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If you have sold or transferred all your shares in Honghua Group Limited (the “**Company**”), you should at once hand this circular together with the accompanying form of proxy to the purchaser or transferee or to the bank, stockbroker or other agent through whom the sale or the transfer was effected for transmission to the purchaser(s) or transferee(s).

This circular appears for information purposes only and does not constitute an invitation or offer to acquire, purchase or subscribe for the securities of the Company.

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宏华集团
HONGHUA GROUP

Honghua Group Limited
宏華集團有限公司

(a company incorporated in the Cayman Islands with limited liability)

(Stock Code: 196)

**ISSUE OF NEW SHARES UNDER SPECIFIC MANDATES
AND
NOTICE OF EXTRAORDINARY GENERAL MEETING**

Financial Advisor



A notice convening the EGM of Honghua Group Limited to be held at Novotel Century Hong Kong, 238 Jaffe Road, Wan Chai, Hong Kong on Thursday, 16 February 2017 at 10:00 a.m. is set out on pages 25 to 27 of this circular. Whether or not you are able to attend the EGM, you are requested to complete the accompanying form of proxy in accordance with the instructions printed thereon and return it to the branch share registrar and transfer office in Hong Kong, Computershare Hong Kong Investor Services Limited, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong as soon as possible and in any event not later than 48 hours before the time for holding the EGM or any adjournment thereof. Completion and return of the form of proxy will not preclude you from attending and voting in person at the EGM or any adjournment thereof should you so wish.

24 January 2017

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DEFINITIONS

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

“Ally Giant”	Ally Giant Limited, a company incorporated in the British Virgin Islands with limited liability on 10 July 2006;
“Announcement”	the announcement of the Company dated 19 December 2016 in relation to the issue of new shares under specific mandates;
“Beijing Jianhong”	Beijing Jianhong Capital Management Co., Ltd* (北京建宏富鑫投資管理有限公司), a company incorporated in the PRC;
“Board”	the board of Directors;
“CASIC”	China Aerospace Science and Industry Corporation* (中國航天科工集團公司), a company incorporated in the PRC, the investor of the CASIC Subscription Shares;
“CASIC Subscription Agreement”	the conditional subscription agreement dated 19 December 2016 entered into between the Company and CASIC in relation to the issue and subscription of the CASIC Subscription Shares;
“CASIC Subscription Share(s)”	the 1,606,000,000 new Shares to be subscribed by CASIC and issued by the Company at the Subscription Price pursuant to the CASIC Subscription Agreement;
“Company”	Honghua Group Limited, a company incorporated in the Cayman Islands with limited liability, the Shares of which are listed on the Main Board of the Stock Exchange of Hong Kong Limited;
“Director(s)”	directors of the Company;
“EGM”	an extraordinary general meeting to be convened by the Company to consider and approve the Specific Mandates;
“EPC”	an acronym which stands for “engineering, procurement and construction”, a particular form of contracting arrangement used in the petroleum industry where the EPC contractor is made responsible for all the activities from design, procurement, construction, to commissioning and handover of the project to the owner;
“Group”	the Company and its subsidiaries;
“HK\$”	Hong Kong dollars, the lawful currency of Hong Kong;

DEFINITIONS

“Hong Kong”	the Hong Kong Special Administration Region of the PRC;
“Honghua America”	Honghua America LLC, a limited liability company established in the USA, an indirect wholly-owned subsidiary of the Company;
“Honghua Company”	Sichuan Honghua Petroleum Equipment Co., Ltd., formerly known as Chuangyou Guanghan Honghua Co., Ltd., a limited liability company established in the PRC on December 1997, and an indirect wholly-owned subsidiary of the Company;
“Honghua International”	Sichuan Honghua International Co., Ltd., formerly known as Sichuan Honghua Trading Co., Ltd., a limited liability company established in the PRC on 13 January 2004, and an 85%-owned subsidiary of Honghua Company;
“Independent Third Party(ies)”	persons independent of the Company and its connected persons (as defined in the Listing Rules) and not acting in concert with any of the connected persons of the Company or any of their respective associates;
“Jianhong”	Jianhong Capital Fund I L.P., a limited partnership established in the Cayman Islands, the investor of Jianhong Subscription Shares;
“Jianhong Subscription Agreement”	the conditional subscription agreement dated 19 December 2016 entered into between the Company and Jianhong in relation to the issue and subscription of Jianhong Subscription Shares;
“Jianhong Subscription Share(s)”	the 508,000,000 new Shares to be subscribed by Jianhong and issued by the Company at the Subscription Price pursuant to the Jianhong Subscription Agreement;
“Latest Practicable Date”	17 January 2017, being the latest practicable date prior to the printing of this circular for the purpose of ascertaining certain information contained herein;
“Listing Rules”	the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited;
“PRC”	the People’s Republic of China, for the purpose of this circular, excludes Hong Kong, the Macau Special Administration Region and Taiwan;
“RMB”	Renminbi, the lawful currency of the PRC;

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“SFC”	the Securities and Futures Commission of Hong Kong;
“Share(s)”	ordinary share(s) of nominal value of HK\$0.10 each in the share capital of the Company;
“Shareholder(s)”	holder(s) of Shares of the Company;
“Specific Mandates”	the specific mandates for the allotment and issue of the CASIC Subscription Shares to CASIC and the Jianhong Subscription Shares to Jianhong to be sought from the Shareholders at the EGM;
“Stock Exchange”	The Stock Exchange of Hong Kong Limited;
“Subscription Agreements”	the CASIC Subscription Agreement and the Jianhong Subscription Agreement;
“Subscription Price”	HK\$0.77 per Subscription Share;
“Subscription Share(s)”	CASIC Subscription Shares and Jianhong Subscription Shares;
“Subscriptions”	the subscriptions of Shares by CASIC and Jianhong, respectively, pursuant to the Subscription Agreements;
“Takeovers Code”	the Code on Takeovers and Mergers; and
“%”	per cent.

LETTER FROM THE BOARD



宏华集团
HONGHUA GROUP

Honghua Group Limited

宏華集團有限公司

(a company incorporated in the Cayman Islands with limited liability)

(Stock Code: 196)

Executive Directors:

Mr. Zhang Mi (*Chairman*)
Mr. Ren Jie
Mr. Liu Zhi

Non-executive Director:

Mr. Siegfried Meissner
(Mr. Popin Su as his alternate)

Independent Non-executive Directors:

Mr. Liu Xiaofeng
Mr. Qi Daqing
Mr. Chen Guoming
Mr. Shi Xingquan
Mr. Guo Yanjun

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24 January 2017

To the Shareholders

Dear Sir/Madam,

**ISSUE OF NEW SHARES UNDER SPECIFIC MANDATES
AND
NOTICE OF EXTRAORDINARY GENERAL MEETING**

A. INTRODUCTION

Reference is made to the Announcement whereby the Board announced, *inter alia*, that the Company entered into the CASIC Subscription Agreement with CASIC and the Jianhong Subscription Agreement with Jianhong and Beijing Jianhong on 19 December 2016 (after trading hours) pursuant to which the Company has conditionally agreed to (i) allot and issue an aggregate of 1,606,000,000 Shares to CASIC at the Subscription Price of HK\$0.77 per Share,

LETTER FROM THE BOARD

which will be settled by payment in cash of HK\$1,236,620,000; and (ii) allot and issue an aggregate of 508,000,000 Shares to Jianhong at the Subscription Price of HK\$0.77 per Share, which will be settled by payment in cash of HK\$391,160,000.

The Company will seek the Specific Mandates from the Shareholders at the EGM for the allotment and issue of the Shares to CASIC and Jianhong respectively. An EGM will be convened by the Company for the Shareholders to consider and, if thought fit, to approve the Specific Mandates.

The purpose of this circular is to provide the Shareholders with (i) further information on the Subscription Agreements and the transactions contemplated thereunder, including the Subscriptions which are the subject of the Specific Mandate; and (ii) the notice of the EGM.

B. THE SUBSCRIPTION AGREEMENTS

On 19 December 2016 (after trading hours), the Company entered into the CASIC Subscription Agreement with CASIC and the Jianhong Subscription Agreement with Jianhong and Beijing Jianhong. The major terms are set out below:

1. The CASIC Subscription Agreement

Date: 19 December 2016 (after trading hours)

Parties: (1) the Company as the issuer
(2) CASIC as the subscriber

To the best knowledge, information and belief of the Directors, having made all reasonable enquiries, CASIC and its ultimate beneficial owner are Independent Third Parties as at the Latest Practicable Date. The Company further understands that CASIC is independent of and not acting in concert with Jianhong, Beijing Jianhong or Ally Giant.

LETTER FROM THE BOARD

CASIC Subscription Shares:

Pursuant to the CASIC Subscription Agreement, CASIC has conditionally agreed to subscribe for and the Company has conditionally agreed to allot and issue at the Subscription Price an aggregate of 1,606,000,000 CASIC Subscription Shares, representing (i) approximately 49.55% of the total number of issued Shares as at the Latest Practicable Date; (ii) approximately 33.13% of the total number of issued Shares as enlarged by the issue of the CASIC Subscription Shares; and (iii) approximately 29.99% of the total number of issued Shares as enlarged by the issue of the CASIC Subscription Shares and Jianhong Subscription Shares. The aggregate nominal value of the CASIC Subscription Shares will be HK\$160,600,000.

The CASIC Subscription Shares will be issued pursuant to the Specific Mandate to be approved at the EGM. Such Specific Mandate will be valid until the end of 18 May 2017, should the completion of the CASIC Subscription Agreement take place after 18 May 2017, the Company will seek another specific mandate for the issue of the CASIC Subscription Shares from the Shareholders.

An application will be made by the Company to the Listing Committee of the Stock Exchange for the listing of, and permission to deal in, the CASIC Subscription Shares. The CASIC Subscription Shares, when allotted and issued, will rank *pari passu* with the then existing Shares in issue.

CASIC Subscription Price:

The Subscription Price of HK\$0.77 per CASIC Subscription Share represents:

- (i) an approximately 2.53% discount to the closing price of HK\$0.79 per Share as quoted on the Stock Exchange on the Latest Practicable Date;
- (ii) an approximately 2.04% discount to the average closing price of HK\$0.79 per Share as quoted on the Stock Exchange for the last five consecutive trading days prior to the Latest Practicable Date;
- (iii) an approximately 1.41% discount to the average closing price of HK\$0.78 per Share as quoted on the Stock Exchange for the last ten consecutive trading days prior to the Latest Practicable Date; and

LETTER FROM THE BOARD

- (iv) an approximately 50.64% discount to the unaudited net asset value (the “NAV”) per Share of approximately HK\$1.56 on 30 June 2016 (based on the consolidated net asset value of the Group of HK\$5,061,051,000 and 3,241,056,900 issued Shares on 30 June 2016).

The Subscription Price was determined by the Company and CASIC after arm’s length negotiations with reference to (i) the current market price of the Shares and current market condition; and (ii) the financing requirements of the Company in relation to the Subscriptions. Although the Subscription Price represents a 50.64% discount to the NAV per Share, the Company considers the trading price to represent a fairer indication of the value of the Company particularly considering the fact that the trading price of the Shares has been consistently below the Company’s NAV per Share as the Group has been loss-making in the last two years.

Conditions:

The CASIC Subscription Agreement is subject to the following conditions being fulfilled or waived:

- (a) the passing of a resolution by the Shareholders at the EGM to approve the granting of the Specific Mandate to the Board to allot and issue the CASIC Subscription Shares;
- (b) CASIC not being obliged to make a mandatory offer under Rule 26 of the Takeovers Code as a result of its subscription of the CASIC Subscription Shares;
- (c) the Listing Committee of the Stock Exchange granting the listing of and permission to deal in the CASIC Subscription Shares (and such approval not subsequently revoked prior to completion);
- (d) the Company maintaining the listing and trading of the Shares on the Stock Exchange at or prior to completion, other than any trading halt of not more than seven business days (excluding any trading halt as a result of the transactions contemplated under the this agreement or in other circumstances as agreed by CASIC);

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- (e) the parties to this agreement having complied with all applicable laws and regulations (including the Listing Rules and the Takeovers Code) in relation to the subscription, and the Group having obtained all important approvals, consents and waivers and filings (if applicable) mandatorily required for the transactions under this agreement in accordance with all applicable laws and regulations;
- (f) CASIC or its group enterprises having obtained all applicable approvals, filings, registrations, licences or authorisations of competent authorities of the PRC government in connection with the offshore investment and outbound funds transfer; and
- (g) CASIC having completed, to its satisfaction, due diligence on the Company, and any outstanding issues found in the due diligence being settled.

The Company will use all reasonable endeavours, and CASIC will provide reasonable assistance, to procure the fulfilment of the conditions set out in paragraphs (a), (c) and (d). CASIC will use all reasonable endeavours, and the Company will provide reasonable assistance, to procure the fulfilment of the conditions set out in paragraphs (e), (f) and (g).

CASIC may waive any of the conditions set out in paragraphs (d), (f) and (g) by way of written notice at any time. Each party may waive the obligation of the other party under the condition set out in paragraph (e).

The Company understands that the Executive Director of the Corporate Finance Division of the SFC has ruled that the class (1) presumption in the definition of “acting in concert” that arises between CASIC on the one hand and Ally Giant on the other hand upon completion of the CASIC Subscription Agreement and the Jianhong Subscription Agreement is rebutted.

If the above conditions are not fulfilled or waived by 31 March 2017 (or such other date as agreed by both parties in writing), either party may terminate the CASIC Subscription Agreement by way of written notice to the other party.

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The completion of the CASIC Subscription Agreement is not conditional on the completion of the Jianhong Subscription Agreement. The Company expects the Jianhong Subscription Agreement to complete before the completion of the CASIC Subscription Agreement. In the unlikely event that the CASIC Subscription Agreement completes before the Jianhong Subscription Agreement, condition precedent (b) stated above will have to be satisfied before completion takes place. If, in relation to this, CASIC subsequently decides to seek a whitewash waiver from the obligation to make a mandatory general offer, an announcement will be made.

Completion:

The CASIC Subscription Agreement will be completed within five business day(s) upon the satisfaction or waiver of the conditions or such other date as the Company and CASIC may agree.

Director nomination rights:

Pursuant to the CASIC Subscription Agreement, the Company agrees that CASIC will have the right to nominate a total of three Directors (including the chairman of the Board) after completion, to the extent that this does not contravene the requirements of the Listing Rules and the Stock Exchange, and subject to the Directors' reasonable belief that it is in the interests of the Company and its Shareholders as a whole. If the appointment of the new chairman of the Board is passed (subject to the aforementioned conditions), the existing chairman of the Board of the Company will be re-designated as vice-chairman of the Board after the appointment of the new chairman of the Board has become effective. The appointment of the new Directors nominated by CASIC will be subject to the same approval procedures as required under the Company's memorandum and articles of association.

The appointment of the new Directors nominated by CASIC will not take place at this EGM.

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Indemnity:

The Company will indemnify CASIC in full for all losses arising from or attributable to a material breach by the Company of its guarantees, representations and undertakings under the CASIC Subscription Agreement, and will indemnify CASIC for all reasonable expenses (including reasonable consulting fees and expenses) incurred by CASIC for the investigation, preparation or defence of any pending or threatened third party claims or any legal procedures initiated by third parties. This indemnity is not applicable to any losses caused by or resulting from any wilful misconduct, material fault or dishonesty on the part of CASIC.

The Company will also provide a specific indemnity to CASIC for losses arising from certain legal proceedings and liabilities involving the Group prior to completion which the parties have confirmed in writing, including the following:

- (a) two claims originated by former shareholders of a subsidiary of the Company relating to the legacy issue of employees' shareholding in Honghua Company prior to the Company's initial public offering on 25 February 2008. The total amount of damages claimed against the defendants, including any interest, under the Shareholder Claims is RMB349,455,650 (HK\$391,390,328.00). In the first instance, damages, dividends and litigation fee of HK\$28,008,717.81 (not including loss and dividend interests) was awarded against the defendants. The defendants filed their appeals and are waiting for the final decision of the court. The Group is indemnified for any loss arising from the Shareholder Claims under an indemnity agreement with Ally Giant and others dated 15 February 2008. Thus, the Company does not consider the Shareholder Claims to constitute a material liability to the Group;

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- (b) any award of damages against Honghua Company in legal proceeding bought by AI Roumi General Trading Est. (“**AI Roumi**”), the Company’s agency in United Arab Emirates, against the Company for approximately USD18 million (HK\$139.6 million). The claim was dismissed in 2013 and the appeal by the plaintiff was dismissed in 2014. The plaintiff and Honghua Company both appealed and are waiting for the final decision of the court;
- (c) any award of damages against the Company and Honghua America ordered by court to pay to the plaintiff in relation to the death of a former employee of Nabors Drilling USA in 2013 in relation to equipment supplied by the Group. The claim was for the amount of over USD1 million (HK\$7,754,600) and was dismissed by the court in October 2016. The Company understands that the plaintiff may bring further legal action against two other subsidiaries of the Company, Honghua Company and Honghua International but is yet to receive the pleading; and
- (d) any outstanding tax liability of the Group or social security payment or redundancy repayments owed to its employees and or former employees.

If the Company suffers any losses in connection with the above items, the Company will indemnify and pay CASIC a portion of the total losses for the reduction in the net asset value of the Company, which will be determined on a pro-rata basis by reference to the number of the CASIC Subscription Shares over the total number of issued Shares upon completion of the CASIC Subscription Agreement.

Limitations on the liabilities of the Company:

All liabilities and obligations of the Company under this agreement and in connection with the subscription and all claims (including claims for indemnity) (“**Relevant Claims**”) made by CASIC against the Company under this agreement and in connection with the subscription will be subject to the following limitations:

- (a) the maximum aggregate liability of the Company in respect of all Relevant Claims will not exceed the total consideration for the CASIC Subscription Shares;

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- (b) the time limit for CASIC to bring Relevant Claims against the Company is 36 months from the date of completion. The Company will not be liable for Relevant Claims made by CASIC beyond that time limit;
- (c) the Company will not be liable, save for the special indemnity as agreed between the parties, if CASIC is aware of any events or circumstances prior to completion which have caused or may cause the Relevant Claims, or if such events or circumstances have been publicly or fairly disclosed to CASIC by the Company;
- (d) the de minimis for Relevant Claims is HK\$1,000,000 for a single claim or HK\$10,000,000 for an aggregate of claims. The Company will compensate CASIC in full for Relevant Claims exceeding such de minimis;
- (e) the Company will not be liable for any Relevant Claims arising in connection with any amendment in laws or regulations or changes in the interpretation of any laws which occur after the date of signing of this agreement;
- (f) the Company will not be liable for any Relevant Claims more than once;
- (g) the Company will not be liable for any indirect, special, consequential or punitive losses; and
- (h) if CASIC is able to claim from any insurance policy in respect of any event which has led to a Relevant Claim, the actual amount claimed under such insurance policy will be deducted from such Relevant Claim, provided that CASIC will use its reasonable endeavours to make a claim.

**Assignment and CASIC
Nominee:**

CASIC may assign its rights and obligations under this agreement to an affiliate with prior written notice to the Company or nominate an affiliate to hold the CASIC Subscription Shares for purposes of completion.

LETTER FROM THE BOARD

Termination of agreement:

The CASIC Subscription Agreement may be terminated if:

- (a) the conditions are not satisfied by 31 March 2017 (or such other date as agreed by both parties);
- (b) one of the parties is unable to proceed to completion when the conditions have been satisfied, the other party may elect to terminate the agreement;
- (c) both parties agree to terminate this agreement in writing;
- (d) there has been a material breach of this agreement by one of the parties, in which case the non-defaulting party may terminate this agreement by way of written notice to the defaulting party;
- (e) in the reasonable opinion of CASIC, there has been any material adverse change in respect of the Company between signing and completion of this agreement which has rendered the Company unable to carry on its normal business, in which case CASIC may terminate this agreement by written notice to the Company; and
- (f) the guarantees, representations and undertakings made by the Company under this agreement have become materially untrue, inaccurate or misleading at the signing of this agreement or at completion.

Senior management lock up:

The Company has reached a preliminary understanding with the CASIC that it will procure the senior management of the Company to undertake that they will not sell or otherwise dispose of more than 20% of their individual holdings of the Shares within three years of the completion of the CASIC Subscription Agreement.

The Directors believe that the CASIC Subscription Agreement was entered into between the Company and CASIC after arm's length negotiations and the terms (including but not limited to the Subscription Price) are fair and reasonable and in the interests of the Company and its Shareholders as a whole.

LETTER FROM THE BOARD

2. The Jianhong Subscription Agreement

Date: 19 December 2016 (after trading hours)

Parties:

- (1) the Company as the issuer
- (2) Jianhong as the subscriber
- (3) Beijing Jianhong as Jianhong's guarantor

To the best knowledge, information and belief of the Directors having made all reasonable enquiries, Jianhong, Beijing Jianhong and their ultimate beneficial owners are Independent Third Parties as at the Latest Practicable Date. The Company further understands that each of Jianhong and Beijing Jianhong is independent of and not acting in concert with CASIC and Ally Giant.

**Jianhong Subscription
Shares:**

Pursuant to the Jianhong Subscription Agreement, Jianhong has conditionally agreed to subscribe for and the Company has conditionally agreed to allot and issue at the Subscription Price an aggregate of 508,000,000 Jianhong Subscription Shares, representing (i) approximately 15.67% of the total number of issued Shares as at the Latest Practicable Date; (ii) approximately 13.55% of the total number of issued Shares as enlarged by the issue of the Jianhong Subscription Shares; and (iii) approximately 9.49% of the total number of issued Shares as enlarged by the issue of the CASIC Subscription Shares and Jianhong Subscription Shares. The aggregate nominal value of the Jianhong Subscription Shares will be HK\$50,800,000.

The Jianhong Subscription Shares will be issued pursuant to the Specific Mandate to be approved at the EGM. Such Specific Mandate will be valid until the end of 18 May 2017, should the completion of the Jianhong Subscription Agreement take place after 18 May 2017, the Company will seek another specific mandate from the Shareholders for the issue of the Jianhong Subscription Shares.

An application will be made by the Company to the Listing Committee of the Stock Exchange for the listing of, and permission to deal in, the Jianhong Subscription Shares. The Jianhong Subscription Shares, when allotted and issued, will rank *pari passu* with the then existing Shares in issue.

LETTER FROM THE BOARD

Jianhong Subscription Price:

The Subscription Price of HK\$0.77 per Jianhong Subscription Share represents:

- (i) an approximately 2.53% discount to the closing price of HK\$0.79 per Share as quoted on the Stock Exchange on the Latest Practicable Date;
- (ii) an approximately 2.04% discount to the average closing price of HK\$0.79 per Share as quoted on the Stock Exchange for the last five consecutive trading days prior to the Latest Practicable Date;
- (iii) an approximately 1.41% discount to the average closing price of HK\$0.78 per Share as quoted on the Stock Exchange for the last ten consecutive trading days prior to the Latest Practicable Date; and
- (iv) an approximately 50.64% discount to the unaudited net asset value per Share of approximately HK\$1.56 on 30 June 2016 (based on the consolidated net asset value of the Group of HK\$5,061,051,000 and 3,241,056,900 issued Shares on 30 June 2016).

The Subscription Price was determined by the Company and Jianhong after arm's length negotiations with reference to (i) the current market price of the Shares and current market condition; and (ii) the financing requirements of the Company in relation to the subscription.

Conditions:

The Jianhong Subscription Agreement is subject to the following conditions being fulfilled or waived:

- (a) the passing of a resolution by the Shareholders at the EGM to approve the granting of the Specific Mandate to the Board to allot and issue the relevant Shares pursuant to the Jianhong Subscription Agreement; and
- (b) the Listing Committee of the Stock Exchange granting the listing of and permission to deal in the Jianhong Subscription Shares (and such approval not subsequently revoked prior to completion).

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If the above conditions are not fulfilled by 31 March 2017 (or such other date as agreed by both parties in writing), either party may terminate the Jianhong Subscription Agreement by way of written notice to the other party unless otherwise agreed in writing by the parties to the Jianhong Subscription Agreement.

The completion of the Jianhong Subscription Agreement is not conditional on the completion of the CASIC Subscription Agreement.

Jianhong lock-up undertaking:

Jianhong undertakes that it will not sell or otherwise dispose of the Shares held by it within six months after completion.

Completion:

The Jianhong Subscription Agreement will be completed within five business day(s) upon the conditions being fulfilled or waived or such other date as the Company and Jianhong may agree.

Limitations on the liabilities of the Company:

All liabilities and obligations of the Company under this agreement and in connection with the subscription and all claims (“**Relevant Claims**”) made by Jianhong against the Company under this agreement and in connection with the subscription will be subject to the following limitations:

- (a) the maximum aggregate liability of the Company in respect of all Relevant Claims will not exceed 50% of the total consideration for the Jianhong Subscription Shares;
- (b) the time limit for Jianhong to bring Relevant Claims against the Company is 6 months from the date of completion. The Company will not be liable for Relevant Claims made by Jianhong beyond that time limit;
- (c) the Company will not be liable if Jianhong is aware of any events or circumstances prior to completion which have caused or may cause Relevant Claims, or if such events or circumstances have been publicly or fairly disclosed to Jianhong by the Company;

LETTER FROM THE BOARD

- (d) the de minimis is HK\$10,000,000 in respect of a single claim. The Company will compensate Jianhong in full for Relevant Claims exceeding such de minimis;
- (e) the Company will not be liable for such Relevant Claims arising in connection with any amendment in laws or regulations or changes in the interpretation of any laws which occur after the date of signing of this agreement;
- (f) the Company will not be liable for any Relevant Claims more than once;
- (g) the Company will not be liable for any indirect, special, consequential or punitive losses; and
- (h) if Jianhong is able to claim from any insurance policy in respect of any event which causes a Relevant Claim, the actual amount claimed under such insurance policy will be deducted from such Relevant Claim, provided that Jianhong will use its reasonable endeavours to make a claim.

Beijing Jianhong does not have any right to claim against the Company under this agreement.

**Beijing Jianhong
guarantee:**

Beijing Jianhong will guarantee the performance of Jianhong's obligations under this agreement, and the Company may claim from Beijing Jianhong in case Jianhong is in breach of any of its obligations.

**Termination of
agreement:**

The Jianhong Subscription Agreement may be terminated if:

- (a) the conditions are not satisfied by 31 March 2017 (or such other date as agreed by both parties);
- (b) one of the parties is unable to proceed to completion when the conditions have been satisfied, the other party may elect to terminate this agreement;
- (c) both parties agree to terminate this agreement in writing; and

LETTER FROM THE BOARD

- (d) there has been a material breach of this agreement by one of the parties, in which case the non-defaulting party may terminate this agreement by written notice to the defaulting party.

The Directors believe that the Jianhong Subscription Agreement was entered into between the Company, Jianhong and Beijing Jianhong after arm's length negotiations and the terms (including but not limited to the Subscription Price) are fair and reasonable and in the interests of the Company and its Shareholders as a whole.

C. BEIJING JIANHONG COMMISSION

In September 2016, the Company entered into a strategic cooperation agreement with Beijing Jianhong ("**Beijing Jianhong Agreement**"), relating to the introduction by Beijing Jianhong of CASIC to the Company with a view to subscribing for new Shares in the Company.

Pursuant to the Beijing Jianhong Agreement, the Company has made an upfront payment of RMB500,000 to Beijing Jianhong for its services in relation to finding CASIC as an investor to the Company.

In addition, under the Beijing Jianhong Agreement, Beijing Jianhong may opt to receive one of the following two compensation alternatives:

1. the opportunity to subscribe for Shares which constitute between 5% and 10% of the enlarged share capital of the Company after the subscription by CASIC and by Beijing Jianhong, the exact percentage of which will be determined by the resolution of the Board and subject to the approval by the Shareholders; or
2. a fee of 1.5% of the total consideration payable by CASIC under the CASIC Subscription Agreement (being the amount of HK\$1,236,620,000), subject to the completion of such subscription.

Beijing Jianhong has chosen to subscribe for Shares through Jianhong, a fund of which it is the general partner and has control. It will therefore not be entitled to the 1.5% fee in connection with CASIC's subscription, unless the Jianhong Subscription Agreement does not proceed to completion due to the Company's default. The terms of the Beijing Jianhong Agreement were arrived at after arm's length negotiations between the Company and Beijing Jianhong.

D. USE OF PROCEEDS AND REASONS FOR AND BENEFITS OF THE SUBSCRIPTIONS

General background and reasons for the Subscriptions

Since 2014, the Group's major business segments, including the oil and gas land equipment and offshore equipment businesses, have come under tremendous pressure due to continued volatility and downward trend in international oil prices and have not been able to achieve their expected results. Meanwhile, the oil and gas engineering service

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segment remains underdeveloped. To facilitate business development and maintain liquidity, the Company considered other forms of financing in the past year, including debt financing and issue of convertible bonds. Given the relatively high debt level of the Group (interest-bearing liabilities of the Group were approximately RMB4.4 billion and the total liabilities/total assets ratio was approximately 63% as at 30 June 2016) and the fact that debt financing normally requires a pledge of assets as collateral to creditors, the Board therefore considers that further debt financing or issue of convertible bonds are not conducive to maintaining a healthy financial structure for the Group.

The Board has considered the financial conditions of the Group against the background of the current oil and gas industry during the course of negotiating the Subscriptions. Based on the principles of safeguarding the best interests of the Company and maximising shareholder value, the Board ultimately selected CASIC as the strategic investor and Jianhong as the financial investor. As CASIC is a large state-owned enterprise, the Company believes that the introduction of CASIC may directly improve the credit status of the Group, improve its financial conditions and further broaden its financing channels. Meanwhile, the investment by Jianhong will also help the Company obtain the necessary funds to improve its cash flow.

The net cash proceeds (after deducting all relevant costs and expenses) from the issue of the Subscription Shares are estimated to be approximately HK\$1.617 billion. The Company intends to use around 50% of the net proceeds from the Subscriptions for repayment of its debts which are becoming due and payable (reducing the total liabilities/total assets ratio to 56.5%) and the rest of such proceeds for its general working capital.

Repayment of loans

The Company will repay the following loans (totalling approximately HK\$802 million) with the net proceeds from the Subscriptions:

Bank Name	Maturity Date	Ending Balance (HK\$) <i>(Note 1)</i>
China Industrial Bank	March to June 2017	339,800,827.64
Bank of China	1 March 2017	223,989,248.52
Industrial and Commercial Bank of China	April to June 2017	111,994,624.26
Ping An Bank	1 June 2017	125,858,886.77

Note 1: “Ending Balance” refers to the aggregate of the loan amounts with a particular lender if there are multiple loans with the same lender; where the loans are denominated in foreign currencies, they are converted to HK\$ for the purpose of aggregation at exchange rates applicable on 10 January 2017.

LETTER FROM THE BOARD

The abovementioned loans will be repaid as they fall due. The Company does not have any arrangement with the abovementioned lenders regarding extension of the repayment term.

Increasing working capital

As shown in the Group's unaudited interim report for the 6 months ended 30 June 2016, the Group's operating cash flow for that period was negative, i.e. a cash outflow of approximately RMB180 million, due to the ongoing difficult conditions facing the oil and gas industry. Based on the unaudited consolidated management accounts of the Group for the year ended 31 December 2016 ("**2016 Accounts**"), the Company estimates having a small positive operating cash flow for the entire 2016 financial year, but it will be significantly less than the operating cash flow generated in 2014 (approximately RMB558 million) and 2015 (approximately RMB318 million). The Company sees very limited scope for operating cash flow to improve in the first half of 2017 given the Group has already adopted aggressive cost cutting measures in 2016. Meanwhile, financing expenses continue to put pressure on the Group's cash flow.

As the Group is unable to generate sufficient operating cash flow to cover its operating and financing expenses, for the purposes of future budgeting and to ensure liquidity, the Company considers it necessary to substantially increase the Group's working capital.

The Group's regular operating expenditure, including, amongst other things, procurement and remuneration of staff, is normally around HK\$120 million per month, based on 2016 production levels and the latest management accounts in November and December 2016. Procurement accounts for around 50% of the HK\$120 million operating expenditure, which includes the purchase of raw materials used in production such as steel and spare parts. Remuneration of staff accounts for around 30% of the HK\$120 million operating expenditure, which includes salaries and wages and social security payments. Other miscellaneous expenses, such as transport and taxes, account for 20% of the monthly operating expenditure.

On average, it takes around 6 months from the date of receiving the order for the Group to receive payment for the products and/or service it provides to its customers, while large orders may take much longer. The Company envisages that due to the recovery in oil price in the second half of 2016, there may be an increase in customer orders in 2017, which is likely to cause a rise in the Group's operating expenditure compared with 2016 levels. Although increased orders should eventually lead to higher revenue and operating cash flow, as mentioned, there is a substantial time lag (often several months) between when the Group incurs operating expenditure and when it receives payment for the order. To prepare for the potential increase in customer orders, the Company considers it necessary to increase the Group's working capital.

As the Company aims to keep a level of available cash and working capital sufficient to cover operating expenditure, accordingly, the Company intends for the remaining 50% of the net proceeds, being approximately HK\$808.5 million, to be used as working capital to ensure liquidity.

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In addition to repayment of debts and working capital, the Company does not anticipate other major funding needs in the next 12 months.

Benefits of the Subscriptions

The Directors believe that the Subscriptions will strengthen the Group's cash position without resulting in additional interest expenses, and provide the Company with an opportunity to widen its shareholder base.

From a business operation perspective, the Board considers that the introduction of CASIC as a shareholder will create synergy and help the Group with its transformation from an equipment manufacturer to a provider of integrated (encompassing both equipment and services) solutions as follows:

1. CASIC as a large-scale Chinese state-owned enterprise can participate in the strategic cooperation with governments extensively in and outside the PRC, which will further help the Group consolidate its position and expand its market share outside the PRC;
2. CASIC's experience in EPC contracting and its overseas customer base will help the Group breakthrough in the overseas oil and gas engineering services segment in the future;
3. help the Group open the domestic shale gas oilfield services market and enhance the performance of the oilfield services segment; and
4. the injection of CASIC's technology will greatly enhance the computerisation and artificial intelligence level of the Group's land equipment sector.

In addition, the Company understands that CASIC plans to focus on the development of its global energy equipment segment by leveraging off the Group in future. Upon completion of the transaction, the Company, as the first non-PRC listed company and the largest energy equipment developer in which CASIC has a major shareholding, will become the main platform for CASIC to develop its global energy equipment business line and will be supported by CASIC as a major shareholder.

The Company has not entered into any discussion or agreement with CASIC or its associates on any acquisition of new business or assets or disposal of the Company's existing business.

The share subscriptions by CASIC and Jianhong also reflect their recognition of the Group as a leader in upstream oil and gas equipment manufacturing sector and their confidence in the recovery of oil and gas industry.

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E. THE SHAREHOLDING STRUCTURE OF THE COMPANY

	As the Latest Practicable Date		Immediately after the allotment and issuance of the Subscription Shares (assuming no other issue of Shares)	
	Number of Shares	%	Number of Shares	%
Subscribers:				
— CASIC	—	—	1,606,000,000	29.99
— Jianhong	—	—	508,000,000	9.49
Ally Giant Limited and Concert Group (<i>Note 2</i>)	1,510,258,620	46.60	1,510,258,620	28.20
Public (excluding Jianhong)	<u>1,730,798,280</u>	<u>53.40</u>	<u>1,730,798,280</u>	<u>32.32</u>
Total	<u><u>3,241,056,900</u></u>	<u><u>100.00</u></u>	<u><u>5,355,056,900</u></u>	<u><u>100.00</u></u>

Note 2: “Concert Group” is defined in the prospectus of the Company dated 25 February 2008.

F. FUNDRAISING ACTIVITIES IN THE PAST 12 MONTHS

The Company has not conducted any equity fund raising activities in the twelve months preceding the Latest Practicable Date.

G. APPLICATION FOR LISTING

The Company will apply to the Listing Committee for the listing of, and permission to deal in, the Subscription Shares. None of the securities of the Company is listed or dealt in on any stock exchange other than the Stock Exchange and no such listing or permission to deal is proposed to be sought.

H. INFORMATION ON THE PARTIES

The Group is mainly engaged in the research and development, design and manufacturing of oil drilling rigs, offshore engineering and oil exploration and development equipment, manufacturing and general assembly of large-scale equipment and provision of oil drilling engineering services. In addition to the aforementioned activities in the upstream oil and gas equipment sector, the Group is also committed to the development of overseas EPC projects and shale gas, liquefied natural gas and clean energy.

CASIC is a large Chinese state-owned enterprise mainly engaged in the research and development and manufacturing of high-tech products, such as aerospace and defence technology, information technology and equipment in the PRC.

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Jianhong, a limited partnership controlled by Beijing Jianhong, is mainly engaged in offshore mergers and acquisitions and fund management related businesses.

Beijing Jianhong is an asset management firm committed to providing comprehensive solutions in connection with mergers and acquisitions and corporate development to listed companies and corporate groups.

I. NOTICE OF EGM

Set out on pages 25 to 27 of this circular is a notice convening the EGM which will be held at Novotel Century Hong Kong, 238 Jaffe Road, Wan Chai, Hong Kong on Thursday, 16 February 2017 at 10:00 a.m. at which ordinary resolutions will be proposed to consider and, if thought fit, to approve each of the Subscription Agreements and the transactions contemplated thereunder (including the grant of the Specific Mandates for the allotment and issue of Subscription Shares). Voting at the EGM will be taken by poll in accordance with the Listing Rules.

A form of proxy for use at the EGM is also enclosed with this circular. Whether or not you are able to attend and vote at the EGM, you are requested to complete the accompanying form of proxy in accordance with the instructions printed thereon and return it to the branch share registrar of the Company, Computershare Hong Kong Investor Services Limited, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong, as soon as possible but in any event not less than 48 hours before the time appointed for holding of the EGM or any adjournment thereof. Completion and delivery of the form of proxy will not preclude Shareholders from attending and voting in person at the EGM if they so wish.

To the best knowledge, information and belief of the Directors having made all reasonable enquiries, none of the Shareholders has a material interest in the Subscriptions which would otherwise require them to abstain from voting at the EGM.

J. RECOMMENDATION

The Directors (including the independent non-executive Directors) consider that the terms of each of the Subscription Agreements, the transactions contemplated thereunder and the granting of the Specific Mandates are on normal commercial terms following arm's length negotiations between the relevant parties, and are fair and reasonable and in the interests of the Company and the Shareholders as a whole.

Accordingly, the Directors (including the independent non-executive Directors) consider that the resolutions proposed in the notice of the EGM are in the best interests of the Company and the Shareholders and therefore recommend the Shareholders to vote in favour of the relevant resolutions to approve each of the Subscription Agreements and the transactions contemplated thereunder and the grant of each of the Specific Mandates.

LETTER FROM THE BOARD

K. RESPONSIBILITY STATEMENT

This circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Group. The Directors, having made all reasonable enquiries, confirm that to the best of their knowledge and belief the information contained in this circular is accurate and complete in all material respects and not misleading or deceptive, and there are no other matters the omission of which would make any statement herein or this circular misleading.

Yours faithfully,
For and on behalf of the Board
HONGHUA GROUP LIMITED
Zhang Mi
Chairman

NOTICE OF EXTRAORDINARY GENERAL MEETING



宏华集团
HONGHUA GROUP

Honghua Group Limited

宏華集團有限公司

(a company incorporated in the Cayman Islands with limited liability)

(Stock Code: 196)

NOTICE IS HEREBY GIVEN that an extraordinary general meeting (the “**EGM**”) of Honghua Group Limited (the “**Company**”) will be held at Novotel Century Hong Kong, 238 Jaffe Road, Wan Chai, Hong Kong on Thursday, 16 February 2017 at 10:00 a.m. for the purposes of considering and, if thought fit, passing with or without modifying the following resolutions which will be proposed as ordinary resolutions of the Company:

ORDINARY RESOLUTIONS

1. In relation to the CASIC Subscription Agreement

“THAT:

- (a) the subscription agreement dated 19 December 2016 (the “**CASIC Subscription Agreement**”) and entered into between the Company as the issuer and China Aerospace Science and Industry Corporation* (中國航天科工集團公司) (“**CASIC**”) as the subscriber in respect of the allotment and issue of an aggregate of 1,606,000,000 new shares of the Company (the “**CASIC Subscription Shares**”) at a subscription price of HK\$0.77 per share to be subscribed by CASIC or its successor or nominee and the transactions contemplated thereunder be and are hereby approved, confirmed and ratified;
- (b) any director of the Company (“**Director**”) be and is hereby authorised to do such acts and things, to sign and execute all such further documents and to take such steps which, in the opinion of the Board may be necessary, appropriate, desirable or expedient, to give effect to the CASIC Subscription Agreement or any transactions contemplated thereunder and all other matters incidental thereto or in connection therewith, and to agree to and make such variations, amendments or waivers of any of the matters relating thereto or in connection therewith; and
- (c) subject to fulfilment of the conditions set out in the CASIC Subscription Agreement, the Directors be and are hereby granted a specific mandate to exercise the powers of the Company to allot and issue the CASIC Subscription Shares pursuant to the terms and conditions of the CASIC Subscription Agreement, where such CASIC Subscription Shares shall rank *pari passu* with the existing shares in issue. This

NOTICE OF EXTRAORDINARY GENERAL MEETING

specific mandate is in addition to, and shall not prejudice nor revoke any general or special mandate which has/have been granted or may from time to time be granted to the Directors prior to the passing of this resolution.”

2. In relation to the Jianhong Subscription Agreement

“THAT:

- (a) the subscription agreement dated 19 December 2016 (the “**Jianhong Subscription Agreement**”) and entered into between the Company as the issuer and Jianhong Capital Fund I L.P. (“**Jianhong**”) as the subscriber in respect of the allotment and issue of an aggregate of 508,000,000 new shares of the Company (the “**Jianhong Subscription Shares**”) at a subscription price of HK\$0.77 per share to be subscribed by Jianhong and the transactions contemplated thereunder be and are hereby approved, confirmed and ratified;
- (b) any Director be and is hereby authorised to do such acts and things, to sign and execute all such further documents and to take such steps which, in the opinion of the Board may be necessary, appropriate, desirable or expedient, to give effect to the Jianhong Subscription Agreement or any transactions contemplated thereunder and all other matters incidental thereto or in connection therewith, and to agree to and make such variations, amendments or waivers of any of the matters relating thereto or in connection therewith; and
- (c) subject to fulfilment of the conditions set out in the Jianhong Subscription Agreement, the Directors be and are hereby granted a specific mandate to exercise the powers of the Company to allot and issue the Jianhong Subscription Shares pursuant to the terms and conditions of the Jianhong Subscription Agreement, where such Jianhong Subscription Shares shall rank *pari passu* with the existing shares in issue. This specific mandate is in addition to, and shall not prejudice nor revoke any general or special mandate which has/have been granted or may from time to time be granted to the Directors prior to the passing of this resolution.”

By Order of the Board
HONGHUA GROUP LIMITED
Zhang Mi
Chairman

People's Republic of China, 24 January 2017

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KY1-1108, Cayman Islands

Head Office:

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Post code: 610036

*Principal Place of Business in
Hong Kong:*

Room 2508, Harcourt House
39 Gloucester Road
Wan Chai, Hong Kong

NOTICE OF EXTRAORDINARY GENERAL MEETING

Notes:

1. A Shareholder who is entitled to attend and vote at the EGM convened by the above notice is entitled to appoint a proxy to attend and vote on his behalf.
2. A proxy (who must be an individual) need not be a Shareholder but must attend in person to represent the Shareholder.
3. A Shareholder who is the holder of two or more shares may appoint more than one proxy to represent him and vote on his behalf. If more than one proxy is so appointed, the appointment shall specify the number and class of shares in respect of which each such proxy is so appointed.
4. In order to be valid, the form of proxy (enclosed under the circular of the Company dated the same date of this notice) together with any power of attorney or other authority under which it is signed, or a certified copy of such power of attorney or authority, must be deposited with the Company's branch share registrar in Hong Kong, Computershare Hong Kong Investor Services Limited, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not less than 48 hours before the time fixed for holding the EGM, or any adjournment thereof. Delivery of the form of proxy shall not preclude a Shareholder from attending and voting in person at the EGM and in such event, the instrument appointing a proxy shall be deemed to be revoked.

As at the date of this notice, Mr. Zhang Mi, Mr. Ren Jie and Mr. Liu Zhi are the Executive Directors of the Company, and Mr. Siegfried Meissner (Mr. Popin Su as his alternate) is the Non-Executive Director of the Company, and Mr. Liu Xiaofeng, Mr. Qi Daqing, Mr. Chen Guoming, Mr. Shi Xingquan and Mr. Guo Yanjun are the Independent Non-Executive Directors.

** For identification purposes only*