
THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

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

If you have sold or transferred all your securities in Shenji Group Kunming Machine Tool Company Limited (the “Company”), you should at once hand this circular and the accompanying form of proxy to the purchaser(s) or transferee(s), or to the bank, stockbroker, registered dealer in securities or other agent through whom the sale or transfer was effected for transmission to the purchaser(s) or transferee(s).

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沈機集團昆明機床股份有限公司
SHENJI GROUP KUNMING MACHINE TOOL COMPANY LIMITED
(A joint stock limited company incorporated in the People's Republic of China with limited liability)
(Stock Code: 0300)

CONNECTED TRANSACTION:
PROVISION OF FINANCIAL ASSISTANCE TO CONNECTED PERSON
AND
SUPPLEMENTAL NOTICE OF EXTRAORDINARY GENERAL MEETING

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



中州國際融資有限公司
CENTRAL CHINA INTERNATIONAL CAPITAL LIMITED

Central China International Capital Limited

Capitalised terms used on this cover page shall have the same meanings as those defined in the section headed “Definitions” in this circular.

A letter from the Board is set out on pages 4 to 10 of this circular. A letter from the Independent Board Committee is set out on pages 11 to 12 of this circular. A letter from the Independent Financial Adviser containing its advice to the Independent Board Committee and the Independent Shareholders is set out on pages 13 to 30 of this circular.

A supplemental notice convening the EGM, which should be read in conjunction with the notice of EGM of the Company dated 14 December 2017 and the announcement of the Company dated 30 January 2018, to be held at 9:30 a.m. on 8 May 2018 at Conference Room, 2nd Floor, Office Building, 23 Ciba Road, Kunming City, Yunnan Province, the People's Republic of China is set out on pages 35 to 36 of this circular.

Whether or not you intend to attend the EGM, you are requested to complete and return the enclosed form of proxy in accordance with the instructions printed thereon and deposit it with the Company's Hong Kong branch share registrar and transfer office, Hong Kong Registrars Limited at Shops 1712-1716, 17/F., Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong as soon as possible and in any event not less than 48 hours before the time appointed 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 if you so wish.

20 April 2018

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DEFINITIONS

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

“A Shares”	domestic shares of the Company with nominal value of RMB1.00 each, which are subscribed for in RMB
“Announcements”	the announcements of the Company dated 12 January 2018 and 19 April 2018
“associates”	has the meaning ascribed to this term under the Listing Rules
“Bank”	The Export-Import Bank of China, a PRC licensed bank and an Independent Third Party
“Bank Loan Agreement”	the loan agreement entered into between the Bank and the Substantial Shareholder
“Bank Loan Facility”	the loan facility up to RMB200 million under the Bank Loan Agreement
“Board”	the board of Directors
“Business Day”	a day(s) (excluding Saturday, Sunday or public holiday) on which licensed banks in Hong Kong and the PRC generally open for business throughout their normal business hours
“Company”	Shenji Group Kunming Machine Tool Company Limited, a joint stock limited company incorporated in the PRC, whose H Shares are listed on the Main Board of the Stock Exchange and whose A Shares are listed on the Shanghai Stock Exchange
“Connected Loan Agreement”	the loan agreement to be and entered into between the Substantial Shareholder as lender and the Company as borrower
“connected person”	has the meaning ascribed to this term under the Listing Rules
“Director(s)”	director(s) of the Company
“EGM”	the extraordinary general meeting of the Company to be held and convened to approve, among others, the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder
“Group”	the Company and its subsidiaries

DEFINITIONS

“H Shares”	overseas listed foreign shares of the Company with a nominal value of RMB1.00 each, which are listed on the Main Board of the Stock Exchange
“Hong Kong”	the Hong Kong Special Administrative Region of the PRC
“Independent Board Committee”	the independent committee of the Board comprising all the independent non-executive Directors established to advise the Independent Shareholders in respect of the terms of the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder
“Independent Financial Adviser” or “CCIC”	Central China International Capital Limited, a licensed corporation to carry out Type 1 (dealing in securities) and type 6 (advising on corporate finance) regulated activities under the SFO and the independent financial adviser to the Independent Board Committee and the Independent Shareholders
“Independent Shareholders”	Shareholders other than the Substantial Shareholder and its associates
“Independent Third Party(ies)”	an individual(s) or a company(ies) who or which is(are) independent of and not connected with any connected persons or any of their respective associate(s) (within the meaning of the Listing Rules) of the Group
“Latest Practicable Date”	16 April 2018, 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
“PRC”	the People’s Republic of China
“SFO”	Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)
“Substantial Shareholder”	瀋陽機床(集團)有限責任公司 (Shenyang Machine Tool (Group) Company Limited*), an enterprise established in the PRC and a substantial shareholder (as defined in the Listing Rules) of the Company
“Shares”	shares of RMB1.00 each in the capital of the Company
“Shareholder(s)”	the registered holder(s) of A Share(s) and/or H Share(s)

DEFINITIONS

“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“HK\$”	Hong Kong dollar(s), the lawful currency of Hong Kong
“RMB”	Renminbi, the lawful currency of the PRC

LETTER FROM THE BOARD



沈機集團昆明機床股份有限公司
SHENJI GROUP KUNMING MACHINE TOOL COMPANY LIMITED
(A joint stock limited company incorporated in the People's Republic of China with limited liability)
(Stock Code: 0300)

Executive Directors:

WANG He
ZHANG Xiaoyi
PENG Liangfeng

Non-executive Directors:

LIU Chunshi
XIA Changtao
KANG Jun
WU Yu

Independent non-executive Directors:

NA Chaohong
CHI Yilin
JIN Mei
TIAN Ruihua

*Registered office and principal place
of business in the PRC:*

23 Ciba Road
Kunming City
Yunnan Province
The People's Republic of China

20 April 2018

To the Shareholders

Dear Sir or Madam,

**CONNECTED TRANSACTION:
PROVISION OF FINANCIAL ASSISTANCE TO CONNECTED PERSON
AND
NOTICE OF EXTRAORDINARY GENERAL MEETING**

INTRODUCTION

Reference is made to the Announcements. As disclosed in the Announcements, the Board announces that (1) the Substantial Shareholder entered into of the Bank Loan Agreement with the Bank pursuant to which the Bank shall provide the Bank Loan Facility of up to RMB200 million to the Substantial Shareholder subject to the terms of the Bank Loan Agreement; and (2) the Company as borrower and the

LETTER FROM THE BOARD

Substantial Shareholder as lender will enter into the Connected Loan Agreement pursuant to which the Substantial Shareholder shall provide a unsecured loan facility of not more than RMB200 million to the Group subject to the terms of the Connected Loan Agreement.

The purpose of this circular is to provide you with, among other things, (i) details of the Bank Loan Agreement, the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge; (ii) the recommendation of the Independent Board Committee to the Independent Shareholders; (iii) the letter of advice from CCIC, the Independent Financial Adviser, to the Independent Board Committee and the Independent Shareholders; (iv) the notice of EGM.

THE BANK LOAN AGREEMENT

Date

22 December 2017

Parties

- (i) the Substantial Shareholder as borrower; and
- (ii) the Bank as lender.

The Substantial Shareholder is a company established in the PRC. As the Substantial Shareholder is the substantial shareholder of the Company holding approximately 25.08% equity interests of the Company, the Substantial Shareholder is a connected person of the Company under Chapter 14A of the Listing Rules.

The Bank is a licensed bank in the PRC. To the best of the Directors' knowledge, information and belief having made all reasonable enquiries, the Bank and its ultimate beneficial owner(s) are Independent Third Parties.

Subject matter

Pursuant to the Bank Loan Agreement, the Bank shall provide the Bank Loan Facility of up to RMB200 million to the Substantial Shareholder subject to the terms of the Bank Loan Agreement. The Bank Loan Facility shall be secured by, among others, the corporate guarantee by the Company (the "**Corporate Guarantee**"); and the pledge of certain properties held by the Group (the "**Property Pledge**"). For the avoidance of doubt, the Corporate Guarantee and the Property Pledge shall be subject to the approval of the Independent Shareholders' approval at the EGM and will only be entered into and become effective with the approval of the Independent Shareholders at the EGM.

The Bank Loan Facility shall be for a term for fifteen months from the date of first drawing of the Bank Loan Facility and the interest rate shall be determined at 4.9875% per annum which was determined after arm's length negotiations between the parties to the Bank Loan Agreement.

LETTER FROM THE BOARD

THE CONNECTED LOAN AGREEMENT

Date

Within five (5) Business Days after obtaining Independent Shareholders' approval at the EGM

Parties

- (i) the Company as borrower; and
- (ii) the Substantial Shareholder as lender.

Subject matter

Pursuant to the Connected Loan Agreement, the Substantial Shareholder shall provide the Group a unsecured loan facility of up to RMB200 million (the "**Connected Loan Facility**") subject to the terms of the Connected Loan Agreement.

Any amount(s) to be advanced by the Substantial Shareholder to the Group under the Connected Loan Agreement shall constitute unsecured indebtedness of the Group.

The Connected Loan Facility shall have the same term as the Bank Loan Facility and shall have the same interest rate as the Bank Loan Facility at 4.9875% per annum which was determined after arm's length negotiations with reference to the terms and conditions of the Bank Loan Agreement.

The Company will draw the amount under the Connected Loan Facility equivalent to the amount to be drawn under the Bank Loan Facility immediately after the entering into of the Connected Loan Agreement to repay the existing outstanding indebtedness owed by the Company to the Bank.

Any repayment by the Group to the Bank directly will automatically offset against the indebtedness of the Group under the Connected Loan Facility.

THE CORPORATE GUARANTEE AND THE PROPERTY PLEDGE

As disclosed in the section headed "the Bank Loan Agreement" above, it is a term thereof that (1) the Company will provide the Corporate Guarantee; and (2) the Group will pledge the property under the Property Pledge in favour of the Bank as security for the obligations and liabilities of the Substantial Shareholder under the Bank Loan Agreement. As such, the provision of the Corporate Guarantee and the Property Pledge for the obligations and liabilities of the Substantial Shareholder, which is a connected person of the Company, constitutes a provision of financial assistance to a connected person and is therefore a connected transaction on the part of the Company. The properties under the Property Pledge are with a total area of approximately 358,991.55 sq. m. and based on the valuation on the properties under the Property Pledge issued by an independent property valuer on 2 February 2017, the market value of such properties is estimated to be approximately RMB138.25 million as at 30 January 2017. For the avoidance of

LETTER FROM THE BOARD

doubt, the Corporate Guarantee and the Property Pledge shall be subject to the approval of the Independent Shareholders' approval at the EGM and will only become effective with the approval of the Independent Shareholders at the EGM.

The Company will execute the Corporate Guarantee in favour of the Bank as security for the obligations and liabilities of the Substantial Shareholder under the Bank Loan Agreement within five Business Days upon the obtaining of the Independent Shareholders' approval at the EGM. There would be no costs to be incurred by the Company to execute the Corporate Guarantee. However, in the unlikely event that the Substantial Shareholder would be in default under the Bank Loan Agreement, the Bank shall be entitled to enforce the Corporate Guarantee and the maximum possible liability of the Company to be borne by the Company would be the outstanding Bank Loan Facilities plus interest accrued thereon.

In the unlikely event that the Company is required to make any payment to the Bank under the Corporate Guarantee, the Substantial Shareholder undertakes that it will waive the same amount under the Connected Loan Agreement owed by the Company to the Substantial Shareholder and will indemnify any damages to be suffered by the Company under the Corporate Guarantee and/or the Property Pledge in the event that the Bank enforces the Corporate Guarantee and/or the Property Pledge.

The properties under the Property Pledge comprise a building (electricity substation) with gross floor area of approximately 1895.85 m² located in Songming County, Yunnan Province of the PRC and an industrial land with gross area of approximately 358991.55 m² located in Songming County, Yunnan Province of the PRC. The valuation of the building was approximately RMB4,040,000 and the valuation of the industrial land was approximately RMB134,210,000 as at 30 January 2017 based on the independent property valuation report dated 2 February 2017.

The Directors consider that the terms of the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge are on normal commercial terms, fair and reasonable and are in the interests of the Company and the Shareholders as a whole.

Condition precedent

The entering into of the Bank Loan Agreement, the Connected Loan Agreement and the provision of the Corporate Guarantee and the Property Pledge shall be subject to fulfillment of the following condition:

- (a) all necessary consents and approvals on the part of the Company in relation to the Connected Loan Agreement and the provision of the Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder having been obtained, including the passing of necessary resolution(s) by the Independent Shareholders at the EGM to approve the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder; and

In the event that the above conditions cannot be fulfilled on or before 31 May 2018 (or such other date as the parties to the Connected Loan Agreement may agree), the Company will not enter into of the Connected Loan Agreement and the Group will not provide the Corporate Guarantee and the Property Pledge.

LETTER FROM THE BOARD

REASONS FOR AND BENEFITS OF ENTERING INTO THE CONNECTED LOAN AGREEMENT AND THE PROVISION OF CORPORATE GUARANTEE AND PROPERTY PLEDGE

The Group is principally engaged in the research and development, design, manufacture and distribution of machine tool products. The Group's main products consists of, among others horizontal boring machine, large NC floor-type milling and boring machine, NC gantry-type boring and milling machine, NC planer-type boring and milling machine, jig boring machine, horizontal boring and milling machining center and precision rotary table.

Prior to the entering into of the Connected Loan Agreement, the Group entered into a loan facility agreement with the Bank with the same principal amount and pursuant to which the Company also provided property pledge in favour of the Bank. Due to the continuous losses of the Group, bank and financial institutions have lowered down the credit rating of the Company and banks are no longer willing to lend directly to the Company. After arm's length negotiations, the Bank in principal agrees to renew the existing loan by way of the Bank Loan Agreement with the borrower being the Substantial Shareholder (instead of the Company).

In order to maintain the loan facility for the Group, after the Substantial Shareholder having obtained borrowings from the Bank under the Bank Loan Agreement, the Substantial Shareholder will onward lend to the Company the same amount at the same interest rate. Due to the risk control requirements of the Bank, the Company still needs to provide Property Pledge as security for the Bank Loan borrowed by the Substantial Shareholder under the Bank Loan Agreement, which is consistent with the previous security requirements under the existing and previous bank credit arrangement between the Bank and the Company. Therefore, the Company has good reason to consider that the Property Pledge and Connected Loan Agreement are beneficial to the Company and in the interests of the Company and its Shareholders as a whole.

As (i) all the borrowings from the Bank under the Bank Loan Agreement from the Substantial Shareholders would be onward advanced to the Company at the same interest rate and terms under the Connected Loan Agreement; and (ii) the Group will make repayments to the Bank directly, the default risk on the part of the Substantial Shareholder under the Bank Loan Agreement would in fact be the default risk on the part of the Company to repay under the Loan Agreement. As such, the Company considers that the default risk on the part of the Substantial Shareholder under the Bank Loan Agreement would be relatively low.

In the unlikely event that the Company is required to make any payment to the Bank under the Corporate Guarantee, the Substantial Shareholder undertakes that it will waive the same amount under the Connected Loan Agreement owed by the Company to the Substantial Shareholder and will indemnify any damages to be suffered by the Company under the Corporate Guarantee and/or the Property Pledge in the event that the Bank enforces the Corporate Guarantee and/or the Property Pledge.

Based on above, the Directors (including the independent non-executive Directors whose recommendation is set out in the letter from the Independent Board Committee) consider that it is fair and reasonable for the Group to provide the Corporate Guarantee and the Property Pledge in favour of the Bank as security under the Bank Loan Agreement.

LETTER FROM THE BOARD

LISTING RULES IMPLICATIONS

As the Substantial Shareholder is the substantial shareholder of the Company, the Substantial Shareholder is a connected person of the Company under Chapter 14A of the Listing Rules and the entering into of the Connected Loan Agreement, the provision of Corporate Guarantee and the Property Pledge under the Bank Loan Agreement and the transactions contemplated thereunder also constitute connected transaction on the part of the Company under Chapter 14A of the Listing Rule and will be subject to, among others, the Independent Shareholders' approval at the EGM.

Each of Mr. Wang He, Mr. Zhang Xiaoyi, Mr. Peng Liangfeng, Mr. Liu Chunshi and Mr. Xia Changtao has abstained from voting at the relevant board resolution(s) approving the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder.

The Independent Board Committee comprising all the independent non-executive Directors has been established to advise the Independent Shareholders in respect of the terms of the Bank Loan Agreement, the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder. CCIC has been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in this regard.

EGM

The EGM will be convened and held at 9:30 a.m. on 8 May 2018 at Conference Room, 2nd Floor, Office Building, 23 Ciba Road, Kunming City, Yunnan Province, the People's Republic of China to consider and, if thought fit, approve the Connected Loan Agreement, the provision of Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder.

The resolution(s) will be put to the vote at the EGM by poll as required by the Listing Rules. A notice of the EGM is set out on pages 35 to 36 of this circular. At the EGM, the Substantial Shareholder and its associates are required to abstain from voting on the resolution(s) to approve the Connected Loan Agreement, the provision of Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder.

As at the Latest Practicable Date, the Substantial Shareholder and its associates controlled or entitled to exercise control over 133,222,774 A Shares (representing approximately 25.08% of the total Shares in issue of the Company). The Directors confirm that, after due and reasonable enquiries, except the Substantial Shareholder and its associates who have a material interest in the Connected Loan Agreement, the provision of Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder and are therefore required to abstain from voting on the resolution proposed to be approved by the Independent Shareholders at the EGM, no other Shareholders are known to the Directors to have a material interest in the Connected Loan Agreement, the provision of Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder and are required to abstain from voting at the EGM.

A form of proxy for use at the EGM is also enclosed with this circular. Whether or not you intend to attend the EGM, you are requested to complete and return the enclosed form of proxy in accordance with the instructions printed thereon and deposit it with the Company's Hong Kong branch share registrar and transfer office, Hong Kong Registrars Limited at Shops 1712-1716, 17/F., Hopewell Centre, 183 Queen's

LETTER FROM THE BOARD

Road East, Wanchai, Hong Kong as soon as possible and in any event not less than 48 hours before the time appointed 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 if you so wish.

Shareholders who intend to attend the EGM in person or by proxy should complete and sign the reply slip for the first EGM in 2018 despatched on 14 December 2017 in accordance with the instructions printed thereon and return it to the registered address of the Company at Room 310, office of board of directors, 23 Ciba Road, Kunming City, Yunnan Province, the People's Republic of China (post code: 650203) not later than 20 days before the date of EGM. Completion and return of the reply slip do not affect the right of a shareholder to attend the EGM.

RECOMMENDATION

The Directors (including the independent non-executive Directors whose recommendation is set out in the letter from the Independent Board Committee) consider that the Connected Loan Agreement, the provision of the Corporate Guarantee and the Property Pledge under the Bank Loan Agreement and the transactions contemplated thereunder are on normal commercial terms, fair and reasonable so far as the Company and the Independent Shareholders are concerned and in the interests of the Company and the Shareholders as a whole. Accordingly, the Directors recommend the Independent Shareholders to vote in favour of the resolution(s) to be proposed at the EGM to approve the Connected Loan Agreement, the provision of the Corporate Guarantee and the Property Pledge under the Bank Loan Agreement and the transactions contemplated thereunder.

Your attention is drawn to (i) the letter from the Independent Board Committee as set out on pages 11 to 12 of this circular which contains its recommendation to the Independent Shareholders in relation to the terms of the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder after taking into account the advice from CCIC; and (ii) the letter from CCIC as set out on pages 13 to 30 of this circular which contains its advice to the Independent Board Committee and the Independent Shareholders regarding the terms of the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder.

By order of the Board
Shenji Group Kunming Machine Tool Company Limited
Wang He
Executive Director

LETTER FROM THE INDEPENDENT BOARD COMMITTEE



沈機集團昆明機床股份有限公司
SHENJI GROUP KUNMING MACHINE TOOL COMPANY LIMITED
(A joint stock limited company incorporated in the People's Republic of China with limited liability)
(Stock Code: 0300)

20 April 2018

To the Independent Shareholders

Dear Sir or Madam,

**CONNECTED TRANSACTION:
PROVISION OF FINANCIAL ASSISTANCE TO CONNECTED PERSON
AND
NOTICE OF EXTRAORDINARY GENERAL MEETING**

We refer to the circular of the Company dated 20 April 2018 (the “**Circular**”) of which this letter forms part. Capitalised terms used herein have the same meanings as those defined in the Circular unless the context otherwise requires.

We have been appointed as members of the Independent Board Committee to advise you (i) as to whether, in our opinion, the Connected Loan Agreement and the provision of Corporate Guarantee and the Property Pledge under the Bank Loan Agreement are on normal commercial terms and in the ordinary and usual course of business of the Group, the terms of the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge are fair and reasonable so far as the Independent Shareholders are concerned, and the Connected Loan Agreement and the provision of Corporate Guarantee and the Property Pledge under the Bank Loan Agreement are in the interests of the Company and the Shareholders as a whole; and (ii) as to the voting in respect of the ordinary resolution to be proposed at the EGM to approve the Connected Loan Agreement and the provision of Corporate Guarantee and the Property Pledge under the Bank Loan Agreement. CCIC has been appointed as the Independent Financial Advisor to advise us and you in this regard. Details of their advice, together with the principal factors and reasons they have taken into account, are contained in their letter set out on pages 13 to 30 of the circular. Your attention is also drawn to the letter from the Board and the additional information set out in the appendices to the circular.

Having considered the terms of the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge and the advice and recommendation of CCIC, the Connected Loan Agreement and the provision of Corporate Guarantee and the Property Pledge under the Bank Loan Agreement are in the ordinary and usual course of business of the Group and on normal commercial terms, fair and reasonable so far as the Company and the Independent Shareholders are concerned and in the interests of the Company and

LETTER FROM THE INDEPENDENT BOARD COMMITTEE

the Shareholders as a whole. We therefore recommend the Independent Shareholders to vote in favour of the resolution(s) to be proposed at the EGM to approve the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge under the Bank Loan Agreement and the transactions contemplated thereunder.

Yours faithfully,

Independent Board Committee of

Shenji Group Kunming Machine Tool Company Limited

Mr. Na Chaohong

Mr. Chi Yilin

Ms. Jin Mei

Ms. Tian Ruihua

Independent non-executive Directors

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

The following is the text of a letter of advice from Central China International Capital Limited, the Independent Financial Adviser for the purpose of inclusion in this circular, to the Independent Board Committee and the Independent Shareholders regarding the Connected Loan Agreement, the provision of Corporate Guarantee and the Property Pledge under the Bank Loan Agreement of Shenji Group Kunming Machine Tool Company Limited.



Suites 3108,
Two Exchange Square,
8 Connaught Place,
Central, Hong Kong

20 April 2018

*To the Independent Board Committee and the Independent Shareholders of
Shenji Group Kunming Machine Tool Company Limited*

CONNECTED TRANSACTION PROVISION OF FINANCIAL ASSISTANCE TO CONNECTED PERSON

Dear Sir/Madam,

INTRODUCTION

We refer to our appointment as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the Connected Loan Agreement, the provision of Corporate Guarantee and the Property Pledge under the Bank Loan Agreement, details of which are set out in the letter from the Board (the “**Letter from the Board**”) contained in the circular of the Company dated 20 April 2018 (the “**Circular**”) issued to the Shareholders, of which this letter forms part. Terms used in this letter shall have the same meanings as those defined in the Circular and the appendix to the Circular, unless otherwise specified.

In an announcement dated 12 January 2018, the Company disclosed that (i) the Substantial Shareholder had entered into the Bank Loan Agreement with the Bank pursuant to which the Bank shall provide the Bank Loan Facility of up to RMB200 million to the Substantial Shareholder subject to the terms of the Bank Loan Agreement; and (ii) the Company as borrower and the Substantial Shareholder as lender will enter into the Connected Loan Agreement pursuant to which the Substantial Shareholder shall provide a unsecured loan facility of not more than RMB200 million to the Group subject to the terms of the Connected Loan Agreement.

It is a term of the Bank Loan Agreement that the (i) the Company will provide the Corporate Guarantee; and (ii) the Company will pledge the properties under the Property Pledge in favour of the Bank as security for the obligations and liabilities of the Substantial Shareholder under the Bank Loan Agreement. As such, the provision of the Corporate Guarantee and the Property Pledge for the obligations and liabilities of the Substantial Shareholder, which is a connected person of the Company as it owns 25.08% of the latter’s shares, constitutes a provision of financial assistance to a connected person and is therefore a connected transaction on the part of the Company under the Main Board Listing Rules.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

The Independent Board Committee comprising Mr. Na Chaohong, Mr. Chi Yilin, Ms. Jin Mei and Ms. Tian Ruihua has been established to advise the Independent Shareholders in respect of the terms of the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder. We, CCIC, have been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in this regard.

As at the Latest Practicable Date, we were not aware of any relationships or interest between us and the Company or any other parties that could reasonably be regarded as hindrance to our independence as defined under Rule 13.84 of the Listing Rules to act as the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders in respect of the Connected Loan Agreement and the provision of Corporate Guarantee and the Property Pledge.

We are not associated with the Company, its subsidiaries, its associates or their respective substantial shareholders or associates, and accordingly, are eligible to give independent advice and recommendations on the terms of the Connected Loan Agreement and the provision of Corporate Guarantee and the Property Pledge under the Bank Loan Agreement. Apart from normal professional fees payable to us in connection with this appointment as the independent financial adviser to the Independent Board Committee and the Independent Shareholders, no arrangement exists whereby we will receive any fees from the Company, its subsidiaries, its associates or their respective substantial shareholders or associates.

BASIS OF OUR OPINION

In formulating our opinion, advice and recommendation, we have relied on the statements, information, opinions and representations contained or referred to in the Circular and the information and representations as provided by the Directors and the management of the Company and have assumed that the information and facts provided and opinions expressed to us are true, accurate and complete in all material respects at the time they were made and up to the date of this letter. We have also sought and received confirmation from the management of the Company that no material facts have been omitted from the information supplied and opinions expressed to us. We have relied on such information and considered that the information we have received is sufficient for us to reach an informed view and have no reason to believe that any material information has been withheld, nor doubt the truth or accuracy of the information provided and to provide a reasonable basis for our recommendation. We have not, however, conducted any independent investigation into the businesses and affairs of the Group, nor have we carried out any independent verification on the information supplied.

The Directors have collectively and individually accepted full responsibility for the accuracy of the information contained in the Circular and have confirmed, having made all reasonable enquiries, which to the best of their knowledge and belief, that there are no other facts the omission of which would make any statement in the Circular misleading.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In giving our recommendation to the Independent Board Committee and the Independent Shareholders in respect of the terms of the Connected Loan Agreement and the provision of Corporate Guarantee and the Property Pledge, we have taken into consideration the following principal factors and reasons:

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

1. Background Information of the Group

The Group is principally engaged in the research and development, design, manufacture and distribution of machine tool products. The Group's main products consist of, among others horizontal boring machine, large NC floor-type milling and boring machine, NC gantry-type boring and milling machine, NC planer-type boring and milling machine, jig boring machine, horizontal boring and milling machining centre and precision rotary table.

Set out below is a summary of financial results of the Group which was extracted from the published financial reports of the Group for the six months ended 30 June 2017, two years ended 31 December 2016 and 31 December 2015, before the Company's H shares were suspended for trading on the Stock Exchange on 23 March 2017. As a result of the identification of accounting errors in the Company's annual reports, details of which are set out below, Independent Shareholders are reminded to treat these results with caution.

(a) For the 6-month period ended 30 June 2017

As set out in the interim report of the Company for the 6-month period ended 30 June 2017 (the "IR 2017"), the Group recorded unaudited revenue of approximately RMB274,846,147, representing an increase of approximately 8.56% from that for the 6-month period ended 30 June 2016 of approximately RMB253,174,146. According to the IR 2017, the increase in revenue was primarily attributable to the increased sales of a subsidiary company in the Group.

The Group recorded an unaudited net loss of approximately RMB154,665,502 for the 6-month period ended 30 June 2017, as compared to a net loss of approximately RMB108,922,583 for the 6-month period ended 30 June 2016. The increase in the net loss was due to higher operating costs which could not be offset by the higher revenue in the corresponding period.

As set out in the IR 2017, the Group had unaudited current assets of approximately RMB1,204,033,138 as at 30 June 2017 with cash at bank and on hand of approximately RMB89,757,802 and the Group's current liabilities as at 30 June 2017 were approximately RMB1,372,782,421.

(b) For the year ended 31 December 2016

According to a summary of the annual report of the Company for the year ended 31 December 2016 (the "AR 2016") published on 24 April 2017, the Group achieved sales revenue of RMB617,752,190.35, of which, sales revenue of machine tool was RMB594,996,715.94; comprehensive gross profit margin was 3.61%; net loss for the year attributable to shareholders of the Company was RMB209,295,551.74 and loss per share was RMB0.39.

In an announcement dated 14 April 2017, the Company's then auditors were quoted as saying that due to the fact that they had not been able to obtain sufficient appropriate audit evidence as the basis for expressing audit opinions, they would issue a disclaimer of opinion in respect of the financial statements of the Group for the year ended 2016. In another statement dated 14 September 2017, the Company disclosed that it had received auditors' report with "disclaimer of opinion" for the AR 2016, and the Company was suspected of financial irregularities and was being investigated by

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the China Securities Regulatory Commission (the “CSRC”), according to relevant requirements. As a result, the Company is required to conduct re-auditing of the AR 2016. A revised AR 2016 is yet to be issued to date.

(c) For the year ended 31 December 2015

As set out in the annual report of the Company for the 12 months period ended 31 December 2015 (the “AR 2015”), the Group recorded audited revenue of approximately RMB776,594,761, representing a decrease of approximately 10.52% from that the unaudited revenue for the year ended 31 December 2014 of approximately RMB867,889,305. According to AR 2015, operating income inched down on a year-on-year basis because machine tool market demand decreased amid slowdown of global economic growth, although the Company had proactively adjusted its product mix and intensified promotion and sales.

The Group recorded an audited net loss of RMB219,653,196 as compared to an audited net loss for the year ended 31 December 2014 of approximately RMB209,463,320. The increase of loss was mainly due to the increased finance expenses of RMB35,097,267 for the year ended 31 December 2015 compared to RMB17,591,439 for the year ended 31 December 2014 and the increased asset impairment losses of RMB 67,139,035 for the year ended 31 December 2015 compared to RMB36,349,437 for the year ended 31 December 2014, which was partly offset by generally decreased operating expenses.

As set out in the AR 2015, the Group has audited current assets of approximately RMB1,464,752,150 as at 31 December 2015 in which cash and cash equivalents approximately RMB84,429,583 and the Group’s current liabilities as at 31 December 2015 were approximately RMB1,299,000,328.

2. Background and reasons for the entering into of Connected Loan Agreement and the provision of Corporate Guarantee and the Property Pledge

As advised and confirmed by the management of the Company, prior to entering into the Connected Loan Agreement, the Group had entered into a loan facility agreement with the Bank (the “**Previous Loan Agreement**”), which has the same principal amount as in the Bank Loan Agreement, and pursuant to which the Company also provided property pledge in respect of the same properties under the Property Pledge in favour of the Bank as per the Bank Loan Agreement. Pursuant to the Bank Loan Agreement, all the loans extended to the Substantial Shareholder in respect of the Bank Loan Facility can only be used for settlement of the loans extended to the Company under the Previous Loan Agreement between the Company and the Bank.

As further confirmed by the management of the Company, the Company is concerned that due to the deteriorating financial position of the Group (for example, the Group recorded unaudited revenue of approximately RMB253,174,146 for the six months ended 30 June 2016, representing a decrease of approximately 47.41% from that for the corresponding period in 2015), banks and financial institutions are no longer prepared to lend directly to the Company and that they are inclined to lower the credit rating of the Company.

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After arm's length negotiations between the Bank and the Company, the Bank in principle agrees to renew the loan under the Previous Loan Agreement by entering into the Bank Loan Agreement with the Substantial Shareholder replacing the Company as the borrower. Pursuant to the Bank Loan Agreement, (i) all the loans from the Bank extended to the Substantial Shareholder under the Bank Loan Agreement would be onward lent to the Company at the same interest rate and terms under the Connected Loan Agreement; and (ii) the Group will make repayments to the Bank directly. The Company is required to provide the Corporate Guarantee and the Property Pledge as security for the Bank Loan Facility provided to the Substantial Shareholder under the Bank Loan Agreement. For its part, the Substantial Shareholder will not provide any collaterals/securities in favour of the Bank.

It is also noted that in the event that the Company is required to make any payment to the Bank under the Corporate Guarantee, the management of the Company indicated the Substantial Shareholder might undertake to the effect of waiving the same amount under the Connected Loan Agreement owed by the Company to the Substantial Shareholder and indemnifying any damages to be suffered by the Company under the Corporate Guarantee and/or the Property Pledge in the event that the Bank enforces the Corporate Guarantee and/or the Property Pledge (the "**Undertaking**").

For the above reasons, the Directors consider that Connected Loan Agreement and the provision of the Corporate Guarantee and the Property Pledge are beneficial to the Company and in the interests of the Company and the Shareholders as a whole.

Having noted that (i) the poor financial situation of the Group may deter banks and other financial institutions from extending to the Company new loans and/or renewing existing credit lines; (ii) the proposed terms under the Connected Loan Agreement are no less favourable than the terms under the Bank Loan Agreement; and (iii) the requirement of the Company to provide security for the Bank Loan Facility under the Bank Loan Agreement is a reasonable one by the Bank to ensure repayments of the obligations arising from the Bank Loan Agreement, we concur with the view of the Directors that it is fair and reasonable for the Company and in the interest of the Company and the Independent Shareholders as a whole to (i) enter into the Connected Loan Agreement; and (ii) provide the Corporate Guarantee and the Property Pledge in favour of the Bank as security under the Bank Loan Agreement.

3. Principal terms of the relevant agreements

Bank Loan Agreement

Date:	22 December 2017
Parties:	(i) the Substantial Shareholder as borrower; and (ii) the Bank as lender
Loan facilities amount:	up to RMB200 million
Interest rate:	4.9875%
Term:	15 months, from the date of first drawing of the Bank Loan Facility

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Security:	(i) the Corporate Guarantee; and (ii) the Property Pledge
Purpose:	to effect a loan subject replacement (貸款主體置換).
Default:	default occurs if the Substantial Shareholder fails to make payments to the Bank to discharge its obligations under the Bank Loan Agreement before the end of the term of the loan, i.e., 15 months.
Breach of terms	<p>the circumstances under which the Substantial Shareholder would breach the terms of the Bank Loan Agreement include, but are not limited, to the following:</p> <ul style="list-style-type: none">• the Substantial Shareholder fails to pay the principal of the loan amount together with interests under the Bank Loan Agreement;• the Substantial Shareholder fails to put the loan amount to the use as stipulated under the Bank Loan Agreement;• warranties given by the Substantial Shareholder under the Bank Loan Agreement are incorrect, untrue or misleading;• the Substantial Shareholder fails to honour any commitment promised under the Bank Loan Agreement;• the Substantial Shareholder's operational performance and financial situation have deteriorated substantially; and• the Substantial Shareholder has breached other terms of the Bank Loan Agreement.
Consequences of breach of terms	<p>if there is a breach of the terms of the Bank Loan Agreement, the Bank is entitled to take the following measures, without limitation, either singly or jointly:</p> <ul style="list-style-type: none">• demand that the Substantial Shareholder correct the breach within a stipulated time period;• cancel the balance of the loan extended to the Substantial Shareholder;• demand additional collateral from the Substantial Shareholder;• enforce the Corporate Guarantee and/or Property Pledge; and

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- exercise its rights prescribed under the Bank Loan Agreement and by law.

Connected Loan Agreement

Parties:	(i) the Company as borrower; and (ii) the Substantial Shareholder as lender
Loan facilities amount:	up to RMB200 million
Interest rate:	4.9875%
Term:	15 months
Execution date	within five Business Days after obtaining Independent Shareholders' approval at the EGM

Condition precedent

The entering into of the Bank Loan Agreement, the Connected Loan Agreement and the provision of the Corporate Guarantee and the Property Pledge shall be subject to fulfillment of the following condition:

- (a) all necessary consents and approvals on the part of the Company in relation to the Connected Loan Agreement and the provision of the Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder having been obtained, including the passing of necessary resolution(s) by the Independent Shareholders at the EGM to approve the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder; and
- (b) In the event that the above conditions cannot be fulfilled on or before 31 May 2018 (or such other date as the parties to the Connected Loan Agreement may agree), the Company will not enter into the Connected Loan Agreement and the Group will not provide the Corporate Guarantee and the Property Pledge.

In order to assess the fairness and reasonableness of the terms of the Connected Loan Agreement, the Corporate Guarantee and the Property Pledge, we have conducted the following analysis.

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4. Analysis of the relevant agreements

4.1 Summary of the principal terms of the Connected Loan Agreement

The Company has provided us with a sample copy of the Corporate Loan Agreement (資金統借統還協議), which consists of two agreements, for the loan amounts of RMB141,665,275.66 and RMB50,000,000, respectively. The terms of these two agreements are identical, except for the different loan amounts, and are summarised below.

Nature	Terms
Type of loan:	Unified borrowing and repaying loans (資金統借統還)
Purpose of loan:	Replace the Company as borrower of loans with the Bank
Interest rate:	4.9875%
Duration of loan:	15 months
Subject matter:	<p>Pursuant to terms of this agreement, the Substantial Shareholder shall provide the Group a unsecured loan facility of up to RMB200 million (the “Connected Loan Facility”), which shall constitute unsecured indebtedness of the Group.</p> <p>The Company will draw the amount under the Connected Loan Facility equivalent to the amount to be drawn under the Bank Loan Facility immediately after the entering into of the Connected Loan Agreement to repay the existing outstanding indebtedness owed by the Company to the Bank. Any repayment by the Group to the Bank directly will automatically offset against the indebtedness of the Group under the Connected Loan Facility.</p>
Rights and obligations:	<ul style="list-style-type: none">• The borrower is entitled to use the loan as per the purpose and duration of the loan as stipulated in this contract.• The borrower should discharge its obligations (principal + interest) arising from this contract; and• Unless with express written consent from the lender, the borrower cannot transfer to a third party its obligations arising from this contract.

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Default: If the borrower does not use the loan amount in the manner stipulated for in this contract, the lender is entitled to call in the full amount of the loan and add a 5% interest on top of the loan amount.

According to the management of the Company, the Substantial Shareholder knows full well the Company's purpose of using the funds under the Connected Loan Agreement, and the Substantial Shareholder is unlikely to withhold the funds to be lent to the Company, since to do so would only damage its corporate image and credit rating.

4.2 Assessment of the Corporate Guarantee and the Property Pledge

(a) Principal terms

A summary of the principal terms of the Corporate Guarantee and the Property Pledge are as follows:

Corporate Guarantee

Guarantor: The Company

Lender: The Bank

Reference contract: The Bank Loan Agreement

Guaranteed amount: Bank Loan Facility + Interest + other applicable fees and charges

Default: Defaulting circumstances include, but are not limited to, the following:

- breach of the terms of the Bank Loan Agreement by the Substantial Shareholder;
- any warranties given by the Company under the Corporate Guarantee are incorrect, untrue or misleading;
- the engagement of any conduct by the Company which may cause serious impact to its economic situation and operations; breach of any undertakings and/or other terms by the Company under the Corporate Guarantee;

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- the occurrence of event such as liquidation or material litigation which would cause material adverse effects on the financial position of the Company and its performance of the obligations arising from the Corporate Guarantee; and
- the occurrence of any event which would (i) contravene the guarantor's obligations; or (ii) adversely impact the rights of the Bank under the Corporate Guarantee.

Lender's rights upon default:

Upon default, the Bank is entitled to, among others, to immediately demand the borrower, i.e. the Substantial Shareholder, to make all the outstanding payments under the Bank Loan Agreement.

Property Pledge

Pledgor:

The Company

Pledgee:

The Bank

Reference contract:

The Bank Loan Agreement

Guaranteed amount:

Bank Loan Facility

Properties pledged:

A building (electricity substation) with gross floor area of approximately 1,895.85 m² located in Songming County, Yunnan Province of the PRC and an industrial land with gross area of approximately 358,991.55 m² located in Songming County, Yunnan Province of the PRC (collectively the "**Properties**"). As per the report dated 2 February 2017 issued by an independent property valuer in the PRC, the valuation of the building was approximately RMB4,040,000 and the industrial land was approximately RMB134,210,000 as at 30 January 2017.

Default:

Defaulting circumstances include, but are not limited, to the following:

- breach of the terms of the Bank Loan Agreement by the Substantial Shareholder;
- any warranties given by the Company under the Property Pledge are incorrect, untrue or misleading;

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- any seizure, confiscation and purchase of the Properties regardless of compensation being paid or not;
- the Company, among others, sell or rent out the Properties without permission;
- the occurrence of event such as liquidation or material litigation which would cause material adverse effects on the financial position of the Company and its performance of the obligations arising from the Property Pledge;
- the engagement of any conduct by the Company which would reduce the value of the Properties;
- the occurrence of any event which would (i) contravene the guarantor's obligations; or (ii) adversely impact the rights of the Bank under the Property Pledge.

Pledgee's rights upon default

Upon default, the Bank is entitled to, among others, (i) come to agreement with the Company to dispose of the Properties; or (ii) auction off the Properties.

For the avoidance of doubt, the Corporate Guarantee and the Property Pledge shall be subject to the approval of the Independent Shareholders' approval at the EGM and will only become effective with the approval of the Independent Shareholders at the EGM.

As mentioned in the Company's announcement dated 12 January 2018, the Company will execute the Corporate Guarantee and the Property Pledge in favour of the Bank as security for the obligations and liabilities of the Substantial Shareholder under the Bank Loan Agreement. This requirement is also consistent with the risk control requirement of the Substantial Shareholder. It follows that should the Substantial Shareholder be in default under the Bank Loan Agreement, the Bank shall be entitled to enforce the Corporate Guarantee and the maximum possible liability of the Company to be borne by the Company would be the outstanding Bank Loan Facility plus interest accrued thereon. In the case of the enforcement of the Property Pledge by the Bank, the Company may be subject to the disposal of the Properties under the Property Pledge for the repayment of such outstanding amount.

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(b) Disclosure of accounting errors

In an announcement dated 27 April 2017, the Company disclosed, among others, that following the identification of discrepancies during the audit for the preparation of the AR 2016, the Company had launched a self-inspection scheme according to requirements and conducted correction of accounting errors in the annual reports of 2013, 2014 and 2015 (collectively the “**Annual Reports**”). Amongst the discrepancies identified in the Annual Reports was the failure of internal control and other reasons which resulted in the consolidated income statements and income statements in the Annual Reports, (i) an overstatement of the Company’s main business income of RMB470,670,958.87; (ii) main business cost and bad debt provision by RMB190,267,128.61 and RMB36,094,476.58, respectively; (iii) provisions relevant to main business income by RMB2,589,621.36; (iv) main business taxes and surcharges by RMB9,601,687.58; and (v) an understatement of general and administrative expenses by RMB29,608,616.03.

The announcement ended by stating that the Company was required to engage an accounting firm with suitable qualifications to conduct audit on the amended annual reports. The Company would continue to communicate with the accountants to correct the accounting errors and disclose the corrected Annual Reports as audited by the accounting firm. The final data in the correction shall be subject to the data as audited by the accounting firm.

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(c) *Bank loans*

Further, the Company has confirmed that it had borrowed money from the following banks:

Name	Collateral	Interest rate	Term loan (dd-mm-yy)	Loan amount (RMB, '000)
Bank of Communications Co., Ltd. (交通銀行)	Corporate guarantee by parent group	5.6550%	1 year (26.06.2017 – 26.06.2018)	30,000
Bank of Communications Co., Ltd. (交通銀行)	Corporate guarantee by parent group	6.3075%	1 year (29.06.2017 – 29.06.2018)	30,000
Bank of Communications Co., Ltd. (交通銀行)	Corporate guarantee by parent group	6.3075%	1 year (05.07.2017 – 05.07.2018)	30,000
Bank of Communications Co., Ltd. (交通銀行)	Corporate guarantee by parent group	6.3075%	1 year (10.07.2017 – 10.07.2018)	30,000
Bank of Communications Co., Ltd. (交通銀行)	Corporate guarantee by parent group	6.3075%	1 year (12.07.2017 – 12.07.2018)	15,000
HengFeng Bank Co., Ltd (恒豐銀行)	Corporate guarantee by parent group	5.2200%	1 year (14.07.2017 – 13.07.2018)	70,000
China Guangfa Bank (廣發銀行)	Corporate guarantee by parent group	5.2200%	1 year (26.10.2017 – 25.10.2018)	20,000
China Guangfa Bank (廣發銀行)	Corporate guarantee by parent group	5.2200%	1 year (02.11.2017 – 01.11.2018)	20,000
Total				245,000

According to the management of the Company, none of the above-mentioned banks have provided it with any firm indication as to whether they would or would not be prepared to further lend directly to the Company.

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(d) Our view on the fairness and reasonableness of the Corporate Guarantee and the Property Pledge

Given that the Company is required to (i) correct the accounting errors as described above which would impact negatively on its financial performance from 2013 to 2015; and (ii) discharge its obligations arising from the loans set out above which have been extended to it by the above-mentioned banks, there are legitimate concerns over whether or not the Company would possess sufficient financial resources to make full payments to the Bank should the latter enforce the Corporate Guarantee and/or the Property Pledge. If the Company does not possess the financial resources to make such payments, this might have a bearing on the assessment of the fairness and reasonableness of the terms of the Corporate Guarantee and the Property Pledge.

We are of the view that these concerns should be viewed together with the following observations. Firstly, in light of the negative publicity caused by, among others, (i) the necessary adjustments to be made to the Company's accounts caused by the accounting errors; (ii) the investigation by the CSRC of the accounting errors in the Annual Reports and other related matters (see the Company's announcements dated 16 May 2017, 16 June 2017 and 12 February 2018); (iii) the suspension of trading in the Company's H shares and A shares since March and May 2017, respectively; and (iv) the resumption conditions which the Company has to meet for lifting the trading suspension of its H shares (see the Company's announcement dated 21 June 2017), it would be relatively difficult for the Company to raise any future loans from banks and other financial institutions. The Bank Loan Agreement and the Connected Loan Agreement may therefore be one of the few means that the Company may be able to obtain funding for continuous business operations. Should the proposed arrangements be rejected by the Independent Shareholders at the EGM, this may cause significant disruption to the Company's existing business operations and future development.

With respect to the Bank Loan Facility, the management of the Company has indicated to the following effect: (i) if the Connected Loan Agreement could not be submitted to the EGM for approval as soon as possible, the Company would face serious disruptions to its business operations; (ii) the Bank can always resort to the Properties subject to the Property Pledge, which, as mentioned before, have an estimated value of approximately RMB134.2 million in total, for repayment of the loan; and (iii) finally, given the Company's financial situation, the Company is likely to negotiate with other banks or the Bank to renew the Bank Loan Facility when the 15-month is up.

Secondly, while we noted the following: (i) the estimated value of the Properties is approximately RMB134.2 million; (ii) the consolidated cash flow statement in the unaudited consolidated interim results of the Company for the period ended 30 June 2017 has shown, among others, cash and cash equivalents at the end of the 6-month period (i.e. 30 June 2017) was approximately RMB89.7 million; and (iii) upon request, the Company has also provided us with the estimated cash flow statement for 2018 and the contracts which it had entered into as at 26 March 2018; however, given that the value of the Properties subject to the Property Pledge may not be sufficient to cover the full amount of the loan and that the issue of the accounting errors was still unresolved, we are unable at this stage to opine on whether or not

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the Company is likely to possess, on balance, sufficient financial resources to make full payments to the Bank should the latter enforce the Corporate Guarantee and/or the Property Pledge.

Finally, even in the absence of the Undertaking, the Company is of the view, with which we concur, that the Substantial Shareholder, which is a State-owned enterprise with relatively low default risk and has net assets of approximately RMB1 billion based on its 2017 annual report, is most likely to come to the Company's aid when the Bank enforces the Corporate Guarantee as any failure to do so would be likely to sully the credibility and credit rating of the Substantial Shareholder which has enjoyed strong support from the Central Government.

Notwithstanding the above-mentioned factors such as the unresolved issue of accounting errors and the value of the Properties subject to the Property Pledge may not be able to cover the full loan amount, we note that the Company is facing various difficulties and the Connected Loan Agreement will thus help alleviate its problems and improve the Company's finances and provide it with more resources to run its business operations. If the Connected Loan Agreement fails to be approved, it will further exacerbate the problems the Company is facing. Based on the above, we are of the view that the Connected Loan Agreement is, on balance, fair and reasonable and in the interests of the Company and the Shareholders as a whole.

4.3 Assessment of the Company's default risk

As mentioned before, (i) all the loans from the Bank extended to the Substantial Shareholders under the Bank Loan Agreement would be onward lent to the Company at the same interest rate and terms under the Connected Loan Agreement; and (ii) the Group will make repayments to the Bank directly. Under this arrangement, the default risk on the part of the Substantial Shareholder under the Bank Loan Agreement would in fact be the default risk on the part of the Company to repay the loan under the Previous Loan Agreement, which has been secured by the Corporate Guarantee/Property Pledge. Moreover, in the event that the Company is required to make any payment to the Bank under the Corporate Guarantee, the Substantial Shareholder undertakes that it will waive the same amount under the Connected Loan Agreement owed by the Company to the Substantial Shareholder and will indemnify any damages to be suffered by the Company under the Corporate Guarantee and/or the Property Pledge in the event that the Bank enforces the Corporate Guarantee and/or the Property Pledge. All things considered, the Company is of the view, with which we concur, that the Company's default risk would be relatively low.

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4.4 *Assessment of the interest rate of 4.9875%*

(a) *The setting of the interest rate under the Bank Loan Facility*

We note that the People's Bank of China (the "PBOC") benchmark rate for a one-year loan was 4.35% per annum. We further note that the current RMB Loan Prime Rate for loan tenor between 1 to 5 years (including 5 years) is 4.75%. Given that the interest rate of the Bank Loan Facility is a reference to the RMB interest rate set by the PBOC, which is a benchmark, and the Bank is an independent third party to the Company, we are of the view that the interest rate of the Bank Loan Facility is on normal commercial terms, fair and reasonable so far as the Company and the Independent Shareholders are concerned.

(b) *The interest rate of 4.9875% per annum*

We understand that the definition of normal commercial terms under chapter 14A of the Main Board Listing Rules are terms which a party could obtain if the transaction were on an arm's length basis or terms no less favourable to the listed issuer's group than terms available to or from independent third parties. Bearing this in mind, we have attempted to compare interest rates for RMB loans charged by commercial banks in the PRC extended to the companies which meet the following criteria for comparison: (i) they are engaged in similar business activities as the Company's; (ii) they are listed on the Stock Exchange, the Shenzhen Stock Exchange or the Shanghai Stock Exchange; (iii) they have recently raised loans denominated in RMB with commercial banks in the PRC with terms more than 12 months; and (iv) the loans are still ongoing to date. To our best knowledge and endeavor, we have identified three companies which fully meet the selection criteria set out above and which we believe to be exhaustive. The companies identified for comparison with the Company are: (i) Shenyang Machine Tool Co. Ltd. (瀋陽機床股份有限公司) (stock code: 000410.SZ); and (ii) Qinchuan Machine Tool & Tool Group Share Co. Ltd. (秦川機床工具集團股份有限公司) (stock code: 000837.SZ), both of which are listed on the Shenzhen Stock Exchange whereas (iii) China First Heavy Industries Co. Ltd. (中國第一重型機械股份有限公司) (stock code: 601106.SH) is listed on the Shanghai Stock Exchange.

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The following table contains information on the loans raised by these three companies which is extracted from (i) the 2016 annual reports of Qinchuan Machine Tool & Tool Group Share Co. Ltd. (“**QMTT**”) and China First Heavy Industries Co. Ltd. (“**CFHI**”); and (ii) the 2017 annual report of Shenyang Machine Tool Co. Ltd. (“**SMTCL**”), respectively.

Name	Nature of technologies developed and manufactured	Loan amount (RMB)	Term loan	Collateral	Range of interest rates paid for RMB loans of more than 12 months
QMTT	• Wheel gear grinding machine	• 300,000,000.00	• 19 August 2016 – 31 July 2019	• Corporate guarantee by Shaanxi Electronic Information Group Co. Ltd. (“ SEC ”) (陝西電子信息集團有限公司)	• 4.45%
		• 300,000,000.00	• 15 August 2016 – 31 July 2019	• Corporate guarantee by SEC	• 4.45%
CFHI	• Heavy machinery • Metal products designs, manufacture, installation and repair	• 350,000,000.00	• 30 June 2016 – 29 June 2018	• Share pledge guarantee over parent company’s CFHI holding	• 4.275%
SMTCL	• General machine tools • Computer numerical control machine tools (CNC machine tools)	• 36,300,000.00	N/A (note 1)	• Property pledge by group subsidiary	• 4.35%- 5.88%
		• 17,059,862.76		• Corporate guarantee by group subsidiary	• 4.35%- 5.88%

Note 1: not disclosed in the annual report

As can be seen from the above table, the interest rates which the surveyed companies paid for RMB loans of more than 12 months to the commercial banks in the PRC range from 4.275% to 5.88% (the “**Comparable IR Range**”). The interest rate of 4.9875% per annum lies within the Comparable IR Range.

Given that the interest rate of 4.9875% was determined upon arm’s length negotiation between the Bank and the Substantial Shareholder under the Bank Loan Agreement and it lies within the Comparable IR Range, we are of the view that the interest rate of 4.9875% is on normal commercial term. Having further considered that the interest rate in the Connected Loan Agreement will not exceed 4.9875%, we are of the view that the interest rate of 4.9875% is fair and reasonable.

Noting that the interest rate of 4.9875% per annum under the Bank Loan Agreement are the actual interest rate charged under that Agreement and has been agreed upon at arm’s length between the Substantial Shareholder and the Bank, which is a licensed commercial bank regulated by the China Banking Regulatory Commission in the PRC and independent of the

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Company and the Substantial Shareholder, we are of the view that the interest rate of 4.9875% is on normal commercial terms, fair and reasonable so far as the Company and the Independent Shareholders are concerned.

4.5 Assessment of the Undertaking

As described in the Letter from the Board of the Circular, the purpose of the Undertaking is to provide for the situation where the Company is required to make any payment to the Bank under the Corporate Guarantee. The Substantial Shareholder undertakes that it will waive the same amount under the Connected Loan Agreement owed by the Company to the Substantial Shareholder and indemnify any damages that the Company will suffer in the event that the Bank enforces the Corporate Guarantee and/or the Property Pledge.

RECOMMENDATION

Having taken into account the principal factors and reasons referred to above, we are of the view that the Connected Loan Agreement and the provision of the Corporate Guarantee and the Property Pledge are, on balance, on normal commercial terms and their terms are fair and reasonable so far as the Independent Shareholders are concerned and in the interests of the Company and the Shareholders as a whole. Accordingly, we advise the Independent Shareholders and recommend the Independent Board Committee to advise the Independent Shareholders to vote in favour of the resolution(s) for these transactions at the EGM.

Yours faithfully,
For and on behalf of
Central China International Capital Limited
Billy C. W. Cheung
General Manager

Note: Mr. Cheung is a licensed person under the SFO to engage in type 1 (dealing in securities) and type 6 (advising on corporate finance) regulated activities. He has over 20 years of experience in corporate finance.

1. RESPONSIBILITY STATEMENT

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

2. DIRECTORS' INTERESTS IN THE SHARES, UNDERLYING SHARES AND DEBENTURES OF THE COMPANY OR ITS ASSOCIATED CORPORATIONS

As at the Latest Practicable Date, none of the Directors or chief executives of the Company had any interest or short position in the Shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which were required:

- (a) to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including any interests and short positions which he/she was taken or deemed to have under such provisions of the SFO); or
- (b) pursuant to section 352 of the SFO, to be entered in the register maintained by the Company referred to therein; or
- (c) pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers contained in the Listing Rules, to be notified to the Company and the Stock Exchange.

As of the Latest Practicable Date, save that certain executive Directors also held office as directors of the Substantial Shareholder, none of the Directors was a director or employee of a company which had an interest or short position in the Shares and underlying Shares of the Company which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO.

3. INTERESTS OF SUBSTANTIAL SHAREHOLDERS

As of the Latest Practicable Date, so far as is known to the Directors or the chief executives of the Company, the following persons (other than a Director or chief executive of the Company) had an interest or short position in the Shares or underlying Shares which fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or recorded in the register kept by the Company pursuant to Section 336 of the SFO, or who were, directly or indirectly interested in 5% or more of the issued voting shares of any other member of the Group:

Name of Shareholder	Class of Shares	Number of issued Shares held	Approximate percentage of the existing issued share capital of the Company
The Substantial Shareholder	A Shares	133,222,774	25.08%
Yunnan Industrial Investment Holding Group Company Limited* (雲南省工業投資控 股集團有限責任公司)	A Shares	34,153,444	6.43%

Note: As at the Latest Practicable Date, the Company's total issued share capital comprised 531,081,103 Shares, including 390,186,291 A Shares and 140,894,812 H Shares.

Save as disclosed above, so far as is known to the Directors or chief executive of the Company as at the Latest Practicable Date, no other person had an interest or short position in the Shares or underlying Shares which fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or recorded in the register kept by the Company pursuant to Section 336 of the SFO, or who were, directly or indirectly interested in 10% or more of the issued voting shares of any other member of the Group.

4. COMPETING BUSINESS

As at the Latest Practicable Date, none of the Directors and their respective close associates had any interests in any business which competes or was likely to compete, either directly or indirectly, with the Group's business.

5. SERVICE CONTRACTS

As at the Latest Practicable Date, no Director had a service contract with any member of the Group which is not determinable within one year without payment of compensation other than statutory compensation.

6. DIRECTORS' INTEREST IN ASSETS

None of the Directors had any direct or indirect interest in any asset which had been, since 31 December 2015 (being the date to which the latest published audited financial statements of the Group were made up) and up to the Latest Practicable Date, acquired or disposed of by or leased to or are proposed to be acquired or disposed of by or leased to any member of the Group.

7. DIRECTORS' INTEREST IN CONTRACTS

There was no contract of significance in relation to the Group's business to which the Company, its subsidiaries, its fellow subsidiaries or its holding company was a party and in which a Director had a material interest, whether directly or indirectly, subsisting as at the Latest Practicable Date.

8. MATERIAL ADVERSE CHANGE

As at the Latest Practicable Date, save as previously announced, the Directors were not aware of any material adverse change in the financial or trading position of the Group since 31 December 2015, being the date to which the latest audited financial statements of the Group were made up.

9. EXPERT AND CONSENT

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

Name	Qualification
CCIC	A licensed corporation to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities under the SFO

CCIC has given and has not withdrawn its written consent to the issue of this circular with the inclusion of its letter and references to its name in the form and context in which it appears.

As at the Latest Practicable Date, CCIC did not have any shareholding in any member of the Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group, or any interests, directly or indirectly, in any assets which have been, since 31 December 2015, being the date to which the latest published audited financial statements of the Group were made up, acquired, disposed of or leased to any member of the Group, or were proposed to be acquired, disposed of or leased to any member of the Group.

10. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents are available for inspection during normal business hours from 9:00 a.m. to 5:00 p.m. on any weekdays (except public holidays) at the head office and principal place of business of the Company in the PRC at 23 Ciba Road, Kunming City, Yunnan Province, the PRC from the date of this circular up to the date of EGM

- (i) the letter from the Independent Board Committee to the Independent Shareholders, the text of which is set out on pages 11 to 12 of this circular;
- (ii) the letter of advice from CCIC to the Independent Board Committee and the Independent Shareholders, the text of which is set out on pages 13 to 30 of this circular;
- (iii) the Connected Loan Agreement;

- (iv) the Bank Loan Agreement;
- (v) the Corporate Guarantee and the Property Pledge; and
- (vi) this circular.

11. MISCELLANEOUS

- (a) The registered address of the Company is at 23 Ciba Road, Kunming City, Yunnan Province, the PRC.
- (b) The H Share registrar and transfer office of the Company in Hong Kong is Hong Kong Registrars Limited, at Shops 1712-1716, 17/F., Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong.
- (c) In the event of inconsistency, the English texts of this circular and the enclosed form of proxy shall prevail over the Chinese texts.

SUPPLEMENTAL NOTICE OF EGM



沈機集團昆明機床股份有限公司 SHENJI GROUP KUNMING MACHINE TOOL COMPANY LIMITED

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

(Stock Code: 0300)

Reference is made to the notice of the first extraordinary general meeting of 2018 (the “**Meeting**”) of Shenji Group Kunming Machine Tool Company Limited (the “**Company**”) dated 14 December 2017 (the “**EGM Notice**”) and the announcement of the Company dated 30 January 2018 and the announcement of the Company dated 17 April 2018 on the postponements of the EGM, which set out the time and venue of the EGM and contains the resolutions to be tabled before the EGM for approval by the Company’s shareholders.

NOTICE IS HEREBY GIVEN that the meeting will be held at 9:30 a.m. on 8 May 2018 at Conference Room, 2nd Floor, Office Building, 23 Ciba Road, Kunming City, Yunnan Province, the People’s Republic of China for the purpose of considering and, if thought fit, passing the following resolutions with or without amendments as ordinary resolutions, in addition to the proposed resolutions set out in the EGM Notice and the announcement of the Company dated 30 January 2018:

ORDINARY RESOLUTIONS

1. “**THAT**

- (a) the loan agreement (the “**Connected Loan Agreement**”) to be entered into within five (5) business days after passing this resolution between 瀋陽機床(集團)有限責任公司 (Shenyang Machine Tool (Group) Company Limited*) (the “**Substantial Shareholder**”) as lender and the Company as borrower in relation to, among others, the provision of the unsecured loan facility up to RMB200 million by the Substantial Shareholder to the Company and its subsidiaries (a copy of which is marked “A” and produced to the Meeting and signed by the chairman of the Meeting for identification purpose) and the transactions contemplated thereunder be and are hereby ratified, confirmed and approved and the directors of the Company (the “**Directors**”) be and hereby authorised to do all such acts and things and execute all such documents (including but not limited to the Connected Loan Agreement) which they consider necessary, desirable or expedient for the implementation of and giving effect to the Connected Loan Agreement and the transactions contemplated thereunder; and
- (b) any Director be and is hereby authorised for and on behalf of the Company to execute all such other documents, instruments and agreements (whether under common seal or not) and to do all such acts or things deemed by him/her/them to be incidental to, ancillary to or in connection with the matters contemplated in the Connected Loan Agreement and the transactions contemplated thereunder as he/she/they may in his/her/

SUPPLEMENTAL NOTICE OF EGM

their absolute discretion consider necessary, desirable or expedient to give effect to the Connected Loan Agreement and the implementation of all transactions contemplated thereunder and to agree with such variation, amendment or waiver as, in the opinion of the Directors, in the interest of the Company and its shareholders as a whole.”

2. **“THAT**

- (a) the bank loan agreement (the **“Bank Loan Agreement”**) between an independent PRC licensed commercial bank (the **“Bank”**) and the Substantial Shareholder in relation to, among others, the provision of the bank loan facility up to RMB200 million by the Bank to the Substantial Shareholder secured by, among others, the relevant corporate guarantee (the **“Corporate Guarantee”**) to be provided the Company and the property pledge of PRC properties held by the Company and its subsidiaries (the **“Property Pledge”**) (a copy of which is marked “A” and produced to the Meeting and signed by the chairman of the Meeting for identification purpose) and the transactions contemplated thereunder be and are hereby ratified, confirmed and approved and the Directors be and are hereby authorised to do all such acts and things and execute all such documents (including but not limited to the Corporate Guarantee and the Property Pledge) which they consider necessary, desirable or expedient for the implementation of and giving effect to the Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder; and

- (b) any Director be and is hereby authorised for and on behalf of the Company to execute all such other documents, instruments and agreements (whether under common seal or not) and to do all such acts or things deemed by him/her/them to be incidental to, ancillary to or in connection with the matters contemplated in the Bank Loan Agreement, the Corporate Guarantee and the Property Pledge and the transactions contemplated thereunder as he/she/they may in his/her/their absolute discretion consider necessary, desirable or expedient to give effect to the Corporate Guarantee and the Property Pledge and the implementation of all transactions contemplated thereunder and to agree with such variation, amendment or waiver as, in the opinion of the Directors, in the interest of the Company and its shareholders as a whole.”

By order of the Board
Shenji Group Kunming Machine Tool Company Limited
Wang He
Executive Director

Kunming, PRC, 20 April 2018

* *For identification purposes only*

SUPPLEMENTAL NOTICE OF EGM

Registered office and principal place of business in the PRC:

23 Ciba Road

Kunming City

Yunnan Province

The People's Republic of China

Notes:

1. Any member entitled to attend and vote at the meeting convened by the above notice is entitled to appoint one or more proxies. to attend and, in the event of a poll, vote in his/her stead. A proxy needs not be a member of the Company.
2. Whether or not you intend to attend the EGM, you are requested to complete and return the enclosed form of proxy in accordance with the instructions printed thereon and deposit it with the Company's Hong Kong branch share registrar and transfer office, Hong Kong Registrars Limited at Shops 1712-1716, 17/F., Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong as soon as possible and in any event not less than 48 hours before the time appointed for holding the EGM or any adjournment thereof.
3. Completion and return of a form of proxy will not preclude a member from attending in person and voting at the above meeting or any adjournment thereof, should he so wish, and in such event, the form of proxy shall be deemed to be revoked.