	<u>427,726,350</u>	<u>1,114,702,109</u>	<u>943,298,268</u>
EARNINGS PER SHARE				
Basic earnings per share (<i>cent/share</i>)	<u>14.86 cents</u>	<u>44.52 cents</u>	<u>77.18 cents</u>	<u>53.62 cents</u>
Diluted earnings per share (<i>cent/share</i>)	<u>14.86 cents</u>	<u>44.52 cents</u>	<u>77.18 cents</u>	<u>53.62 cents</u>

(1) Revenue

Revenue of the Group increased from approximately RMB73 billion in 2017 to approximately RMB82 billion in 2018, representing a growth of approximately 12%. As disclosed in the Company's 2018 annual report, the Group's key finished products include long products, steel plates, wheels and axles, and over 90% of the revenue was generated in the PRC. The increase in revenue in 2018 was mainly driven by an increase in sales price and sales volume of steel during the year. According to China Iron and Steel Association, the monthly average value of consolidated price index for domestic steel products in 2018 was 114.75 with a year-on-year increase of approximately 6.5% as compared to that of 2017. As advised by the executive Directors, the increase in sales volume of steel was mainly driven by both increase in demand for the Group's finished products and its production volume (other than steel plates) in 2018.

The Group recorded revenue of approximately RMB37 billion for the six months ended 30 June 2019, representing a drop of approximately 8% as compared to approximately RMB40 billion in the same period of 2018. As disclosed in the Company's 2019 interim report, the decrease was mainly driven by the decrease in steel sales price and sales volume in the first six months of 2019. As advised by the executive Directors, according to the data sourced from China Iron and Steel Association, the monthly average value of consolidated price index for domestic steel products in the first half of 2019 was approximately 109.61, representing a decrease of approximately 4.4% as



compared with that in the same period of 2018. The decrease in steel sales price and sales volume was attributable to, among other things, general increase in production and supply in the industry, as well as a decrease in the Group's production capacity of pig iron and crude steel as set out in the Company's 2019 interim report.

(2) Net profit attributable to owners of the parent

As disclosed in the Company's 2018 annual report, the Group recorded net profit attributable to owners of the parent of approximately RMB5,943 million in 2018. Excluding non-recurring items (mainly comprised of gain from disposal of non-current assets/subsidiaries and government grants) of approximately RMB851 million, the Group recorded net profit excluding non-recurring gains or losses attributable to owners of the parent of approximately RMB5,092 million in 2018, representing an increase of approximately 28% compared to approximately RMB3,969 million (on the same basis) in 2017. Such increase was mainly driven by the increase of gross margin of the Group's steel products in 2018. Iron ore is the key raw materials used in the production of steel of the Group. According to the data extracted from "SBB Steel Markets Daily" published by S&P Global Platts (a leading provider of information, benchmark prices and analytics for the energy and commodities markets) provided by the Company, in 2018, the average Platts iron ore index, which is commonly used in the industry and internationally for the determination of iron ore prices, was approximately US\$69.5 per tonne in 2018, representing a slight decline of approximately 3% from an average of US\$71.3 per tonne in 2017. On the other hand, the monthly average value of consolidated price index for domestic steel products increased in 2018 as mentioned in the paragraph headed "Revenue" of this letter above.

For the six months ended 30 June 2019, the Group recorded net profit attributable to owners of the parent of approximately RMB1,145 million, representing a drop of approximately 67% as compared to approximately RMB3,429 million in the same period of 2018. As disclosed in the Company's 2019 interim report, the decrease was mainly driven by the decrease in gross margin of the Group's steel products resulted from the decrease in steel sales volume and price and increase in procurement price of certain raw materials and fuels during the period. As mentioned above, iron ore is the key raw materials used in the production of steel of the Group. According to the data extracted from "SBB Steel Markets Daily" published by S&P Global Platts provided by the Company, the average Platts iron ore index in the first half of



2019 was approximately US\$91.4 per tonne, representing a notable increase of approximately 32% from an average of approximately US\$69.5 per tonne in 2018. In addition, the monthly average value of consolidated price index for domestic steel products has declined in the first half of 2019 as mentioned in the paragraph headed “Revenue” of this letter above.

(3) Earnings per Share

Basic and diluted earnings per Share for the year ended 31 December 2017, 2018 and the six months ended 30 June 2019 was approximately RMB53.62 cents, RMB77.18 cents and RMB14.86 cents respectively. The movements in the earning per Share generally followed the movements of the Group’s financial results.

(4) Dividends

As disclosed in the Company’s 2017 annual report, the Group recorded net profit excluding non-recurring gains or losses attributable to owners of the parent of approximately RMB3,969 million in 2017, representing an increase of approximately 181% comparing to approximately RMB1,410 million in 2016. The Group did not declare dividend in 2016. Total dividend per H Share for the financial year ended 31 December 2017 amounted to RMB0.165 (equivalent to HK\$0.19908 as extracted from the website of the Stock Exchange). As mentioned above, in 2018, net profit excluding non-recurring gains or losses attributable to owners of the parent increased by approximately 28% to approximately RMB5,092 million from approximately RMB3,969 million in 2017. For the financial year ended 31 December 2018, total dividend per H Share amounted to RMB0.36, which includes interim dividend of RMB0.05 (equivalent to HK\$0.05647 as extracted from the website of the Stock Exchange) and final dividend of RMB0.31 (equivalent to HK\$0.35278 as extracted from the website of the Stock Exchange). This translates to an implied dividend yield (based on the Offer Price of HK\$2.97 per H Share) of approximately 13.8%. For the six months ended 30 June 2019, the Group recorded net profit attributable to owners of the parent of approximately RMB1,145 million, representing a drop of approximately 67% as compared to approximately RMB3,429 million in the same period of 2018. The Group did not declare interim dividend for the six months ended 30 June 2019.



(ii) *Financial position*

Set out below is an extract of the financial position of the Group (a) as at 31 December 2017 and 2018 (both 2017 and 2018 financial position having been extracted from the Company's 2018 annual report); and (b) as at 30 June 2019 (having been extracted from the Company's 2019 interim report).

	As at 30 June	As at 31 December	
	2019	2018	2017
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
	(unaudited)	(audited)	(audited)
ASSETS			
Current assets			
Cash and bank balances	9,045,908,246	9,762,844,718	4,978,352,093
Financial assets held for trading	2,013,174,319	2,084,414,075	–
Financial assets at fair value through profit or loss	–	–	1,546,139,404
Notes and trade receivables	11,234,218,005	6,091,882,823	9,341,614,275
Prepayments	649,466,090	712,340,548	750,818,831
Other receivables	252,101,927	147,965,534	285,228,074
Inventories	11,515,468,174	11,053,918,748	11,445,747,808
Financial assets purchased under agreements to resell	199,454,377	2,432,279,109	1,204,603,000
Loans and advances to customers	5,703,566,034	2,845,298,103	1,251,315,253
Assets classified as held for sale	–	–	73,454,334
Held-to-maturity investments	–	–	305,228,376
Non-current assets due within one year	51,302,205	101,201,184	–
Other current assets	<u>2,887,172,154</u>	<u>3,173,122,975</u>	<u>916,037,331</u>
Total current assets	<u>43,551,831,531</u>	<u>38,405,267,817</u>	<u>32,098,538,779</u>
Non-current assets			
Available-for-sale financial assets	–	–	1,111,168,160
Held-to-maturity investments	–	–	100,854,230
Long-term equity investments	3,007,031,216	2,809,063,381	1,525,225,202
Other equity instruments investments	264,667,164	263,122,364	–
Investment properties	65,617,636	55,804,755	57,508,684



	As at 30 June	As at 31 December	
	2019	2018	2017
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
	(unaudited)	(audited)	(audited)
Property, plant and equipment	30,696,182,408	31,545,176,835	33,130,499,862
Construction in progress	1,829,563,471	1,662,672,077	1,805,955,609
Right-of-use asset	431,128,508	–	–
Intangible assets	1,860,731,274	1,855,265,330	1,883,604,173
Deferred tax assets	256,801,026	275,626,734	478,235,280
Total non-current assets	<u>38,411,722,703</u>	<u>38,466,731,476</u>	<u>40,093,051,200</u>
TOTAL ASSETS	<u><u>81,963,554,234</u></u>	<u><u>76,871,999,293</u></u>	<u><u>72,191,589,979</u></u>
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Deposits and balances from banks and other financial institutions	500,213,889	900,366,111	200,000,000
Customer deposits	7,746,869,667	4,915,309,311	2,947,639,610
Repurchase agreements	1,285,032,037	1,133,772,377	308,100,956
Short-term loans	10,986,627,110	10,917,293,181	4,630,303,694
Financial liabilities held for trading	–	8,012,670	–
Financial liabilities at fair value through profit or loss	–	–	10,498,810
Notes and trade payables	14,443,837,895	10,342,007,979	11,778,382,830
Advances from customers	3,676,458,851	3,572,594,400	3,842,903,332
Payroll and employee benefits payable	390,845,491	563,642,908	654,822,505
Taxes payable	609,957,899	1,325,517,987	1,342,836,597
Other payables	5,306,673,942	3,530,746,914	2,354,327,866
Non-current liabilities due within one year	1,636,709,676	1,470,868,462	4,928,758,378
Provision	30,290,993	29,997,521	38,537,369
Other current liabilities	–	1,026,897,260	3,081,026,301
Total current liabilities	<u>46,613,517,450</u>	<u>39,737,027,081</u>	<u>36,118,138,248</u>



	As at 30 June	As at 31 December	
	2019	2018	2017
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
	(unaudited)	(audited)	(audited)
Non-current liabilities			
Long-term loans	2,890,868,796	3,596,387,552	6,975,958,634
Lease liabilities	419,478,118	–	–
Long-term payables	–	–	210,000,000
Long-term employee benefits payable	143,217,190	157,371,474	160,896,586
Deferred revenue	1,368,917,400	1,364,795,555	1,462,490,533
Deferred tax liabilities	22,783,318	24,066,311	26,841,665
	<u>4,845,264,822</u>	<u>5,142,620,892</u>	<u>8,836,187,418</u>
Total non-current liabilities			
	<u>51,458,782,272</u>	<u>44,879,647,973</u>	<u>44,954,325,666</u>
Total liabilities			
Shareholders' equity			
Share capital	7,700,681,186	7,700,681,186	7,700,681,186
Capital reserve	8,352,287,192	8,352,287,192	8,352,287,192
Other comprehensive income	(114,881,624)	(112,702,163)	(124,156,060)
Special reserve	47,230,430	31,037,123	31,929,722
Surplus reserve	4,571,901,256	4,571,901,256	4,100,007,341
General reserve	224,841,404	224,841,404	191,546,668
Retained earnings	6,163,026,117	7,405,577,274	3,643,443,763
	<u>26,945,085,961</u>	<u>28,173,623,272</u>	<u>23,895,739,812</u>
Equity attributable to owners of the parent			
	<u>3,559,686,001</u>	<u>3,818,728,048</u>	<u>3,341,524,501</u>
Non-controlling interests			
Total shareholders' equity	<u>30,504,771,962</u>	<u>31,992,351,320</u>	<u>27,237,264,313</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>81,963,554,234</u>	<u>76,871,999,293</u>	<u>72,191,589,979</u>



As at 30 June 2019, the Group's total assets were approximately RMB82 billion. Assets of the Group mainly included (a) property, plant and equipment of approximately RMB31 billion; (b) inventories of approximately RMB12 billion; (c) cash and bank balances of approximately RMB9 billion; and (d) notes and trade receivables of approximately RMB11 billion. As at 30 June 2019, the Group recorded total liabilities amounted to approximately RMB51 billion, which mainly consisted of (a) short-term loans of approximately RMB11 billion; and (b) notes and trade payables of approximately RMB14 billion.

As at 30 June 2019, the Group had total borrowings (represented by the sum of short-term and long-term loans) of approximately RMB15.4 billion. Taking into account the cash and bank balances of approximately RMB9.0 billion, the Group had a net debt of approximately RMB6.4 billion as at 30 June 2019. Gearing ratio (calculated as total borrowings divided by total equity) of the Group was approximately 50% as at 30 June 2019.

Net asset value attributable to owners of the parent amounted to approximately RMB28 billion and RMB27 billion respectively as at 31 December 2018 and 30 June 2019, with a value per ordinary share of approximately HK\$4.18 and HK\$3.98 respectively (calculated based on 7,700,681,186 Shares in issue as disclosed in latest monthly return published on the website of the Stock Exchange immediately prior to the Latest Practicable Date and the exchange rate of RMB 0.87620 to HK\$1 and RMB 0.87966 to HK\$1 respectively, being the exchange rate as quoted by the People's Bank of China on the last working day before 31 December 2018 and 30 June 2019). The Offer Price of HK\$2.97 per H Share represents a discount of approximately 29.0% and 25.4% to the net asset value per Share attributable to owners of the parent as at 31 December 2018 and 30 June 2019 respectively. Further analysis on the comparison of the historical price to book (P/B) ratio of the Comparable Companies (as defined below) and implied P/B represented by the Offer Price are set out in the sub-section headed "Analysis of the Offer Price" of this letter below.



(b) Prospects of the Group

As discussed in the paragraph headed “Background and financial information of the Group” of this letter above, the steel industry is in general subject to cyclical factors. The Group recorded net profit attributable to owners of the parent (excluding non-recurring gains or losses) of approximately RMB5,092 million in 2018, representing an increase of approximately 28% as compared to that of 2017. Such increase was mainly driven by the increase of gross margin of the Group’s steel products in 2018. For the six months ended 30 June 2019, the Group recorded net profit attributable to owners of the parent of approximately RMB1,145 million, representing a decrease of approximately 67% as compared to the same period in 2018. Such decrease was mainly attributable to the decrease in gross margin of the Group’s steel products resulted from a decrease in steel sales volume and price and an increase in procurement price of certain raw materials and fuels in the period. As advised by the executive Directors, the cost pressure caused by the rising prices of raw materials, high fuel costs and the surge in environmental protection operating costs is increasing.

As one of the leading iron and steel companies in the PRC, the Company’s financial performance and hence its share price, is bound to be affected by cyclical market factors. The executive Directors are of the view that at present, steel prices remain under pressure and the prices of iron ore are at a high level, thus the Group continues to face pressure in production and operations. Other potential challenges of the Group include slowing down in national demand for steel and increasing supply in the industry. In response to this situation, the Group continues to adapt production to sales, to adopt a flexible production plan and increase the production flexibility. The Group will respond to fluctuating market factors through, among others, strengthening market research, expanding sales channels and enhancing client management. As set out in the section headed “Reasons of the Offer and China Baowu’s and Baosteel’s intention in relation to the Company” in the “Letter from CICC” of the Composite Document, upon completion of the reorganisation, China Baowu will be able to offer strong shareholder’s support to promote the strategic development of the Company. After completion of the reorganisation, synergies between China Baowu and the Company can be achieved in the areas relating to research and innovation, intelligence manufacturing, professional management, quality improvement and efficiency enhancement. The executive Directors consider that synergies and collaboration may be achieved with China Baowu in these areas which in turn is expected to benefit the Group’s development strategically in the long-term. The executive Directors consider, and we concur, that the long-term prospects of the Group remain generally positive, however, its near-term profitability and prospects will be dependent on market factors including future steel sales prices, iron ore purchase prices as well as demand and supply of steel products in the market.



3. Information on China Baowu, Baosteel and intentions of China Baowu and Baosteel regarding the Company

As set out in the section headed “Information on Baosteel and China Baowu” in the “Letter from CICC” of the Composite Document, Baosteel is a public company limited by shares incorporated in Hong Kong and is a direct wholly-owned subsidiary of China Baowu. Its principal business activities are offshore equity investments in the industrial sector for China Baowu’s group companies and other related businesses. China Baowu and its group companies have the largest steel production capacity in the PRC and the second largest steel production capacity worldwide. The principal activities of China Baowu and its group companies are manufacturing, production and sales of iron and steel products. Further details with respect to Baosteel and China Baowu are set out in the same section.

Save as disclosed in the section headed “Reasons of the Offer and China Baowu’s and Baosteel’s intention in relation to the Company” in the “Letter from CICC” of the Composite Document which includes, among others, certain undertakings provided by China Baowu to CSRC to address the overlapping of certain businesses between Baoshan and the Company upon Completion, following and within 12 months after the close of the Offer, Baosteel intends to continue the existing business of the Company, and has no intention to introduce any material change to the business of the Company, including undertaking any redeployment of fixed assets or conducting any reployment or reorganisation business of the Company. Further, Baosteel has no intention to terminate any employment of the employees of the Company and its subsidiaries, nor to introduce any change to the Board composition, during the Offer Period.

4. Maintenance of the listing status of the Company

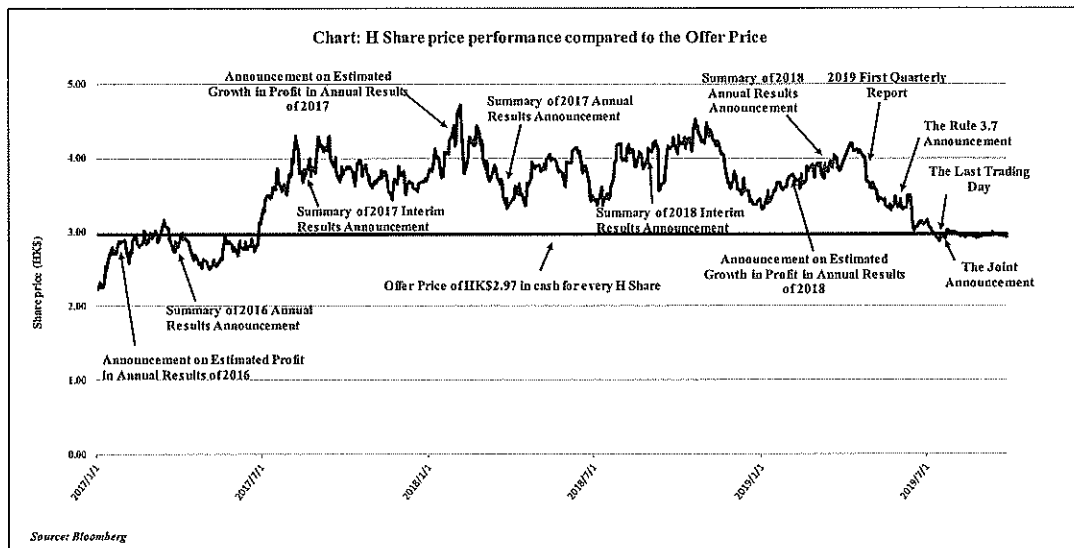
As set out in the section headed “Reasons of the Offer and China Baowu’s and Baosteel’s intention in relation to the Company” in the “Letter from CICC” of the Composite Document, Baosteel intends to maintain the listing status of the H Shares of the Company on the Stock Exchange after the close of the Offer. If, at the close of the Offer, less than the minimum prescribed percentage applicable to the Company is held by the public, being 25% of all the issued shares of the Company, or if the Stock Exchange believes that (i) a false market exists or may exist in the trading in the H Shares; or (ii) there are insufficient H Shares in public hands to maintain an orderly market, the Stock Exchange will consider exercising its discretion to suspend dealings in the H Shares until a level of sufficient public float is attained. The Directors and the directors of Baosteel will jointly and severally undertake to the Stock Exchange to take appropriate steps to ensure that the sufficient public float exists in the shares of the Company following the close of the Offer.



5. Analysis of the Offer Price

(a) *Historical price performance of the H Shares*

The chart below illustrates the daily closing price per H Share from 1 January 2017 up to and including the Latest Practicable Date.



Note: The chart above has been prepared based on figures from Bloomberg where the H Share prices were not stated on the same “ex dividend” basis as mentioned in sub-section (b) below.

The H Shares traded below the Offer Price for over 85% of the trading days in the first half of 2017. The H Share price trended upwards since late June 2017 and reached HK\$4.30 on 7 August 2017. Since then the H Share price fluctuated in the range of HK\$3.45 to HK\$4.30 per H Share for the period from 8 August 2017 to 26 January 2018. As advised by the executive Directors, according to China Iron and Steel Association, the monthly average value of consolidated price index for domestic steel products increased by over 20% in the second half of 2017. On 29 January 2018, the Company published an announcement on estimated growth in profit in annual results of 2017, stating that, among other things, the net profit excluding non-recurring gains or losses attributable to shareholders of the Company is estimated to increase by approximately 180%, compared with the same period in 2016. Subsequently the H Shares reached a high of HK\$4.72 on 5 February 2018. During the rest of 2018, the H Share price fluctuated between HK\$3.32 to HK\$4.52.

The H Share price saw an increasing trend in the first few months of 2019 and closed at HK\$4.20 on 10 April 2019. During this period, the Company published an announcement on the estimated growth in profit in annual results of 2018 on 31 January 2019 before trading hours and a summary of 2018 annual results announcement, including the proposed final dividend for the year ended 31 December 2018, on 22 March 2019 before trading hours.



The H Share price was generally in a downward trend afterwards and closed at HK\$3.34 on 31 May 2019, being the last trading day prior to the issuance of the Rule 3.7 Announcement. The Company announced its 2019 first quarterly report on 26 April 2019 before trading hours. As set out in the report, for the three months ended 31 March 2019, net profit attributable to equity holders of the Company decreased by approximately 94% compared to the corresponding period of 2018. This may have contributed to the decrease in H Share price as discussed above.

On 2 June 2019, the Company published the Rule 3.7 Announcement in relation to the Equity Transfer. The H Share price closed at HK\$3.44 on 3 June 2019, the first trading day after the publication of the Rule 3.7 Announcement, representing a slight increase of approximately 3% comparing to the H Share closing price on the previous trading day, i.e. 31 May 2019. On the first day of dealings in the H Shares on an “ex dividend” basis in respect of the 2018 final dividends (i.e. 17 June 2019), the H Share price dropped from HK\$3.50 on 14 June 2019 to HK\$3.06. The drop of HK\$0.44 per H Share is somewhat higher than the amount of 2018 final dividend (i.e. HK\$0.35278 (including tax)).

The Company and the Offeror jointly announced the Offer on 23 July 2019 before trading hours. On the same day, the H Share price closed at HK\$3.00, representing a slight increase of approximately 3% over the closing price of HK\$2.92 on 22 July 2019. Since the publication of the Joint Announcement and up to and including the Latest Practicable Date, the H Shares closed at a price ranging from HK\$2.92 to HK\$3.03. The H Shares closed at HK\$2.93 as at the Latest Practicable Date, representing a slight discount of approximately 1.3% to the Offer Price.

(b) Offer price comparisons

On 22 March 2019, before trading hours of the H Shares on the Stock Exchange, the Company announced the summary of the annual results for the year ended 31 December 2018 and a final dividend of RMB0.31 per H Share (including tax) (equivalent to HK\$0.35278 (including tax) as extracted from the website of the Stock Exchange). The ex-entitlement date in respect of the final dividend was 17 June 2019. The prices of the H shares during the period between the announcement of final dividend and up to 14 June 2019 (the last trading day of the H Shares on a “cum dividend” basis), as quoted on the Stock Exchange, represented the “cum dividend” prices of the H Shares.

Since the H Shares are being acquired “ex dividend” under the Offer and the amount of final dividend is not immaterial, for the purposes of comparing “like with like”, we have compared the Offer Price with the prices of the H Shares on an “ex dividend” basis by deducting the



final dividend of RMB0.31 per H Share (including tax) (equivalent to HK\$0.35278 (including tax) as extracted from the website of the Stock Exchange) from the closing H Share price as quoted on the Stock Exchange for the period from 22 March 2019 (the first trading day after the announcement of the final dividend by the Company) to 14 June 2019 (the last trading day of the H Shares on a “cum dividend” basis). On this basis, the Offer Price of HK\$2.97 per H Share represents:

- (i) a discount of approximately 13.16% to the average closing price of approximately HK\$3.42 per H Share for the last 120 trading days on an ex dividend basis up to and including the Last Trading Day;
- (ii) a discount of approximately 10.27% to the average closing price of approximately HK\$3.31 per H Share for the last 90 trading days on an ex dividend basis up to and including the Last Trading Day;
- (iii) a discount of approximately 4.19% to the average closing price of approximately HK\$3.10 per H Share for the last 60 trading days on an ex dividend basis up to and including the Last Trading Day;
- (iv) a discount of approximately 2.30% to the average closing price of approximately HK\$3.04 per H Share for the last 30 trading days on an ex dividend basis up to and including the Last Trading Day;
- (v) a premium of approximately 1.02% over the average closing price of approximately HK\$2.94 per H Share for the last 10 trading days up to and including the Last Trading Day;
- (vi) a premium of approximately 1.71% over the average closing price of approximately HK\$2.92 per H Share for the last 5 trading days up to and including the Last Trading Day;
- (vii) a premium of approximately 1.37% over the closing price of approximately HK\$2.93 per H Share as quoted on the Stock Exchange as at the Last Trading Day; and
- (viii) a premium of approximately 1.37% over the closing price of HK\$2.93 per H Share as quoted on the Stock Exchange as at the Latest Practicable Date.



(c) *Trading liquidity*

Set out in the table below are the monthly total trading volumes of the Company's H Shares and the percentages of such monthly total trading volumes to the total issued H Shares (which are all in public hands) during the period from 1 January 2017 up to and including the Latest Practicable Date:

	Monthly total trading volume of the Company's H Shares (Note 1)	Percentage of the monthly total trading volume of the Company's H Shares to the total issued H Shares of the Company (Note 2)
2017		
January	427,767,860	24.7%
February	521,626,166	30.1%
March	497,792,211	28.7%
April	310,310,483	17.9%
May	433,406,509	25.0%
June	476,362,102	27.5%
July	678,275,178	39.1%
August	1,192,522,016	68.8%
September	692,070,590	39.9%
October	441,385,145	25.5%
November	612,278,739	35.3%
December	296,181,604	17.1%



	Monthly total trading volume of the Company's H Shares (Note 1)	Percentage of the monthly total trading volume of the Company's H Shares to the total issued H Shares of the Company (Note 2)
2018		
January	989,067,523	57.1%
February	630,097,986	36.4%
March	659,503,900	38.1%
April	491,543,317	28.4%
May	356,718,712	20.6%
June	405,353,907	23.4%
July	550,785,824	31.8%
August	499,194,943	28.8%
September	593,503,538	34.2%
October	646,613,614	37.3%
November	768,422,590	44.3%
December	377,413,981	21.8%
2019		
January	440,246,518	25.4%
February	415,883,690	24.0%
March	380,525,106	22.0%
April	406,615,399	23.5%
May	321,985,441	18.6%
June	369,393,565	21.3%
July	311,720,545	18.0%
August	362,457,207	20.9%
From 1 September 2019 to the Latest Practicable Date	293,396,745	16.9%

Notes:

1. Source: Bloomberg
2. The calculation is based on the monthly total trading volume of the Company's H Shares divided by the total issued H Shares of the Company at the end of each month (or at the Latest Practicable Date for September 2019).



From January 2017 to August 2019 (except for August 2017 and January 2018), the percentages of the monthly total trading volume of the H Shares to the total issued H Shares of the Company were within the range of approximately 17% to 44%, which we regard as generally high. The percentages of the monthly total trading volume of the H Shares to the total issued H Shares of the Company for August 2017 and January 2018 were approximately 69% and 57% respectively. The management of the Company advised us that they are not aware of any reasons for the higher trading volume in those months.

With trading volume of the H Shares exceeding 20% of the total issued H Shares of the Company during most of the period from January 2017 up to the Latest Practicable Date, we regard the H Shares are relatively actively traded, even before the publication of the Joint Announcement. However, if the Offer Shareholders were to sell a significant number of H Shares within a short period, it is possible that a downward pressure would be exerted on the market price of the H Shares.

(d) Peer comparison

As mentioned in the sub-section headed “Information and prospects of the Group” of this letter, the Group is principally engaged in the manufacture and sale of iron and steel products and related by-products. The market capitalisation of the Company was approximately HK\$23 billion as at the date immediately prior to the Latest Practicable Date. Accordingly, we have conducted a search on Bloomberg for companies (the “Comparable Companies”) listed on the Main Board of the Stock Exchange with closing market capitalisation as at the date immediately prior to the Latest Practicable Date over HK\$10 billion, which, based on their latest published annual reports available as at the date immediately prior to the Latest Practicable Date, are principally engaged in the iron and steel industry. We consider such criteria of market capitalisation to be reasonable for this purpose and the selection of the Comparable Companies in the table below based on the abovementioned criteria (similarity in terms of principal activities, as well as market capitalisation) is fair and representative while allowing a sufficient number of Comparable Companies to be obtained for the purpose of this analysis.



The Comparable Companies set out in the table below represent an exhaustive list of companies comparable to the Company based on the above criteria.

Comparable Companies	Closing market capitalisation as at the date immediately prior to the Latest Practicable Date	Historical P/E (based on annual results for the year ended 31 December 2018)	Historical P/E (based on trailing twelve months earnings)	Historical P/B
	<i>(HK\$' million)</i>	<i>(Approximate times)</i>	<i>(Approximate times)</i>	<i>(Approximate times)</i>
	<i>(Note 1)</i>	<i>(Note 2)</i>	<i>(Note 3)</i>	<i>(Note 4)</i>
Angang Steel Company Limited ("Angang") (stock code: 347)	30,969	2.87	4.64	0.44
Chongqing Iron & Steel Company Limited ("Chongqing Iron") (stock code: 1053)	17,480	4.33	4.73	0.41
China Oriental Group Company Limited ("China Oriental") (stock code: 581)	10,349	1.90	2.61	0.49
Mean (simple average)		3.03	3.99	0.45
Median		2.87	4.64	0.44
Maximum		4.33	4.73	0.49
Minimum		1.90	2.61	0.41
The Offer	22,738	3.37 <i>(Note 5)</i>	5.50 <i>(Note 6)</i>	0.75 <i>(Note 7)</i>



Notes:

1. Closing market capitalisations of the Comparable Companies and the Company are sourced from Bloomberg as at the date immediately prior to the Latest Practicable Date.
2. The historical P/Es of the Comparable Companies (based on annual results for the year ended 31 December 2018) are calculated based on their respective profit attributable to the shareholders of the Comparable Company (for the year ended 31 December 2018) as set out in their respective latest annual report available as at the date immediately prior to the Latest Practicable Date, their respective closing share price as at the date immediately prior to the Latest Practicable Date, and their respective total issued share capital as disclosed in the latest monthly return published on the website of the Stock Exchange immediately prior to the Latest Practicable Date.
3. The historical P/Es of the Comparable Companies (based on trailing twelve months earnings) are calculated based on their respective deduced profit attributable to the shareholders of the Comparable Company for the period from 1 July 2018 to 30 June 2019 by subtracting 2018 interim results from 2018 annual results and adding 2019 interim results as set out in their respective latest annual report and interim report/results announcement available as at the date immediately prior to the Latest Practicable Date, their respective closing share price as at the date immediately prior to the Latest Practicable Date, and their respective total issued share capital as disclosed in the latest monthly return published on the website of the Stock Exchange immediately prior to the Latest Practicable Date.
4. The historical P/Bs of the Comparable Companies are calculated based on their respective net asset value attributable to the shareholders of the Comparable Company as set out in their respective latest interim report/results announcement available as at the date immediately prior to the Latest Practicable Date, their respective closing share price as at the date immediately prior to the Latest Practicable Date, and their respective total issued share capital as disclosed in the latest monthly return published on the website of the Stock Exchange immediately prior to the Latest Practicable Date.
5. The implied P/E of the Company (based on the Group's 2018 annual results) is calculated based on the Offer Price of HK\$2.97 per H Share, the issued share capital of the Company of 7,700,681,186 as disclosed in the latest monthly return published on the website of the Stock Exchange immediately prior to the Latest Practicable Date, and the net profit attributable to owners of the parent of approximately RMB5,943,286,585 for the year ended 31 December 2018, which is translated to HK\$ at a rate of RMB0.87620 to HK\$1 (being the exchange rate as quoted by the People's Bank of China on the last working day before 31 December 2018).
6. The implied P/E of the Company (based on trailing twelve months earnings) is calculated based on the Offer Price of HK\$2.97 per H Share, the issued share capital of the Company of 7,700,681,186 as disclosed in the latest monthly return published on the website of the Stock Exchange immediately prior to the Latest Practicable Date, and the deduced net profit attributable to owners of the parent for the period from 1 July 2018 to 30 June 2019 by subtracting 2018 interim results from 2018 annual results and adding 2019 interim results.



7. The implied P/B of the Company is calculated based on the Offer Price of HK\$2.97 per H Share, the issued share capital of the Company of 7,700,681,186, and the equity attributable to owners of the parent of approximately RMB26,945,085,961 as at 30 June 2019, which is translated to HK\$ at a rate of RMB0.87966 to HK\$1 (being the exchange rate as quoted by the People's Bank of China on the last working day before 30 June 2019).

(i) P/E ratio

As set out in the table above, based on annual results for the year ended 31 December 2018, the historical P/Es of the Comparable Companies range from approximately 1.9 time to 4.3 times, with a mean and median of approximately 3.0 times and 2.9 times respectively. The implied P/E of the Offer of approximately 3.4 times is higher than the mean and median of the historical P/Es of the Comparable Companies. As set out in the sub-section "Information and prospects of the Group" of this letter above, the Group recorded net profit excluding non-recurring gains or losses attributable to owners of the parent of approximately RMB5,092 million in 2018. On this basis, the implied P/E (on an adjusted basis) of the Offer is approximately 3.9 times. Based on the net profit excluding non-recurring gains or losses attributable to owners of the parent of Angang and Chongqing Iron as extracted directly from their respective latest annual report available as at the date immediately prior to the Latest Practicable Date (such adjusted figure are not shown in China Oriental's latest annual report), the historical P/Es of Angang and Chongqing Iron (on an adjusted basis) are approximately 3.4 times and 4.6 times respectively. The adjusted implied P/E of the Offer of approximately 3.9 times ranks between the adjusted historical P/Es of Angang and Chongqing Iron. Based on trailing twelve months earnings, the historical P/Es of the Comparable Companies range from approximately 2.6 time to 4.7 times, with a mean and median of approximately 4.0 times and 4.6 times respectively. On the same basis, the implied P/E of the Offer of approximately 5.5 times is higher than the range of the historical P/Es of the Comparable Companies, which we consider favourable to the Offer Shareholders.

(ii) P/B ratio

As set out in the table above, the historical P/Bs of the Comparable Companies range from approximately 0.4 time to 0.5 times, with a mean and median of approximately 0.45 times and 0.44 times respectively. The implied P/B of the Offer of approximately 0.75 times is above the range of the historical P/Bs of the Comparable Companies, which we consider favourable to the Offer Shareholders. Considering the above, we consider that the Offer Price, based on P/E and P/B analysis set out above, is fair to the Offer Shareholders.



DISCUSSION

(i) Circumstances giving rise to the Offer

As a result of the Equity Transfer which supports the PRC Government's overall policy and strategies in relation to the long-term development of the iron and steel industry, China Baowu has become the indirect holder of a controlling interest in A Shares representing approximately 45.54% of the total issued share capital and voting rights of the Company through Magang Group. This represents a change of control and consequently China Baowu (through its wholly-owned subsidiary, Baosteel) has been required under the terms of the Takeovers Code to make the Offer. The Offer is being made to all Offer Shareholders at an Offer Price of HK\$2.97 per H Share, which is equal to the volume weighted average price of the H Shares of the Company on the Stock Exchange on 31 May 2019, being the last trading day prior to the issuance of the Rule 3.7 Announcement, and deducted therefrom the final dividend declared and paid by the Company for the financial year ended 31 December 2018. The Offer is still conditional on the Offeror and parties acting in concert with it (except Hwabao Fund Management) achieving over 50% control of the voting rights of the Company so Offer Shareholders should be aware that it may not become unconditional.

(ii) Business of the Group

The principal activities of the Group involve manufacturing and sale of iron and steel products in the PRC. Consequently, the Group is exposed to factors including changes in iron ore supply and prices, demand and supply of steel products and their prices and overall market sentiment.

(iii) Profitability and prospects

The Group's net profit attributable to owners of the parent (excluding non-recurring gains or losses) increased by approximately 28% in 2018 as compared to 2017, mainly attributable to increase in gross margin of the Group's steel products. In the first half of 2019, the Group's results were affected mainly as a result of decrease in gross margin of the Group's steel products resulted from a decrease in steel sales volume and price and an increase in procurement price of certain raw materials and fuels. Going forward, while the executive Directors consider the long-term prospects of the Group remain generally positive, the Group continues to face uncertainties with respect to cyclical market factors such as cost pressures caused by rising prices of raw materials, risk of uncertain demand for steel products in certain industries and possibility of increase in supply in the industry.



(iv) Offer Price compared to market prices

The Offer Price is set at the volume weighted average price of the H Shares on the date of entering into the Equity Transfer Agreement. The Offer Price of HK\$2.97, on an “ex dividend” basis as discussed in the sub-section headed “Analysis of the Offer Price” of this letter above, represents a premium ranging from 1.02% to 1.71% for more recent periods up to and including the Last Trading Day, and a discount ranging from 2.30% to 13.16% over longer periods up to and including the Last Trading Day (with ex-dividend adjustment). As set out in the abovementioned sub-section, since around mid April 2019, the H Share price has generally shown a downward trend. The H Shares went further down after the publication of the Company’s 2019 first quarterly report and closed at HK\$3.34 on 31 May 2019, being the last trading day prior to the publication of the Rule 3.7 Announcement. Since the publication of the Joint Announcement and up to and including the Latest Practicable Date, the H Shares closed at a price ranging from HK\$2.92 to HK\$3.03. As at the Latest Practicable Date, the H Shares closed at HK\$2.93, representing a slight discount of approximately 1.3% to the Offer Price.

(v) Listing and liquidity of the H Shares

Baosteel has stated that it intends to maintain the listing status of the H Shares of the Company after the close of the Offer. Based on the table set out in this letter above, the trading volume of the H Shares has exceeded 20% of the H Shares in issue during most of the period from January 2017 up to the Latest Practicable Date, we regard as a relatively high level of liquidity, i.e. the “H” Shares are actively traded.

(vi) P/E, P/B and comparison with Comparable Companies

Based on annual results for the year ended 31 December 2018, the implied P/E of the Company at the Offer Price is higher than the mean and median of the historical P/Es of the Comparable Companies. On an adjusted basis, the implied P/E of the Company (based on annual results for the year ended 31 December 2018) at the Offer Price ranks between the historical P/Es of Angang and Chongqing Iron. On a trailing twelve months basis, the implied P/E of the Offer is higher than the range of the historical P/Es of the Comparable Companies, which we consider favourable to the Offer Shareholders. The implied P/B at the Offer Price of approximately 0.75 times (equivalent to a discount of approximately 25% to the net asset value per Share attributable to owners of the parent as at 30 June 2019) is above the range of the historical P/Bs of the Comparable Companies, which we consider favourable to the Offer Shareholders. Considering the above, we consider that the Offer Price, based on P/E and P/B analysis set out above, is fair to the Offer Shareholders.



(vii) Dividend

Net profit excluding non-recurring gains or losses attributable to owners of the parent in 2016, 2017 and 2018 was approximately RMB1,410 million, RMB3,969 million and RMB5,092 million respectively. The Group did not declare dividend in 2016. Total dividend per H Share of the Company for the financial year ended 2017 and 2018 was RMB0.165 and RMB0.36 respectively. For the six months ended 30 June 2019, the Group recorded net profit attributable to owners of the parent of approximately RMB1,145 million, representing a drop of approximately 67% as compared with approximately RMB3,429 million in the same period of 2018. The Group did not declare interim dividend for the six months ended 30 June 2019.

(viii) Appropriate basis

This case is unusual. Normally, when an offer is triggered under Rule 26.1 of the Takeovers Code, the offer price is set by the terms of the acquisition of shares which triggers the offer. In this case, there was no consideration for the Equity Transfer so the offer price has been set by reference to the average share price (ex dividend) on 31 May 2019, the last trading day before the publication of the Rule 3.7 Announcement. In the circumstances we consider this an appropriate basis, and in assessing the fairness and reasonableness of the Offer, we have also taken particular account of: (i) the premiums over the closing Share prices for more recent periods as set out above before the Last Trading Day; (ii) the financial performance of the Group in the first half of 2019 and the uncertain market factors which affect the Group's prospects in the near-term; and (iii) the peer comparisons of the implied P/E and P/B of the Company at the Offer Price as summarised above.

OPINION AND RECOMMENDATION

Based on the above principal factors and reasons and as summarised in the section headed "Discussion" and the sub-paragraph headed "Appropriate basis" above, we consider the terms of the Offer are fair and reasonable so far as the Offer Shareholders are concerned and advise the Independent Board Committee to recommend the Offer Shareholders to accept the Offer, with the provisos set out below.

Offer Shareholders should note that the H Shares closed at a price ranging from HK\$2.92 to HK\$3.03 since the publication of the Joint Announcement and up to and including the Latest Practicable Date. As at the Latest Practicable Date, the H Shares closed at HK\$2.93, representing a slight discount of approximately 1.3% to the Offer Price. If the market price of the H Shares exceed the Offer Price, Offer Shareholders who are inclined to accept the Offer should instead sell their H Shares in the market if the sales proceeds, net of transaction costs, exceed HK\$2.97 per H Share. We regard the liquidity of the H Shares as relatively strong, so Offer Shareholders should be able to follow this strategy if they so wish.



Offer Shareholders who are attracted to the prospects of the Group and the iron and steel industry may consider retaining their H Shares. Such Offer Shareholders should bear in mind possibility of a temporary suspension in trading of the H Shares following the close of the Offer if the public float requirement is not met. The Directors and the directors of Baosteel will jointly and severally undertake to the Stock Exchange to take appropriate steps to ensure that the sufficient public float exists in the shares of the Company following the close of the Offer.

Offer Shareholders are reminded to monitor carefully the market price and liquidity of the H Shares during the Offer Period.

The procedures for acceptance of the Offer are set out in Appendix I to the Composite Document. Offer Shareholders are urged to read carefully the Composite Document and appendices and act according to the timetable if they wish to accept the Offer.

Yours faithfully,
for and on behalf of
SOMERLEY CAPITAL LIMITED

Stephanie Chow
Director

Ms. Stephanie Chow is a licensed person registered with the Securities and Futures Commission of Hong Kong and a responsible officer of Somerley Capital Limited, which is licensed under the SFO to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities. She has over ten years' experience in the corporate finance industry.