

# Shenhua International Limited

ABN 17 134 436 730

## **Notice of Annual General Meeting, Explanatory Statement, Independent Expert's Report and Proxy Form**

### **Annual General Meeting to be held at:**

2pm (ACST) on Wednesday 30 November 2016 at Level 1, 67 Greenhill Road, Wayville, Adelaide, South Australia

**IMPORTANT NOTE:** The Notice of Annual General Meeting, Explanatory Statement, Independent Expert's Report and Proxy Form should be read in their entirety. If you are in any doubt as to how you should vote, you should seek advice from your accountant, solicitor or other professional advisor prior to voting.

## NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that Shenhua International Limited (or **the Company**) will hold its Annual General Meeting at 2pm (ACST) on Wednesday 30 November 2016 at Level 1, 67 Greenhill Road, Wayville, Adelaide.

The Explanatory Statement that accompanies and forms part of this Notice describes the various matters to be considered when considering how to vote on the Resolutions set out in this Notice. The Proxy Form also forms part of this Notice.

Shareholders should also carefully read the Independent Expert's Report in the Annexure to this Notice when considering how to vote on Resolutions 4 and 5.

Capitalised terms used in this Notice will, unless the context otherwise requires, have the same meaning as given to them in this Notice, in the body of the Explanatory Statement or in the Glossary at the end the Explanatory Statement, as the case may be.

If you are unable to attend the meeting you are encouraged to complete and return the proxy form attached to this Notice. The completed Proxy Form must be received by Link Market Services not later than 2 pm (ACST) on Monday 28 November 2016, being 48 hours before the commencement of the meeting.

## AGENDA

### Ordinary business

#### 1) Receipt of financial report

To receive and consider the annual financial report of the Company for the year ended 30 June 2015 and the accompanying Directors' Report, Directors' Declaration and Auditor's Report as set out in the Company's Annual Report.

#### 2) Resolution 1 - Re-election of Director –Yong Wan

To consider, and if thought fit, pass the following resolution as an **ordinary resolution**:

*"That Mr. Yong Wan, a director retiring by rotation in accordance with clause 13.2 of the Company's constitution, being eligible, is re-elected as a director of the Company."*

#### 3) Resolution 2 - Re-election of Director –Xiaohong Chen

To consider, and if thought fit, pass the following resolution as an **ordinary resolution**:

*"That Ms. Xiaohong Chen, a director retiring by rotation in accordance with clause 13.2 of the Company's constitution, being eligible, is re-elected as a director of the Company."*

#### 4) Resolution 3 - Remuneration Report

To consider and put to a non-binding vote the following resolution as an **ordinary resolution**:

*"That the remuneration report contained in the Directors' Report of the Company for the year ended 30 June 2016 be adopted."*

#### 5) Resolution 4 - First Supplementary Loan Agreement

To consider, and if thought fit, to pass, with or without amendment the following resolution as an **ordinary resolution**:

*"That, for the purpose of Section 208 of the Corporations Act and for all other purposes, the Shareholders approve and ratify the Company and the Lender entering into and complying with the terms of the First Supplementary Loan Agreement dated 26 November 2015 between Shaoxing Shenhua Textile Co. Ltd, as Lender, Shaoxing Shenhua Decoration Co. Ltd, as Borrower, and Zhejiang Binhai Metal Products Co. Ltd, as Guarantor, in accordance with the terms and conditions set out in the Explanatory Statement."*

**Voting Exclusion:** The Company will disregard any votes cast in relation to Resolution 4 by:

- (a) Joyful Huge Holdings Limited;
- (b) any person who might obtain a benefit, or expect a benefit solely in the capacity of a Shareholder, if this Resolution is passed; and
- (c) any Associates of those persons described in paragraphs (a) and (b).

However, the Company need not disregard a vote if it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form, or, if it is cast by the Chair as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

**6) Resolution 5 - Second Supplementary Loan Agreement**

To consider, and if thought fit, to pass, with or without amendment the following resolution as an **ordinary resolution**:

*“That, for the purpose of Section 208 of the Corporations Act and for all other purposes, Shareholders approve and ratify the Company and the Lender entering into and complying with the terms of the Second Supplementary Loan Agreement dated 1 April 2016 between Shaoxing Shenhua Textile Co. Ltd, as Lender, Shaoxing Shenhua Decoration Co. Ltd, as Borrower, and Zhejiang Binhai Metal Products Co. Ltd, as Guarantor, in accordance with the terms and conditions set out in the Explanatory Statement.”*

**Voting Exclusion:** The Company will disregard any votes cast in relation to Resolution 5 by:

- (a) Joyful Huge Holdings Limited;
- (b) any person who might obtain a benefit, or expect a benefit solely in the capacity of a Shareholder, if this resolution is passed; and
- (c) any Associates of those persons described in paragraphs (a) and (b).

However, the Company need not disregard a vote if it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form, or, if it is cast by the Chair as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

**Other business**

To consider any other business that may be brought before the Annual General Meeting in accordance with the Company's constitution.

By order of the Board

Tao, Xue

Company Secretary  
24 October 2016

## ENTITLEMENT TO VOTE

It has been determined that, in accordance with Corporations Regulation 7.11.39, for the purposes of the Annual General Meeting, shares will be taken to be held by the persons who are registered holders at 7.00 pm (ACST) on Monday 28 November 2016. Accordingly, share transfers registered after that time will be disregarded in determining entitlements to attend and vote at the Annual General Meeting.

## PROXIES

Shareholders are advised that:

- (a) each Shareholder entitled to attend and vote at the Annual General Meeting has a right to appoint a proxy to attend and vote instead of the Shareholder;
- (b) the proxy need not be a Shareholder of the Company and may be an individual or body corporate;
- (c) a Shareholder who is entitled to cast two or more votes may appoint not more than two proxies and may specify the proportion or number of votes each proxy is appointed to exercise. If no proportion or number is specified, each proxy may exercise half of the Shareholder's votes;
- (d) a Shareholder may specify the way in which the proxy is to vote on the resolution or may allow the proxy to vote at his or her discretion;
- (e) if a Shareholder who is entitled to attend and vote at the Annual General Meeting does not attend the Annual General Meeting and does not appoint a proxy, the Shareholder will be deemed to have appointed the Chairman of the Meeting as his or her proxy (it is noted that the Chairman of the Meeting intends to vote undirected proxies in favour of all items of business); and
- (f) if a Shareholder appoints a body corporate as a proxy, that body corporate will need to ensure that it: appoints an individual as its corporate representative to exercise its powers at the meeting, in accordance with section 250D of the *Corporations Act 2001* (Cth) (**Corporations Act**) and provides satisfactory evidence of the appointment of its corporate representative prior to commencement of the meeting.

A Proxy Form accompanies this Notice of Annual General Meeting and, to be effective, must be received at the Company's corporate registry, Link Market Services.

Postal Address: Shenhua International Limited c/o Link Market Services Ltd, Locked Bag A14, Sydney South NSW 1235, Australia

Telephone Number: (+61 2) 1300 554 474

Facsimile Number: (+61 2) 9287 0309

Email: [registrars@linkmarketservices.com.au](mailto:registrars@linkmarketservices.com.au)

Online Voting: Lodging your votes online at Link's website ([www.investorcentre.linkmarketservices.com.au](http://www.investorcentre.linkmarketservices.com.au)) in accordance with the instructions given there (you will be taken to have signed your Security holder Voting Form if you lodge it in accordance with the instructions given on the website)

By Hand: Delivering it to Link Market Services Limited, Level 12, 680 George Street, Sydney NSW 2000

Proxies must be received by the Company, at the address or at the facsimile number specified above, no later than 2.00 pm (ACST) on Monday 28 November 2016.

## ANNUAL REPORT

Shareholders are reminded that the Company's Annual Report is available on its website at [www.zjhdbl.com](http://www.zjhdbl.com) under the 'Announcements' section.

## **EXPLANATORY STATEMENT**

This Explanatory Statement should be read in conjunction with and forms part of the accompanying Notice of Annual General Meeting.

The purpose of this Explanatory Statement is to provide Shareholders with all information known to the Company which is material to a decision on how to vote on the Resolutions in the accompanying Notice of Annual General Meeting.

Capitalised terms used in this Explanatory Statement will, unless the context otherwise requires, have the same meaning as given to them in the Notice of Annual General Meeting, in the body of this Explanatory Statement or in the Glossary below, as the case may be.

**Shareholders should also carefully read the Explanatory Statement and the Independent Expert's Report in the Annexure when considering how to vote on Resolutions 4 and 5.**

### **Receipt of financial report**

The Corporations Act requires the Financial Report (including the financial statements and directors' declaration), the Directors' Report and Auditor's Report to be laid before the annual general meeting. Shareholders will be given reasonable opportunity at the Annual General Meeting to ask the Company's auditor for the 2015-2016 financial year, Grant Thornton, questions relevant to the conduct of the audit and the content of the Auditor's Report. Shareholders will also have an opportunity to raise queries to the Board or comment on the business, operations and management of the Company generally.

Shareholders should note that the aforementioned statements and reports will be received in the form presented. It is not the purpose and there is no requirement either in the Corporations Act or in the Constitution of the Company for shareholders to approve these reports and statements.

### **Resolutions 1 and 2 –re-election of directors**

Clause 13.2 of the Company's Constitution requires that at each annual general meeting, at least one third of directors must retire from office. A director appointed during the year either to fill a casual vacancy or as an addition to the directors is not taken into account in determining the directors who must retire by rotation. Therefore, Mr. Yong Wan and Ms. Xiaohong Chen, being directors who have been longest in office, retire by rotation and are respectively eligible for re-election at the next annual general meeting. In accordance with clause 13.2 of the Company's Constitution, both Mr. Yong Wan and Ms. Xiaohong Chen respectively submit themselves for re-election at the Annual General Meeting as a director.

The Directors (other than Mr. Yong Wan and Ms. Xiaohong Chen in relation to their respective re-elections) unanimously recommend the Shareholders to vote in favour of the resolutions for the re-election of Mr. Yong Wan and Ms. Xiaohong Chen as directors of the Company.

### **Resolution 3 - remuneration report**

The Director's Report (comprising the Company's Annual Report) contains a report of key management personnel's remuneration. The remuneration report is submitted to shareholders for consideration and adoption. For further information on the Company's remuneration policy, shareholders may refer to Schedule 4 of the Company's Corporate Governance Policy and clauses 13.7 to 13.9 inclusively of the Company's Constitution. Copies of the Company's Annual Report, Constitution and Corporate Governance Policy are all available on its website [www.zjhdbl.com](http://www.zjhdbl.com).

The Corporations Act requires that a resolution be put to a vote that the remuneration report be adopted. Whereas the Corporations Act expressly provides that the vote is advisory only and does not bind the

directors or the Company, but this is subject to the 'two strikes rules'. That is, if a resolution to adopt a remuneration report at an annual general meeting receives a 'no' vote of 25 per cent or more of the votes cast in relation to two consecutive remuneration reports, then a 'spill resolution' must be put to shareholders at the subsequent annual general meeting. A 'spill resolution' will be passed if 50 per cent or more of eligible votes cast are in favour in which case a 'spill meeting' is to be called within 90 days of the spill resolution being passed. At a spill meeting all directors apart from the managing director must stand for re-election unless all the directors have been replaced by new directors within that time.

Shareholders attending the Annual General Meeting will be given a reasonable opportunity to ask questions about, or make comments on, the remuneration report. Any such comments that were considered at an annual general meeting where there was a 'no' vote of 25 per cent or more of the votes cast in relation to adoption of the remuneration report will be provided with an explanation of the Board's proposed action or reason for inaction in the subsequent remuneration report.

At the date of this notice, there have been no recorded incidences of any 'no' vote of 25 per cent or more of the votes cast in relation to the adoption of a remuneration report at an annual general meeting of the Company. The Board unanimously recommends that the shareholders vote in favour of the resolution to adopt the current remuneration report.

## **Resolutions 4 and 5 - First and Second Supplementary Loan Agreements**

### **1. Summary of Resolutions**

#### **1.1 Background to Resolutions - Historic Loan Agreement**

On 15 October 2014, the Company's subsidiary Shaoxing Shenhua Textile Co. Ltd (**Lender**) and Shaoxing Shenhua Decoration Co. Ltd (**Borrower**) entered into a loan agreement pursuant to which the Lender provided to the Borrower a loan facility with a Principal Limit of RMB 466,693,298 (A\$93,338,656 based on an exchange rate of RMB 1 = A\$0.200 / A\$1 = RMB5.00) (**Historic Loan Agreement**). The terms and conditions of the Historic Loan Agreement are summarised below in section 3.6. The Borrower's subsidiary Zhejiang Binhai Metal Products Co. Ltd (**Guarantor**), acts as Guarantor under the Historic Loan Agreement.

The Historic Loan Agreement involved the giving of a financial benefit by the Lender (being a subsidiary of the Company) to a related party of the Company. The related party nature of the transaction resulted primarily from Mr Philip Widjaya, a Director of the Company, also being the controlling shareholder of the Borrower.

In terms of the Security for the Loan, in the notice of meeting for the Company's 2014 annual general meeting (**2014 AGM Notice**), it was noted that:

*"The Loan carries a fixed interest rate of 6% per annum, payable every six months, and is secured against land use rights (over land in Shaoxing in Zhejiang province, China) and non-current assets of the Borrower and BHMP with the carrying value of approximately RMB 414.66 million (approximately A\$71.322 million) as of 30 June 2014 (and total asset value of RMB 715.5 million, approximately A\$123.067 million) (**Security**)."*

Shareholders were informed that the RMB414.66 million valuation was based on the carrying value (i.e. net book value rather than fair market valuation) at the time of the secured assets of the Borrower and Guarantor and that the total asset value of those two companies combined were RMB715.5 million at the time. It is noted that these carrying values which the Board relied on in granting the Loan were unaudited. Section 8.1 of the Independent Expert Report reports that only Pledged Assets with an aggregate value of RMB 84,280,000 (approximately 19%) (A\$16,856,000 based on an exchange rate of RMB 1 = A\$0.2001139 / A\$1 = RMB5.00) are supported by independent valuation. The remainder of the value of the Pledged Assets have been determined based on the Lender's estimate of value, rather than independent valuation. (further details provided in section 3.7 below)

In the 2014 AGM Notice, Shareholders were informed of the Board's view that the 'arm's length' exception in section 210 of the Corporations Act applied to any financial benefit provided in connection with the Historic Loan Agreement. Notwithstanding, Shareholder approval had been sought due to the related party transaction nature and quantum involved and such approval was received at the 2014 annual general meeting. The reasons why the Board considers that the Historic Loan Agreement was a transaction on arm's length terms is explained in this Explanatory Statement (see in particular section 3.2, 3.3, 6 and 8 below). (These are the views and beliefs of the Board and are not supported by the conclusions drawn by the Independent Expert.)

## **1.2 Summary of Resolution 4 - First Supplementary Loan Agreement**

As a result of a number of extraordinary transactions that arose during the previous financial year ending 30 June 2015 in relation to the business of the Guarantor, the Borrower sought additional advances in excess of the Principal Limit of the Historic Loan Agreement (on a short term basis) from the Lender.

As the Board was only made aware of the additional advances permitted by the Lender after they have been made and repaid, the terms of the Loan were subsequently reviewed and after careful consideration by the Directors and for the reasons set out in this Explanatory Statement and the Independent Expert's Report, the Borrower and the Lender entered into an agreement which amended the terms of the Historic Loan Agreement in accordance with section 4 below on 26 November 2015 (**First Supplementary Loan Agreement**) following Board approval of the First Supplementary Loan Agreement on 18 November 2015. The key amendment to the Loan pursuant to the First Supplementary Loan Agreement was the increase of the Principal Limit of the Loan from RMB 466,693,298 to RMB 666,693,298 (A\$133,338,659 based on an exchange rate of RMB 1 = A\$0.2001139 / A\$1 = RMB5.00) and reduce the Loan interest from 6% per annum to 5.22% per annum.

While there had been instances where prior to the entry into the First Supplementary Loan Agreement, the original Principal Limit had been permitted to be exceeded by the Lender, the Board notes that those instances were on a short term basis and the limit has been kept within the original Principal Limit since 1 July 2015. Since 1 July 2015, the Borrower has shown that it is able to keep up with repayments and at times even accelerated payment. The Borrower's demonstrated ability to keep up with repayments has been a key consideration in the Directors' approval of the First Supplementary Loan Agreement. Another key consideration is that it provided an opportunity for increased interest revenues to be earned. It is noted that the Company has outstanding borrowings in the form of notes payable which are interest bearing with the current interest rate payable being 4.35% per annum. As noted by the Independent Expert, these funds have effectively been on-lent to the Borrower and the Company earns a margin of 0.87% (5.22% - 4.35%) on the Loan.

Under normal circumstances, section 208 requires shareholder approval be obtained prior to a financial benefit being provided. Shareholder approval had not been obtained at the time the First Supplementary Loan Agreement was entered into on the basis that the Board considers that the 'arm's length' exception in section 210 of the Corporations Act applies to any financial benefit provided in connection with the First Supplementary Loan Agreement. The reasons why the Board considers the First Supplementary Loan Agreement to be a transaction on arm's length terms is explained in this Explanatory Statement (see in particular sections 6 and 8 below - these are the views and beliefs of the Board and are not supported by the conclusions drawn by the Independent Expert). In this regard, the Board notes that by 30 June 2015, the additional advances in excess of the Principal Limit of the Historic Loan Agreement (and as permitted by the First Supplementary Loan Agreement) were repaid, resulting in the outstanding principal balance of the Loan, as at 30 June 2015, being RMB 443,003,809 (A\$88,600,762 based on an exchange rate of RMB 1 = A\$0.200 / A\$1 = RMB5.00), being an amount under the Principal Limit of the Loan initially provided by the Lender under the Historic Loan Agreement.

Notwithstanding the above, Shareholder approval for the First Supplementary Loan Agreement is being sought to ratify and affirm the Board's approval of the First Supplementary Loan Agreement. In the event that Shareholder approval is not obtained, the Board will review the status and terms of the First Supplementary Loan Agreement and consider alternative proposals that could be accepted by Shareholders and provide further information and seek further Shareholder approval as necessary.

In relation to the proposal contained in Resolution 4, the Independent Expert is of the opinion that the First Supplementary Agreement is **NOT FAIR AND NOT REASONABLE** when considered in the context of the interests of the non-associated Shareholders. Further details are provided in sections 2 and 4.3 below.

### 1.3 Summary of Resolution 5 - Second Supplementary Loan Agreement

Further, in accordance with the Second Supplementary Loan Agreement discussed below in section 5, the Principal Limit of the Loan was reduced to RMB 386,693,297 (A\$77,338,659 based on an exchange rate of RMB 1 = A\$0.200 / A\$1 = RMB5.00). The reduction in the Principal Limit of the Loan took effect as of 1 April 2016 (following Board approval on 12 March 2016), with the same Security granted under the Historic Loan Agreement continuing to apply.

Under normal circumstances, section 208 requires Shareholder approval be obtained prior to a financial benefit being provided. Shareholder approval had not been obtained at the time the Second Supplementary Loan Agreement was entered into on the basis that the Board considers that the 'arm's length' exception in section 210 of the Corporations Act applies to any financial benefit provided in connection with the Second Supplementary Loan Agreement. The reasons why the Board considers the Second Supplementary Loan Agreement to be a transaction on arm's length terms is explained in this Explanatory Statement (see in particular sections 6 and 8 below - these are the views and beliefs of the Board and are not supported by the conclusions drawn by the Independent Expert.).

Notwithstanding the above, Shareholder approval for the Second Supplementary Loan Agreement is being sought to ratify and affirm the Board's approval of the Second Supplementary Loan Agreement. In the event that Shareholder approval is not obtained, the Board will review the status and terms of the Second Supplementary Loan Agreement and consider alternative proposals that could be accepted by Shareholders and provide further information and seek further Shareholder approval as necessary.

In relation to the proposal contained in Resolution 5, the Independent Expert is of the opinion that the Second Supplementary Agreement:

- is **REASONABLE** provided Shareholders approve Resolution 4;
- is **NOT FAIR AND NOT REASONABLE** if Shareholders reject Resolution 4.

Further details are provided in sections 2 and 5.3 below.

## 2. Independent Expert's Report

The Independent Expert has analysed the terms of the First Supplementary Loan Agreement and Second Supplementary Loan Agreement in detail in the Independent Expert's Report. You should carefully read the Independent Expert's Report before voting on the Resolutions.

Both of the Resolutions seek the approval of Shareholders in relation to the entry into agreements which seek to amend the terms of the Historic Loan Agreement (being the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement).



It is noted that the Independent Expert considers that Resolutions 4 and 5 are not interdependent which means that Shareholders are free to approve or not approve either or both resolutions. For this reason, the Independent Expert has chosen to deal with these two resolutions separately and provide a separate evaluation and conclusion in respect of each resolution.

## **2.1 Fairness and Reasonableness**

For the purposes of reviewing whether the First Supplementary Loan Agreement and Second Supplementary Loan Agreement, as proposed related party transactions, are “fair” and “reasonable”, the Independent Expert has defined those terms as follows:

- *Fairness* – the proposed related party transactions are “fair” if the value of the benefit received by the related party pursuant to each transaction is equal to or less than the value of the consideration offered by the related party in relation to each transaction.
- *Reasonableness* – the proposed related party transactions are “reasonable” if they are fair. They may also be “reasonable” if, despite not being “fair” but after considering other significant factors, shareholders should vote in favour of the proposed related party transactions in the absence of a superior proposal being received.

The Independent Expert considers what is fair for non-associated Shareholders should be judged in all of the circumstances of the proposal.

The methodology used by the Independent Expert to form an opinion whether each of the proposed related party transactions is fair and reasonable is summarised as follows:

- (i) in determining whether the proposed related party transactions are fair, the Independent Expert has:
  - a. assessed the value of the related party benefit that may be received by the Borrower as a result of both the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement;
  - b. assessed the value of the consideration offered by the Borrower to the Lender pursuant to the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement;
  - c. compared the results of (a) and (b) above;
- (ii) in determining whether the proposed related party transactions are reasonable, the Independent Expert has analysed and considered the advantages and disadvantages of the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement;
- (iii) in determining whether the proposed related party transactions are fair and reasonable to non-associated Shareholders, the Independent Expert has considered and concluded upon the results of (i) and (ii) above.

## **2.2 Historic Loan Agreement**

The Historic Loan Agreement was approved by Shareholders at the Company’s 2014 annual general meeting. The Independent Expert Report provides a summary of the Historic Loan Agreement but does not contain any further opinion or assessment of the Historic Loan Agreement.

## 2.3 Resolution 4 - First Supplementary Loan Agreement

The Independent Expert has analysed the terms of the First Supplementary Loan Agreement in the Independent Expert's Report. You should carefully read the Independent Expert's Report before voting on Resolution 4.

In relation to the proposal contained in Resolution 4, the Independent Expert is of the opinion that the First Supplementary Agreement is **NOT FAIR AND NOT REASONABLE** when considered in the context of the interests of the non-associated Shareholders.

## 2.4 Resolution 5 - Second Supplementary Loan Agreement

The Independent Expert has analysed the terms of the Second Supplementary Loan Agreement in the Independent Expert's Report. You should carefully read the Independent Expert's Report before voting on Resolution 5.

In relation to the proposal contained in Resolution 5, the Independent Expert is of the opinion that the Second Supplementary Agreement:

- is **REASONABLE** provided Shareholders approve Resolution 4;
- is **NOT FAIR AND NOT REASONABLE** if Shareholders reject Resolution 4.

## 3. Background information regarding Resolutions

### 3.1 The Historic Loan Agreement

On 15 October 2014, the Lender and the Borrower entered into the Historic Loan Agreement, the terms and conditions of which are summarised in section 3.6 below. The Borrower's subsidiary Zhejiang Binhai Metal Products Co. Ltd acts as Guarantor under the Historic Loan Agreement.

### 3.2 Purpose of the Loan

The key investment drivers underlying the Company's decision to enter into the Historic Loan Agreement on 15 October 2014 are set out and analysed in detail in this Explanatory Statement. Except as set out in this Notice and from the Company and the Lender's perspective, those key investment drivers were not materially different and had not significantly changed on the date of the entry by the Lender into the First Supplementary Loan Agreement, the date of entry by the Lender into the Second Supplementary Loan Agreement or on the date of this Notice.

In summary and from the Board's perspective at the time of entry into the Historic Loan Agreement, the Loan provided the Company's Consolidated Group with the opportunity to earn interest income on market terms (and at a market interest rate), secured against land, buildings and plant and equipment owned by the Borrower and the Guarantor (as discussed below in section 3.7) and also in the view of the Board exposes the Company to a comparatively lesser risk proposition in the capacity as a financier as opposed to a shareholder to a business which is in a category of encouraged business industry under Chinese government policy.

In the view of the Board, the terms of the Historic Loan Agreement, the First Supplementary Loan Agreement (as discussed below in section 4) and the Second Supplementary Loan Agreement (as discussed below in section 5) are consistent with standard market practice in China. All amounts under the Loan are transacted in China and all of the Borrower, the Lender and the Guarantor are companies incorporated in China.

From the Borrower's and Guarantor's perspective, the purpose of the Historic Loan Agreement was to fund investment and working capital in the stainless steel business operated by the Guarantor, but specifically for the acquisition of land use rights for development of the Guarantor's manufacturing facility in China. The First Supplementary Loan Agreement and the Second Supplementary Loan Agreement varied the terms of the Historic Loan Agreement, specifically, as a result of changes in the working capital requirements of the Guarantor since the date of entry into the Historic Loan Agreement.

### **3.3 Approval of the Historic Loan Agreement received at Company's 2014 annual general meeting**

At the 2014 annual general meeting of the Company, the Company sought and received the approval of Shareholders, in accordance with Chapter 2E of the Corporations Act, for the giving of a financial benefit to related parties of the Company as a result of the transactions contemplated by the Historic Loan Agreement.

The related party nature of that transaction resulted because:

- (a) Mr Philip Widjaya is a Director of the Company and accordingly, a related party of the Company;
- (b) Mr Widjaya is also the controlling shareholder of the Borrower and accordingly, the Borrower is also a related party of the Company; and
- (c) the Guarantor is an entity controlled by the Borrower and accordingly, the Guarantor is also a related party of the Company.

In seeking such approval, Shareholders were informed of the Board's view that the 'arm's length' exception in section 210 of the Corporations Act applies to any financial benefit provided in connection with the Historic Loan Agreement. (These are the views and beliefs of the Board and are not supported by the conclusions drawn by the Independent Expert.) Section 210 provides that shareholder approval is not required to give a financial benefit on terms that would be reasonable in the circumstances if the Company and related parties were dealing at arm's length. Notwithstanding, Shareholder approval was sought due to the related party transaction nature and quantum involved.

The Lender is a part of the Company's Consolidated Group. However, neither the Borrower nor the Guarantor are part of the Company's Consolidated Group.

### **3.4 Independent Expert's review of Historic Loan Agreement**

The Independent Expert reviewed the Historic Loan Agreement for the purposes of its analysis of the First Supplementary Loan Agreement and Second Supplementary Loan Agreement. No further assessment or opinion is made in the Independent Expert Report regarding the Historic Loan Agreement.

### **3.5 Board's approval of First Supplementary Loan Agreement and Second Supplementary Loan Agreement**

For the reasons set out in this Explanatory Statement (particularly sections 6 and 8), the Board (noting that Mr Philip Widjaya was excluded from voting due to being a related party) resolved to approve the entry into the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement. Aside from Mr Widjaya, none of the other Directors have any material personal interest in the outcome of Resolutions. The Board's approval of the Loan is made in the context of the terms of the Historic Loan Agreement, the terms of the First Supplementary Loan Agreement and Second Supplementary

Loan Agreement, the information provided in this Explanatory Statement and the Independent Expert's Report.

### 3.6 Summary of key terms of the Historic Loan Agreement

The following are the key terms of the Historic Loan Agreement:

- (a) **(Lender)**: Shaoxing Shenhua Textile Co. Ltd;
- (b) **(Borrower)**: Shaoxing Shenhua Decoration Co. Ltd;
- (c) **(Guarantor)**: Zhejiang Binhai Metal Products Co. Ltd;
- (d) **(Agreement date)**: 15 October 2014;
- (e) **(Principal Limit)**: The limit of the Loan facility advanced by the Lender to the Borrower under the Historic Loan Agreement was RMB 466,693,298 (A\$93,338,656 based on an exchange rate of RMB 1 = A\$0.200 / A\$1 = RMB5.00);
- (f) **(Interest)**: Interest accrues on the outstanding principal advanced by the Lender to the Borrower under the Historic Loan Agreement at an interest rate of 6% per annum and is payable bi-annually;
- (g) **(Principal repayment)**: Principal is repayable bi-annually during the term of the Loan and in accordance with the repayment schedule set out in the Independent Expert's Report;
- (h) **(Security)**: The Security is discussed in section 3.7 of this Explanatory Statement and further considered in the Independent Expert's Report as part of the review of the First Supplementary Loan Agreement and Second Supplementary Loan Agreement;
- (i) **(Term)**: The term of the Historic Loan Agreement ends on 30 June 2022 and the outstanding principal advanced pursuant to the Historic Loan Agreement is required to be repaid in full on 30 June 2022; and
- (j) **(Events of default)**: Under the Historic Loan Agreement, the Borrower would be in default if it fails to pay accrued interest or repay principal as and when due under the Historic Loan Agreement within one month of receiving written notice from the Lender. In the event of default, the Lender will have the right to enforce its Security in respect of the Pledged Assets in accordance with terms customary of this type of loan transaction. That is, in the event of default, it is within the rights of the Lender to cause for title to the Pledged Assets to be transferred to the Lender, or for the Pledged Assets to be sold and the sale proceeds applied in repayment of the Loan and payment of all accrued but unpaid interest. It is noted that such title documents in respect of the Pledged Assets are held by the Lender's financial institution in China. As at the date of this Notice, no factors have been identified that are likely to materially delay a sale of the Pledged Assets, and no other material issues have been identified that would compromise the liquidity of the Security.

### 3.7 Security

The outstanding principal advanced by the Lender to the Borrower under the Loan is secured against land use rights and buildings (in respect of land and buildings in Shao Xing, Zhejiang, China) and plant and equipment of the Borrower and the Guarantor. These assets are set out in the table on page 13 of the Independent Expert's Report (**Pledged Assets**).

In the 2014 AGM Notice, Shareholders were informed that the carrying value for these secured assets to be RMB414.66 million (approximately A\$71.322 million as per the 2014 AGM Notice), and that the total asset value of Borrower and the Guarantor combined were RMB715.5 million (approximately \$A123.067 million as per the 2014 AGM Notice) at the time. It is noted that these carrying values for which the Board relied on in granting the Loan were unaudited.

Based on the certificate of pledge registry, the total value of the Pledged Assets is RMB 449,410,000 (approximately \$90million based on an exchange rate of A\$1.00:RMB5.00) for the period from 26 November 2014 to 26 November 2016. The pledge amount represented 96% of the Principal Limit under the Historic Loan Agreement. Section 8.1 of the Independent Expert Report reports that only Pledged Assets with an aggregate value of RMB 84,280,000 (A\$16,856,000 based on an exchange rate of RMB 1 = A\$0.2001139 / A\$1 = RMB5.00) are supported by an independent valuation. The remainder of the value of the Pledged Assets have been determined based on the Lender's estimate of value, rather than independent valuation.

The value of the Security is based on the unaudited carrying value (i.e. net book value) of the Pledged Assets recorded on the accounts of the Borrower and Guarantor. As some of the Pledged Assets (namely the building, production facility and equipment of the Guarantor) were acquired close to around the time the Historic Loan Agreement was entered into, the Lender's assessment was that the carrying value at the time of the Historic Loan Agreement for those assets should not have been significantly different from their fair value/disposal recoverable value and that in its view does provide a fair representation of the value of the Pledged Assets at that time and is therefore in its view satisfied that the Loan is adequately secured.

Section 8.1 of the Independent Expert Report also notes that of the Pledged Assets with independent valuation, there was a substantial difference between the independent valuation and the amount secured (difference of RMB 54.34 million or \$10.868 million based on an exchange rate of RMB 1 = A\$0.2001139 / A\$1 = RMB5.00). It is noted that these related to land and building of the Guarantor for its production facility which was still under construction at the time. As construction has since been completed, it is the view of the Board that the value of those assets would have substantially increased. In further review the value of the Pledged Assets, the Lender has taken the view that the value of the land forming part of the Pledged Assets has increased in value over time (consistent with the local property market conditions and upward pricing trends and looking at comparable sales figures). Based on the above, the Lender is of the view that there has been an overall increase in the value of the Pledged Assets to support that the Loan is adequately secured. The Independent Expert has also commented on the potential appreciation of the abovementioned assets in section 9.3 of the Independent Expert Report but notes that in the absence of current market valuations it is unable to make a conclusive assessment as to the adequacy of the Loan security.

The Security is the sole and exclusive security granted by the Borrower over the Pledged Assets. The corresponding title documents in respect of Pledged Assets are being held in the safe custody of the Lender's financial institution in China.

#### **4. Resolution 4 - First Supplementary Loan Agreement**

##### **4.1 Background**

Resolution 4 seeks Shareholder approval under section 208 of the Corporations Act for the provision of the following financial benefits to Mr Widjaya, the Borrower and the Guarantor in connection with the entry and performance of the First Supplementary Loan Agreement:

- (a) the interest saving in the range of \$2.1 million to \$4 million to the Borrower as a result of the reduction in the interest rate pursuant to the First Supplementary Loan Agreement

- (b) the provision of additional finance by the Lender to the Borrower (as detailed in section 4.2 of this Explanatory Statement); and
- (c) releasing any obligation of the Borrower and the Guarantor, arising from and solely in connection with any breach of the Principal Limit under the Historic Loan Agreement, prior to the entry by the Borrower and the Lender into the First Supplementary Loan Agreement.

As a result of a number of extraordinary transactions that arose during the last financial year ending 30 June 2015 in relation to the business of the Guarantor, the Borrower sought additional advances in excess of the Principal Limit of the Historic Loan Agreement (on a short term basis) from the Lender.

While there had been instances where prior to the entry into the First Supplementary Loan Agreement, the original Principal Limit had been permitted to be exceeded by the Lender, the Board notes that those instances were on a short term basis and the limit has been kept within the original Principal Limit since 1 July 2015. Since 1 July 2015, the Borrower has shown that it is able to keep up with repayments and at times even accelerated payment. The Borrower's demonstrated ability to keep up with repayments has been a key consideration in the Directors' approval of the First Supplementary Loan Agreement. Another key consideration is that it provides an opportunity for increased interest revenues to be earned.

By 30 June 2015, these additional advances in excess of the Principal Limit of the Historic Loan Agreement were repaid, resulting in the outstanding principal balance of the Loan, as at 30 June 2015, being RMB 443,003,809 (A\$88,600,762 based on an exchange rate of RMB 1 = A\$0.200 / A\$1 = RMB5.00), being an amount under the Principal Limit of the Loan initially provided by the Lender under the Historic Loan Agreement.

In light of the additional advances in excess of the original Principal Limit, the terms of the Loan were reviewed following which the Borrower and the Lender agreed to enter into the First Supplementary Loan Agreement dated 26 November 2015 (following Board approval on 18 November 2015) whereby the Principal Limit was increased to from RMB 466,693,298 to RMB666,693,298 (A\$133,338,659 based on an exchange rate of RMB 1 = A\$0.200 / A\$1 = RMB5.00) and the interest rate reduced from 6% per annum to 5.22% per annum in reflection of the comparable bank lending rate in China at the time, and with the same Security granted under the Historic Loan Agreement continuing to apply. See further discussion on the First Supplementary Loan Agreement in section 4 below.

The increased Principal Limit was further reviewed in March 2016, following which the Borrower and Lender agreed to enter into the Second Supplementary Loan Agreement whereby the Principal Limit of the Loan was reduced to RMB 386,693,297 (A\$77,338,659 based on an exchange rate of RMB 1 = A\$0.200 / A\$1 = RMB5.00). The reduction in the Principal Limit of the Loan took effect as of 1 April 2016 (following Board approval on 12 March 2016) with the same Security granted under the Historic Loan Agreement continuing to apply. See further discussion of the Second Supplementary Loan Agreement in section 5 below.

## **4.2 Summary of key terms of the First Supplementary Loan Agreement**

The following are the key terms the First Supplementary Loan Agreement:

- (a) **(Lender):** Shaoxing Shenhua Textile Co. Ltd;
- (b) **(Borrower):** Shaoxing Shenhua Decoration Co. Ltd;
- (c) **(Guarantor):** Zhejiang Binhai Metal Products Co. Ltd;
- (d) **(Agreement date):** 26 November 2015;

- (e) **(Principal Limit):** The Principal Limit of the Historic Loan Agreement was increased under the First Supplementary Loan Agreement by RMB 200,000,000 (\$40,000,000 based on an exchange rate of RMB 1 = A\$0.200 / A\$1 = RMB5.00) from RMB 466,693,298 to RMB 666,693,298 (A\$133,338,659 based on an exchange rate of RMB 1 = A\$0.2001139 / A\$1 = RMB5.00);
- (f) **(Interest):** The interest rate under the Historic Loan Agreement was reduced under the First Supplementary Loan Agreement from 6% per annum to 5.22% per annum payable bi-annually and applicable as of 1 July 2015 with payments adjusted under a revised repayment schedule (refer to page 14 of the Independent Expert's Report); and
- (g) **(Release):** The Borrower and the Guarantor were released by the Lender in connection with any breach of the Principal Limit of the Historic Loan Agreement which occurred prior to the date of the First Supplementary Loan Agreement. The Board notes that prior to the entry into the First Supplementary Loan Agreement, the Borrower was in breach of the Principal Limit of the Loan as detailed on page 22 of the Independent Expert's Report.

All other terms of the Historic Loan Agreement continued to operate and remained unchanged as a result of the entry into the First Supplementary Loan Agreement, including the same Security which continued to secure the outstanding principal advanced by the Lender to the Borrower under the Loan. The value of the Pledged Assets, as recorded on the certificate of pledge registry, represented 67% of the value of the increased Principal Limit of the Loan pursuant to the First Supplementary Loan Agreement.

#### 4.3 Independent Expert's Report's review of First Supplementary Loan Agreement

In the opinion of the Independent Expert, the proposal contained in Resolution 4 – First Supplementary Agreement is **NOT FAIR AND NOT REASONABLE** when considered in the context of the interest of the non-associated Shareholders.

##### *Assessment of fairness*

The Independent Expert estimated that the value of the interest saving to the Borrower as a result of the reduction in the interest rate from 6.00% per annum to 5.22% per annum is in a range of RMB 10,934,000 and RMB 20,382,000, or \$2.1million to \$4.1 million over the life of the loan (the IER applied an exchange rate of A\$1.00:RMB5.00).

The First Supplementary Loan Agreement did not provide any consideration to the Lender for agreeing to lower the rate of interest.

As the value of the benefit received by the Borrower (estimated to be in a range of \$2.1million to \$4.1million) exceeds the value of the consideration offered by the Company/Lender to (\$nil), the Independent Expert has concluded that Resolution 4 is not fair.

##### *Assessment of reasonableness*

The Independent Expert has set out in section 12.2 of the Independent Expert Report a range of other factors that it has considered in assessing whether the proposal contained in Resolution 4 is reasonable and after considering these factors it has concluded that it is not reasonable. One of the Independent Expert's stated reasons for this view is that the Company has outstanding borrowings in the form of notes payable which are interest bearing with the current interest rate payable being 4.35% per annum. The Independent Expert notes these funds have effectively been on-lent to the Borrower and the Lender earns a margin of 0.87% (5.22% - 4.35%) on the Loan. The Independent Expert is of

the view that the risk premium is not sufficient although it acknowledges that the size risk premium is a matter of judgement.

#### **4.4 Section 208 of the Corporations Act**

Section 208 of the Corporations Act requires that for a public company, or an entity that the public company controls, to give a financial benefit to a related party of the public company, the public company or entity must:

- (a) obtain the approval of the public company's members in the manner set out in Sections 217 to 227 of the Corporations Act; and
- (b) give the benefit within 15 months following such approval,

unless the giving of the financial benefit falls within an exception set out in Sections 210 to 216 of the Corporations Act.

As discussed above:

- (c) Mr Philip Widjaya is a Director of the Company and accordingly, a related party of the Company;
- (d) Mr Widjaya is also the controlling shareholder of the Borrower and accordingly, the Borrower is also a related party of the Company; and
- (e) the Guarantor is an entity controlled by the Borrower and accordingly, the Guarantor is also a related party of the Company.

Under normal circumstances, section 208 requires shareholder approval be obtained prior to a financial benefit being provided. Shareholder approval had not been obtained at the time the First Supplementary Loan Agreement was entered into on the basis that it is the Board's view that the 'arm's length' exception in section 210 of the Corporations Act applies to any financial benefit provided in connection with the First Supplementary Loan Agreement the subject of Resolution 4. (These are the views and beliefs of the Board and are not supported by the conclusions drawn by the Independent Expert.) Section 210 provides that shareholder approval is not required to give a financial benefit on terms that would be reasonable in the circumstances if the Company and related parties were dealing at 'arm's length'. Notwithstanding the above, Shareholder approval for the First Supplementary Loan Agreement is being sought to ratify and affirm the Board's approval of the First Supplementary Loan Agreement. Because Mr Widjaya is a related party to whom the First Supplementary Loan Agreement would provide a financial benefit, he and his Associates are excluded from voting on the approval of the First Supplementary Loan Agreement.

#### **4.5 Technical information required by section 219 of the Corporations Act**

Pursuant to and in accordance with the requirements of section 219 of the Corporations Act, the following information is provided in relation to the First Supplementary Loan Agreement, the subject of Resolution 4:

- (a) the related parties are Mr Widjaya, the Borrower and the Guarantor.
- (b) the nature of the financial benefits is the interest saving in the range of \$2.1 million to \$4 million to the Borrower as a result of the reduction in the interest rate pursuant to the First Supplementary Loan Agreement but also:



- (1) the provision of additional finance by the Lender to the Borrower (as detailed in section 4.2); and
  - (2) releasing the Borrower and the Guarantor in connection with any breach of the Principal Limit under the Historic Loan Agreement, prior to the entry by the Borrower and the Lender into the First Supplementary Loan Agreement.
- (c) based on the information available, including that contained in this Explanatory Statement and the Independent Expert's Report, all of the Directors (with the exception of Mr Widjaya who has abstained from making any recommendation due to his material personal interest in the outcome of the Resolution 4) consider that Resolution 4 is overall in the best interests of the Company and recommend that Shareholders vote in favour of Resolution 4.
- (d) the Directors are not aware of any other information (other than set out in this Explanatory Statement or the Independent Expert's Report) that would be reasonably required by Shareholders to allow them to make a decision whether it is in the best interests of the Company to pass Resolution 4.

## **5. Resolution 5 – Second Supplementary Loan Agreement**

### **5.1 Background**

Resolution 5 seeks Shareholder approval under section 208 of the Corporations Act for the provision of any financial benefits to Mr Widjaya, the Borrower and the Guarantor in connection with the entry and performance of the Second Supplementary Loan Agreement.

Due to strong revenue growth experienced by the Borrower and queries raised by the Company's auditors and ASIC as a result of the outstanding principal balance of the Loan, a Second Supplementary Loan Agreement was entered into between the Lender and the Borrower, which reduced the Principal Limit of the Loan to RMB 386,693,298 (A\$77,338,660 based on an exchange rate of RMB 1 = A\$0.200 / A\$1 = RMB5.00). The reduction in the Principal Limit of the Loan took effect as of 1 April 2016 with the same Security granted under the Historic Loan Agreement and the First Supplementary Loan Agreement continuing to apply.

As a result of the reduction in the Principal Limit under the Loan, the Directors are of the view that given the broad interpretation of the term 'giving of a financial benefit' under section 229 of the Corporations Act and the economic and commercial consequences for the Company as a result of any future loss of opportunity to earn interest income under the Loan, the Company should obtain Shareholder approval in connection with the entry and performance of the Second Supplementary Loan Agreement.

If however Resolution 4 is not approved by Shareholders, the nature of the financial benefit is the interest saving to the Borrower as a result of the reduction in the interest rate pursuant to the Second Supplementary Loan Agreement.

### **5.2 Summary of key terms of the Second Supplementary Loan Agreement**

The following are the key terms of the Second Supplementary Loan Agreement:

- (a) **(Lender):** Shaoxing Shenhua Textile Co. Ltd;
- (b) **(Borrower):** Shaoxing Shenhua Decoration Co. Ltd;
- (c) **(Guarantor):** Zhejiang Binhai Metal Products Co. Ltd;

- (d) **(Agreement date):** 1 April 2016;
- (e) **(Principal Limit):** The Principal Limit of the Historic Loan Agreement (as amended by the First Supplementary Loan Agreement) was reduced under the Second Supplementary Loan Agreement by RMB 280,000,000 from RMB 666,693,298 to RMB 386,693,298 (A\$77,338,660 based on an exchange rate of RMB 1 = A\$0.200 / A\$1 = RMB5.00); and
- (f) **(Interest):** The interest rate remains at 5.22% per annum payable bi-annually.

All other terms of the Historic Loan Agreement (as amended by the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement) continue to operate and remain unchanged, including the Security which will continue to secure the outstanding principal advanced by the Lender to the Borrower under the Loan. The value of the Pledged Assets, as recorded on the certificate of pledge registry, represents 116% of the value of the current reduced Principal Limit of the Loan.

### 5.3 Independent Expert's Report's review of Second Supplementary Loan Agreement

In the Independent Expert's opinion, the proposal contained in Resolution 5 – Second Supplementary Agreement:

- is **REASONABLE** if Shareholders approve Resolution 4;
- is **NOT FAIR AND NOT REASONABLE** if Shareholders reject Resolution 4.

#### *Assessment of fairness*

The Second Supplementary Loan Agreement reduced the facility limit and reconfirmed the interest rate set out in the First Supplementary Loan Agreement.

In the event that the Shareholders approve Resolution 4, the Independent Expert has concluded that the Second Supplementary Loan Agreement does not deal with issues that give rise to a measurement of fairness as the reduction in the interest rate to 5.22% per annum would have already been approved by Resolution 4.

The Independent Expert Report notes that should Shareholders reject Resolution 4, the effect of Resolution 5 will be to effectively reduce the interest rate from 6.00 % per annum to 5.22% per annum. In this scenario, the Independent Expert considers the benefit received by the Borrower (estimated to be in the range of \$2.1 to \$4.0 million) exceeds the value of the consideration offered by the Borrower to the Lender (\$nil) and therefore conclude that Resolution 5 is not fair.

#### *Assessment of reasonableness*

The Independent Expert Report notes that the lower facility limit imposed by the Second Supplementary Agreement Loan Agreement acts to reduce the risks faced by the Company.

### 5.4 Chapter 2E of the Corporations Act

The requirements of Section 208 of the Corporations Act are discussed in section 4.4 above.

As discussed above:

- (a) Mr Philip Widjaya is a Director of the Company and accordingly, a related party of the Company;

- (b) Mr Widjaya is also the controlling shareholder of the Borrower and accordingly, the Borrower is also a related party of the Company; and
- (c) the Guarantor is an entity controlled by the Borrower and accordingly, the Guarantor is also a related party of the Company.

Under normal circumstances, section 208 requires shareholder approval be obtained prior to a financial benefit being provided. Shareholder approval had not been obtained at the time the Second Supplementary Loan Agreement was entered into on the basis that it is the Board's view that the 'arm's length' exception in section 210 of the Corporations Act applies to any financial benefit provided in connection with the Second Supplementary Loan Agreement the subject of Resolution 5. (These are the views and beliefs of the Board and are not supported by the conclusions drawn by the Independent Expert.) Section 210 provides that shareholder approval is not required to give a financial benefit on terms that would be reasonable in the circumstances if the Company and related parties were dealing at arm's length. For the Second Supplementary Loan Agreement, the Board considers that this exception applies on the basis that the terms of the Loan remain comparable to standard market terms in China, and that the Loan is adequately secured.

Notwithstanding the above, Shareholder approval for the Second Supplementary Loan Agreement is being sought for the reasons set out in section 5.1 and to ratify and affirm the Board's approval of the Second Supplementary Loan Agreement. Because Mr Widjaya is a related party to whom the First Supplementary Loan Agreement would provide a financial benefit, he and his Associates are excluded from voting on the approval of the Second Supplementary Loan Agreement.

## **5.5 Technical information required by section 219 of the Corporations Act**

Pursuant to and in accordance with the requirements of section 219 of the Corporations Act, the following information is provided in relation to the Second Supplementary Loan Agreement, the subject of Resolution 5:

- (a) the related parties are Mr Widjaya, the Borrower and the Guarantor.
- (b) the nature of the financial benefit is
  - (1) if Resolution 4 is not approved by Shareholders, the interest saving to the Borrower as a result of the reduction in the interest rate pursuant to the Second Supplementary Loan Agreement but noting that the interest saving to the Borrower under the Second Supplementary Loan is reduced to be in the range of \$2.1 million to \$4.0 million (compared with \$2.1 million to \$4 million under the First Supplementary Agreement) – refer to Independent Expert Report section 11.3;
  - (2) if Resolution 4 is approved by Shareholders, the economic and commercial consequences for the Company as a result of any future loss of opportunity to earn interest income under the Loan.
- (c) based on the information available, including that contained in this Explanatory Statement and the Independent Expert's Report, all of the Directors (with the exception of Mr Widjaya who has abstained from making any recommendation due to his material personal interest in the outcome of the Resolution 5) consider that Resolution 5 is overall in the best interests of the Company and recommend that Shareholders vote in favour of Resolution 5.
- (d) the Directors are not aware of any other information (other than set out in this Explanatory Statement or the Independent Expert's Report) that would be reasonably required by

Shareholders to allow them to make a decision whether it is in the best interests of the Company to pass Resolution 5.

## 6. Advantages and benefits of the Loan to the Company

Set out below are the key advantages of and potential benefits of the Loan to the Company and therefore, possible reasons why Shareholders may wish to approve Resolution 4 and Resolution 5. The following list is not an exhaustive list of all possible advantages and benefits of the Loan.

- (a) **(Commercial opportunity to continue to earn interest income at rates comparable to alternative investments):** Having reviewed the Historic Loan Agreement (as varied by the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement), related repayment plans, financial projections, the financial status of the Borrower and the Guarantor and the Independent Expert's Report, the Board considers that the Loan remains a commercial opportunity to continue to earn interest income at market rate with relatively low risk.

In assessing its options for usage of funds set aside for the Loan, the Board has considered the Company's Consolidated Group's business performance against current market conditions for the home textiles market and is still of the view that its current scale of operations is appropriate and does not warrant any further significant business expansion expenditure for the time being. In light of the foregoing reasons and the Board's view that the Loan is still made on terms comparable to standard market terms in China and is adequately secured, the Board continues to consider the Loan to be an arm's length commercial transaction that does not materially impact on the main operations of the Company's Consolidated Group. (These are the views and beliefs of the Board and are not supported by the conclusions drawn by the Independent Expert.) Notwithstanding this, the Board may review its commitment under the Loan (as varied by the First Supplementary Loan Agreement and Second Supplementary Loan Agreement) if other opportunities arise for the Company to alternatively deploy the funds which could yield relatively better commercial returns.

- (b) **(Encouragement given to industry by Chinese government policy):** The Loan allows the Company to have comparatively lesser risk exposure in its capacity as a financier as opposed to a shareholder, to a business operating in a prospective industry in China. Of particular relevance to Shareholders is the encouragement given by Chinese government policy to the industry sector in which the Guarantor operates, which is relevant in terms of assessing the overall prospects and potential risks for a business in China. In this case, the Borrower's utilisation of the borrowed funds in a business that is in an encouraged industry sector in China means that it will receive preferential treatment and support from Chinese government authorities and Chinese financial institutions and generally have a better prospective risk outlook. Had the borrowed funds been invested as equity in the business, there would have been a direct exposure to the business risks, whereas as secured loans, the risks are indirect and provides the Lender with a greater measure of control and assurance.
- (c) **(Future expectation of the Borrower and Guarantor to generate strong profits and cash flows):** The positive assessment of the Loan given by the Board is due to the Guarantor's strong profits and cash flows since 1 July 2015. Since 1 July 2015, the Borrower has shown that it is able to keep up with repayments and at times even accelerated payment. The Borrower's demonstrated ability to keep up with repayments has been a key consideration underlying the Directors' recommendations in section 8.

However, Shareholders should be aware that, prior to the entry into the First Supplementary Loan Agreement, the original Principal Limit had been permitted to be exceeded by the Lender. This is discussed further in section 7(f).

- (d) **(Reduction in Principal Limit):** While the Company is seeking Shareholder approval as a result of an increase in the Principal Limit in Resolution 4, the Company and the Borrower subsequently agreed to reduce the Principal Limit of the Loan from RMB 666,693,298 to RMB 386,693,298 (A\$133,338,660 to A\$77,338,660 based on an exchange rate of RMB 1 = A\$0.200 / A\$1 = RMB5.00) under the Second Supplementary Loan Agreement. The value of the Pledged Assets, as recorded on the certificate of pledge registry, represents 116% of the value of the now reduced Principal Limit of the Loan.

As at the date of this Explanatory Statement, the Board is considering its strategy for the use of the excess cash available. This will involve the Board looking for further commercial opportunities to invest, or alternatively declaring a dividend to Shareholders.

However, the Board acknowledges that the reduction in the Principal Limit will result in a reduction in the interest income of the Company's Consolidated Group in the next financial year.

- (e) **(Improved coverage rate of the Security):** The value of the Pledged Assets, as recorded on the certificate of pledge registry, represents 116% of the value of the now reduced Principal Limit of the Loan (pursuant to the Second Supplementary Loan Agreement). Nonetheless, the Board will continue to monitor the financial status of the Borrower and the Guarantor (including the value of the Pledged Assets) in relation to whether the Borrower and Guarantor are in a position which would put at risk repayment of the Loan.

## 7. Disadvantages of the Loan

Set out below are the disadvantages of and potential reasons not to approve Resolution 4 and Resolution 5. This is not an exhaustive list of all possible disadvantages or reasons that Shareholders may consider not to approve the Resolutions.

- (a) **(Default):** The Borrower may default under the Loan. This may result in the recovery of some or all of the outstanding principal balance of the Loan, at the time of default, being at risk. There have been instances prior to the entry into the First Supplementary Loan Agreement, where the original Principal Limit had been permitted to be exceeded by the Lender.
- (b) **(Security valuations):** Only approximately 19% of the value of the Pledged Assets is supported by independent valuation. The remainder of the value of the Pledged Assets is based on the Lender's estimate of fair value of those Assets derived from their unaudited carrying value. The value of these Pledged Assets (especially plant and equipment) may have depreciated against the value of those Pledged Assets recorded on the certificate of pledge registry.

Prior to the entry into the Second Supplementary Loan Agreement, the value of the Pledged Assets represented only 67% of the value of then increased Principal Limit of the Loan (as varied by the First Supplementary Loan Agreement).

The Directors do not consider the Borrower is likely to default in its obligations under the Loan (especially given the entry into the Second Supplementary Loan Agreement and the significantly reduced Principal Limit).

- (c) **(Alternative investments):** Limited information has been provided to Shareholders regarding potential alternative uses for the Loan funds or the opportunity cost of lending the Loan funds. The Directors consider that the main alternative purposes would be to use the funds to expand the operations of the Company and other entities comprising the Company's Consolidated Group or alternatively, to invest the money in securities or other investments in

China or in Australia. These alternative investments may provide a better use for the Loan funds advanced to the Borrower.

At the present time, the Directors are of the opinion that it would not be profitable to expand operations of the Company's Consolidated Group and given current market conditions, the Loan with its commercial rate of return provides a fair and reasonable investment opportunity.

- (d) **(Impact on other creditors):** While the Loan has not had a negative impact on the creditors of the Company or those entities comprising the Company's Consolidated Group, it may limit the Company's ability to borrow in the future.
- (e) **(Working capital deficit):** The financial reports of the Company as at 31 December 2015 show a working capital deficiency of approximately \$35,402,000. If the Company is required to borrow to maintain working capital, this would have a negative effect on the benefits provided by the Loan.
- (f) **(History of failure to make Loan repayments):** The Borrower and the Guarantor have previously failed to meet their obligations in relation to periodic repayment of the Loan and have exceeded the Principal Limit of the Loan at various points in 2014 and 2015 (prior to the entry into the First Supplementary Loan Agreement). The Board notes that those instances were on a short term basis and the limit has been kept within the original Principal Limit since 1 July 2015.

Given the entry into the Second Supplementary Loan Agreement and the now significantly reduced Principal Limit, the Directors consider that the risk of the Borrower failing to meet future repayment obligations under the Loan is low, in particular, due to strong revenue of the Guarantor. The Board notes that prior to the entry into the First Supplementary Loan Agreement, the Lender permitted the Borrower to exceed the original Principal Limit of the Loan.

- (g) **(Exchange rate risk):** Exchange rate risk affecting the value of the Loan and the Pledged Assets (both of which are denominated in RMB) when the reporting currency of the Company's Consolidated Group is \$AUD.

## 8. Directors' recommendations

For the reasons given below and additionally by each Company Director respectively below, each Director recommends Shareholder approval of the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement pursuant to Resolutions 4 and 5, with the exception of Mr Philip Widjaya who has abstained from making any recommendation due to his material personal interest in the outcome of the proposed resolutions as a related party.

The Board acknowledges and has considered the Independent Expert's views and assessment of Resolution 4 relating to the First Supplementary Loan Agreement and Resolution 5 relating to the Second Supplementary Loan Agreement. It is noted that the Independent Expert has regarded these two resolutions not to be interdependent and therefore have assessed them separately. However, the Directors are of the view that the First and Second Supplementary Loan Agreements cannot be considered in isolation and should be considered within the context of the Loan (noting the Shareholders prior approval of the Historic Loan Agreement) as both the First and Second Supplementary Loan Agreements seek to amend the underlying terms of that Loan. The business decisions of the Company require consideration of broader commercial considerations taking into account the Company's specific and general state of affairs. In that regard the Board has considered the conduct of the Loan as well the Borrower's repayment performance over time as important considerations. In the Board view's, the Loan (as amended by the First and Second Supplementary

Loan Agreements) has overall presented positive commercial and financial outcomes for the Company.

Whereas it is acknowledged that there are inherent risks involved in transactions of this type, those risks have in the Directors' view been sufficiently mitigated under the current circumstances by the level and type of security provided in the form of the described Pledged Assets. While only a portion of those assets have been independently valued, the Directors accept that there is sufficient experience and information upon which a reasonable overall valuation of the Pledged Assets has been reached by the Lender and which has been accepted by the Board to provide adequate security for the Loan. Even though only a smaller portion of the Pledged Assets has been supported by independent valuation, in terms of assessing the adequacy of the Security for the Historic Loan Agreement, the fact that some of those assets had been acquired close to around the time which the Historic Loan Agreement was entered into provides assurance to the Directors that the market value for those assets should not be significantly different to the carrying value (which formed the basis for the value of the Security). In further consideration of the adequacy of the Security for the purposes of the First Supplementary Loan Agreement which involved an increased Principal Limit, the Board believes there is support that the overall value of the Pledged Assets has increased since the time of the Historic Loan Agreement due to the completion of construction works on the pledged land, building and production facility of the Guarantor as well as based on increasing property prices in the local market where the pledged land and buildings are located.

In terms of the overall conduct of the Loan, while there had been instances where prior to the entry into the First Supplementary Loan Agreement, the original Principal Limit had been permitted to be exceeded by the Lender, the Board notes that those instances were on a short term basis and the limit has been kept within the original Principal Limit of \$93.33 million since 1 July 2015 and further reduced and not exceeding the reduced Principal Limit of \$77.33 million as per the Second Supplementary Agreement since 1 April 2016. Since 1 July 2015, the Borrower has shown that it is able to keep up with repayments and at times even accelerated payment. The Borrower's demonstrated ability to keep up with repayments has been a key consideration in the Directors' approval of the First Supplementary Loan Agreement. Another key consideration is that the increased Principal Limit provides an opportunity for increased interest revenues to be earned. Although it is noted by the Independent Expert that taking into account the Company's outstanding borrowings in the form of notes payable which are interest bearing with the current interest rate being 4.35% per annum, based on the reduced 5.22% interest rate under the First Supplementary Loan Agreement, would represent a margin of 0.87% earned on Loan interest. In any case, in setting the interest rate for the Loan, the Lender has taken account of the comparable bank lending rates to ensure that the Loan interest is comparable and higher. With regards to the Second Supplementary Loan Agreement, the significant reduction of the Principal Limit similarly reduces the associated Loan risks, albeit at the cost of interest revenue. This does however free up capital for the Company to consider alternative usage for the funds and investment opportunities as well as potential dividend return for Shareholders.

In looking at alternative investments, although there are potential options available within and outside of China, as the Company's business experience and expertise are still primarily China based, the preference was to focus on alternative investments in China to take advantage of the Company's Consolidated Group's market knowledge and expertise. While the Board is generally not averse to considering investments outside of China, but given its lack of investment experience in markets outside of China, that was considered to heighten the associated risks for the Company's Consolidated Group. The Directors consider the risks associated with the Loan to be relatively lower than other alternative investments such as equities, financial products and direct investment. In particular, at the time of the Historical Loan Agreement some consideration was given as to whether the Company would directly invest in the steel plate pressing business of the Guarantor given it comes under an encouraged industry in China. However the Board's view is that that would involve a

risk proposition and exposure higher than what the Company was prepared to accept. The Board has considered the overall performance of the Company's Consolidated Group's business and the current reduced home textiles market to determine that further expansion of the Company's business is currently not warranted. In overall, the Loan presented a good opportunity to earn interest income at an acceptable level of risk.

For the reasons above and in this Explanatory Statement, and despite the views of the Independent Expert regarding the two supplementary loan agreement, the Board maintains its view that the Loan and the First and Second Supplementary Loan Agreements still qualify at all material times for the 'arm's length' exception referred to in sections 4.4 and 5.4 above. (These are the views and beliefs of the Board and are not supported by the conclusions drawn by the Independent Expert.) In particular, with reference to the Independent Expert's finding that the First Supplementary Loan Agreement to be not fair and not reasonable, the Board notes that the adjustment of the interest rate under the First Supplementary Loan Agreement from 6% per annum to 5.22% per annum is still comparatively higher than the one-year Chinese bank lending rate of 4.35% at the time. Also the Board relies on the Lender's assessment of the overall improved value of the Pledged Assets since the Historic Loan Agreement to provide adequate security for the Loan despite the increased Principal limit under the First Supplementary Loan Agreement. In relation to the Secondary Loan Agreement, the Board notes that the interest rate is still comparatively higher to the bank lending rate and the reduced Principal Limit is fully secured by the Pledged Assets. The Board also takes into account that the recoverability of the Loan in terms of the nature of the Security is in its view consistent with market practice and expectations and that all other material terms of the Loan agreements are also in its view consistent with agreements of this nature and type in the Chinese market. Notwithstanding this view, Shareholder approval has been sought for the First and Supplementary Agreements as formal ratification and affirmation of the Board's views and actions on the matter, which have been taken by the Board on the basis that such agreements document a Loan transaction on 'arm's length' terms.

(a) Ms Xiaohong Chen

Ms Xiaohong Chen concurs with the Directors' views expressed above and recommends Shareholder approval of the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement for the reasons outlined in this Explanatory Statement, and also expresses the following views with regards to the Loan.

Ms Chen is of the view that the terms of the First and Second Supplementary Loan Agreements are typical of a loan transaction of this type in China, and would therefore likely qualify as a transaction on 'arm's length' terms, taking into account both the interest rate payable by the Borrower and the nature and amount of the underlying Security provided to the Lender, as outlined above and in the Independent Expert's Report.

With regard to Philip Widjaya as a related party to the Loan and the First and Second Supplementary Loan Agreements, Ms Chen believes that Mr Widjaya, as founder of the Shenhua Group and who has led the management and positive performance of the Company's Consolidated Group over the years, has demonstrated that he can be continued to be trusted to reasonably and sufficiently consider and treat the Company's interests with priority and act in the best interests of the Company in all dealings including the current Loan and the First and Second Supplementary Loan Agreements.

(b) Ms Lijuan Wang

Ms Lijuan Wang concurs with the Directors' views expressed above and recommends Shareholder approval of First and Second Supplementary Loan Agreements for the reasons outlined in this Explanatory Statement, and also expresses the following views with regards to the Loan.



Ms Wang is of the view that the terms of the First and Second Supplementary Loan Agreements are typical of a loan transaction of this type in China, and would therefore likely qualify as a transaction on 'arm's length' terms, taking into account both the interest rate payable by the Borrower and the nature and amount of the underlying Security provided to the Lender, as outlined above and in the Independent Expert's Report.

As an executive of the Lender, Ms Wang acknowledges that there should have been better communications between the Lender and the Board regarding the original Principal Limit being permitted to be exceeded. Since then, Ms Wang and the other Company executives have undertaken to ensure that the status of the Loan and repayments are monitored more closely, that the Board is kept up to date regarding its status and to alert the Company if there are any actual or foreseeable risks of default by the Borrower.

(c) Mr James Yong Wan

Mr James Yong Wan concurs with the Directors' views expressed above and recommends Shareholder approval of the First and Second Supplementary Loan Agreements for the reasons outlined in this Explanatory Statement, and also expresses the following views with regards to the Loan.

Mr Wan accepts the view that the First and Second Supplementary Loan Agreements each appears to qualify for the 'arm's length' exception referred to in sections 4.4 and 5.3 above, but as a matter of prudence, considers that Shareholder approval should still be sought.

Mr Wan believes that the Loan, despite being a related party transaction, has been entered into in the best interests of the Company and Shareholders. Given that the Company's business and operating funds are based in China, he considers that alternative investment options would realistically also be China-based and in that context, the Loan is a relatively lower risk proposition compared to other alternatives in China, such as direct investment. Having considerable business experience in Australia and China, his perspective on the related party transaction of the Loan and the First and Second Supplementary Loan Agreements is that it allows the Lender greater insight to the operations of the Borrower and Guarantor for its risk assessment and management, as well as providing a higher measure of control for the Lender over how the Loan is conducted. In this regard, he believes that Philip Widjaya will operate in the best interests of the Company and the Lender.

(d) Mr Pierre Lau

Mr Pierre Lau concurs with the Directors' views expressed above and recommends Shareholder approval of the First and Second Supplementary Loan Agreements for the reasons outlined in this Explanatory Statement and also expresses the following views with regards to the Loan.

Mr Lau has advocated for Shareholder approval of the Loan and the First and Second Supplementary Loan Agreements despite the fact that there are differing views from the Board that it may be overly cautious on account of the grounds for the 'arm's length' exception.

Mr Lau accepts the view that the First and Second Supplementary Loan Agreements each appears to qualify for the 'arm's length' exception referred to in sections 4.4 and 5.3 above, but as a matter of prudence and in light of the views expressed in the Independent Expert Report, considers that Shareholder approval should be sought primarily in light of the quantum involved and so that Shareholders are appropriately informed of the circumstances of the Loan, the opinions of the Independent Expert and the Board's decisions surrounding the First and Second Supplementary Loan Agreements.

**9. Voting Exclusion Statement**

The Company will disregard any votes cast in relation to this resolution by:

- (a) Joyful Huge Holdings Limited;
- (b) any person who might obtain a benefit, or expect a benefit solely in the capacity of a Shareholder, if this resolution is passed; and
- (c) any Associates of those persons described in paragraphs (a) and (b).

However, the Company need not disregard a vote if it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form, or it is cast by the Chair as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

## GLOSSARY

Unless the context otherwise requires, in this Explanatory Statement:

**Annual General Meeting** means the annual general meeting of the Company to be held at 2.00 pm (ACST) on Wednesday 30 November 2016 at Level 1, 67 Greenhill Road, Wayville, Adelaide, South Australia.

**ASIC** means the Australian Securities & Investments Commission.

**ASX** means ASX Limited ACN 008 624 691 or the financial market operated by ASX Limited, as the context requires.

**Associate** has the meaning given to that term in the Corporations Act.

**Board** means the board of directors of the Company.

**Borrower** means Shaoxing Shenhua Decoration Co. Ltd, being a company incorporated under the laws of China.

**Chair** means the chair of the Annual General Meeting.

**Company** means Shenhua International Limited ABN 17 134 436 730.

**Company's Consolidated Group** means the Company and its controlled entities.

**Corporations Act** means the *Corporations Act 2001* (Cth).

**Directors** means the current directors of the Company.

**Explanatory Statement** means this explanatory statement accompanying the Notice.

**First Supplementary Loan Agreement** means the agreement so described in section 4.2 of this Explanatory Statement.

**Guarantor** means Zhejiang Binhai Metal Products Co. Ltd, being a company incorporated under the laws of China.

**Historic Loan Agreement** means the agreement so described in section 3.6 of this Explanatory Statement.

**Independent Expert** means DMR Corporate Pty Ltd.

**Independent Expert's Report** means the independent expert's report accompanying this Explanatory Statement.

**Lender** means Shaoxing Shenhua Textile Co. Ltd, being a company incorporated under the laws of China.

**Loan** means the loan facility advanced under the Historic Loan Agreement (as amended by the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement, as the context requires).

**Notice** means the notice of the Annual General Meeting accompanying this Explanatory Statement.

**Pledged Assets** has the meaning given to that term in section 3.7 of this Explanatory Statement.

**Principal Limit** means the principal limit of the Loan facility advanced by the Lender to the Borrower.

**Proxy Form** means the proxy form accompanying the Notice.

**related party** has the meaning given to that term in Chapter 2E of the Corporations Act.

**Resolutions** means the resolutions set out in the Notice, or any one of them, as the context requires.

**Second Supplementary Loan Agreement** means the agreement so described in section 5.2 of this Explanatory Statement.

**Security** means the security provided by the Borrower and the Guarantor to the Lender over the Pledged Assets as described in section 3.7 of this Explanatory Statement.

**Share** means a fully paid ordinary share in the capital of the Company.

**Shareholder** means the registered holder of one or more Shares.

18 October 2016

Mr Pierre Lau  
Non-executive Director  
Shenhua International Limited  
Level 41,  
ANZ Tower, 55 Collins Street,  
MELBOURNE, VIC 3000

Dear Sir,

**Independent Expert's Report**

**1. Introduction**

The independent directors of Shenhua International Limited ("Shenhua" or "the Company") have requested DMR Corporate Pty Ltd ("DMR Corporate") to prepare an independent expert's report dealing with changes to the terms of an existing loan made by Shaoxing Shenhua Textile Co. Ltd ("Shenhua Textile" or "the Lender"), a wholly owned subsidiary of Shenhua. Shareholders are being asked to approve the changes at the forthcoming Annual General Meeting of Shenhua. The specific approval sought is set out in Resolutions 4 and 5 in the Notice of Meeting to which this report is an attachment.

Shenhua Textile is a company incorporated in the People's Republic of China.

The existing loan was entered into between Shenhua Textile and Shaoxing Shenhua Decoration Co. Ltd ("Shaoxing" or "the Borrower") on 30 June 2014.

We understand that Mr Philip Widjaya, the Managing Director of Shenhua has a beneficial interest in 58.3% of Shenhua's ordinary shares. We also understand that Mr Widjaya is the controlling shareholder of Shaoxing. By virtue of Mr Widjaya's position Shaoxing is a related party of Shenhua.

As both of the proposed resolutions amend the terms of a loan to a related party, the resolutions are covered by provisions of Chapter 2E of the Corporations Act 2001 ("the Act").

**2. Background**

**2.1 Original Loan**

At the Annual General Meeting held on 19 December 2014, the shareholders of Shenhua approved the following resolution:

"That the loan to be made under the Loan agreement between Shaoxing Shenhua Textile Co., and Shenhua Decoration Co., Ltd (Loan Agreement) be approved".

The explanatory notes that accompanied the Notice of Meeting provided the following relevant information in support of the above resolution:

DMR Corporate Pty Ltd  
ACN 063 564 045  
AFSL No. 222050

In association with PKF

Melbourne  
Level 12, 440 Collins Street  
Melbourne VIC 3000 Australia

p (03) 9679 2350  
(03) 96792351

PKF International Limited administers a network of legally independent firms which carry on separate businesses under the PKF Name. PKF International Limited is not responsible for the acts or omissions of individual member firms of the network.

For office locations visit [www.pkf.com.au](http://www.pkf.com.au)

### **5.1 Background to Loan Agreement**

As part of the Company's annual audit, the Company's auditors (Grant Thornton) identified that the loan (Loan) under the Loan Agreement, which is between the Company's subsidiary Shaoxing Shenhua Textile Co., Ltd (the Lender) and Shaoxing Shenhua Decoration Co., Ltd (the Borrower), is a related party transaction. The Loan is transacted in China and both the Borrower and Lender are companies incorporated in China. The terms of the Loan Agreement (as discussed further below) are consistent with standard market practice in China. This investigation process inadvertently caused considerable delay in the completion of the Company's annual audit and issuance of its annual report, which in turn delayed the holding of the AGM.

The purpose of the Loan to the Borrower is to fund investment and working capital in the stainless steel business operated by the Borrower's subsidiary, Zhejiang Binhai Metal Products Co., Ltd (BHMP), but specifically for the acquisition of land use rights for development of BHMP's manufacturing facility in China.

As detailed further in Section 5.3, Mr Philip Widjaya is the controlling shareholder and principal legal representative of the Lender, the Borrower and BHMP. Neither the Borrower nor BHMP are part of the Company's Consolidated Group (as the term is defined in the Company's annual report).

This business operated by BHMP represents a category of encouraged business industry under Chinese government policy. The Borrower sought to obtain the Loan on market terms from the Lender, secured against the land acquired by BHMP (as well as against other assets as detailed in Section 5.2). From the Company's perspective, and as discussed further below, these factors go towards de-risking the Loan, presents the Consolidated Group with the opportunity to earn interest income, and also provides the Company with some exposure to a prospective industry in China.

### **5.2 Terms of Loan Agreement**

Under the Loan Agreement, the Loan amount is RMB 466,693,297 (approximately A\$80.272 million). The Loan carries a fixed interest rate of 6% per annum, payable every six months, and is secured against land use rights (over land in Shaoxing in Zhejiang province, China) and non-current assets of the Borrower and BHMP with the carrying value of approximately RMB 414.66 million (approximately A\$71.322 million) as of 30 June 2014 (and total asset value of RMB 715.5 million, approximately A\$123.067 million) (Security).

The Loan term ends on 30 June 2022 and all principal is required to be repaid in full by the end of the term. The Company's directors expect yearly repayments to be made to reduce the Loan principal amount owed.

Under the Loan Agreement, the Borrower would be in default if it fails to repay the interest or principal due under the Loan within one month of receiving a late repayment notice from the Lender (Default). In the event of a Default, the Lender will have the right to enforce its Security interests in accordance with terms typical of this type of loan transaction. That is, in the event of Default, it is within the rights of the Lender to cause for title to the Security to be transferred to the Lender, or for the Security to be sold and the sale proceeds applied to repayment of the Loan. With regards to the latter, no factors have been identified that are likely to materially delay such sale, and no other material issues have been identified that would compromise the liquidity of the Security.

## 2.2 First Supplementary Loan Agreement

Shenhua's Half Year report for the period to 31 December 2015, released on 29 February 2016 disclosed that:

"A new supplementary agreement was signed on 26 November 2015, in which the interest rate was changed to 5.22% p.a. from 6%. The loan carries a fixed interest rate of 5.22% p.a. (consistent with the market rate in PRC) payable on an annual basis and is secured against land use rights and non-current assets of SDL and BHMP with the carrying value of approximately RMB 332 million (\$70 million) as at 31 December 2015.

The loan receivable is denominated in RMB and has reduced from \$94,598,630 (RMB 442,463,192) as at 30 June 2015 to \$70,225,528 (RMB 332,664,749) as 31 December 2015."

## 2.3 Second Supplementary Loan Agreement

On 12 March 2016 Shenhua Textiles and Shaoxing entered into a further agreement referred to as the Second Supplementary Loan Agreement in the balance of this report. The key change to the term of the loan was to reduce the loan limit to RMB 386,693,298. The Second Supplementary Loan Agreement also provides that interest is payable at a rate of 5.22% per annum, payable six-monthly.

## 3. The Proposed Related Party Transactions

### 3.1 Proposed Resolutions to be Approved by Shareholders

Shenhua is seeking shareholder approval for the following two resolutions:

#### Resolution 4 - First Supplementary Loan Agreement

"That, for the purpose of Section 208 of the Corporations Act and for all other purposes, the Shareholders approve and ratify the Company and the Lender entering into and complying with the terms of the First Supplementary Loan Agreement dated 26 November 2015 between Shaoxing Shenhua Textile Co. Ltd, as Lender, Shaoxing Shenhua Decoration Co. Ltd, as Borrower, and Zhejiang Binhai Metal Products Co. Ltd, as Guarantor, in accordance with the terms and conditions set out in the Explanatory Statement."

#### Resolution 5 - Second Supplementary Loan Agreement

"That, for the purpose of Section 208 of the Corporations Act and for all other purposes, Shareholders approve and ratify the Company and the Lender entering into and complying with the terms of the Second Supplementary Loan Agreement dated 1 April 2016 between Shaoxing Shenhua Textile Co. Ltd, as Lender, Shaoxing Shenhua Decoration Co. Ltd, as Borrower, and Zhejiang Binhai Metal Products Co. Ltd, as Guarantor, in accordance with the terms and conditions set out in the Explanatory Statement."

The Directors of Shenhua have requested DMR Corporate to prepare an independent expert's report in accordance with Australian Securities and Investments Commission ("ASIC") Regulatory Guide 111 – Content of expert reports ("RG 111"). Our report has also been prepared in accordance with the requirements of ASIC Regulatory Guide 76, Related Party Transactions ("RG 76").

Whilst both resolutions seek approval for changes to certain terms of the original loan agreement, the resolutions are not interdependent. This means that shareholders are free to approve or not approve either or both resolutions. For this reason we deal with the two resolutions separately and provide a separate evaluation and conclusion in respect of each resolution.

#### 4. Summary Opinions

In our opinion, the proposal contained in Resolution 4 - First Supplementary Loan Agreement is **not fair and not reasonable** when considered in the context of the interests of the Shenhua Non-Associated Shareholders.

In our opinion, the proposal contained in Resolution 5 - Second Supplementary Loan Agreement:

**is reasonable** provided shareholders approve Resolution 4; and

**is not fair and not reasonable** if shareholders reject Resolution 4.

**Our principal reasons for reaching the above opinions are:**

##### 4.1 Resolution 4 - First Supplementary Loan Agreement

###### Assessment of Fairness

In Section 9.4 we estimated that the value of the interest saving to Shaoxing as a result of the reduction in the interest rate from 6.00% per annum to 5.22% per annum is in a range of RMB 10,394,000 and RMB 20,382,000, or \$2.1 million to \$4.1 million over the life of the loan<sup>1</sup>.

The First Supplementary Loan Agreement did not provide any consideration to Shenhua for agreeing to lower the rate of interest.

As the value of the benefit received by Shaoxing (estimated to be in a range of \$2.1 million to \$4.1 million) exceeds the value of the consideration offered by Shaoxing to Shenhua (\$nil), we have concluded that Resolution 4 is not fair.

###### Assessment of Reasonableness

In Section 12.2 we set out a range of other factors that we considered in assessing whether the proposal contained in Resolution 4 is reasonable and after considering these factors we concluded that it is not reasonable. Our principal reason for this view is that Shenhua has borrowed the funds on-lent to Shaoxing using its own assets as security and it is earning a margin of approximately 0.87% on the transaction. In our opinion this is an insufficient risk premium given the relatively poorer security obtained from Shaoxing.

##### 4.2 Resolution 5 - Second Supplementary Loan Agreement

###### Assessment of Fairness

The Second Supplementary Loan Agreement reduced the facility limit and reconfirmed the interest rate set out in the First Supplementary Loan Agreement.

In the event that shareholders approve Resolution 4, we have concluded that the Second Supplementary Loan Agreement does not deal with issues that give rise to a measurement of fairness as the reduction in the interest rate to 5.22% per annum would have already been approved by Resolution 4.

On the other hand, should shareholders reject Resolution 4, the effect of Resolution 5 will be to effectively reduce the interest rate from 6.00% per annum to 5.22% per annum. In this scenario the benefit received by Shaoxing (estimated to be in a range of \$2.1 million to \$4.0 million – Section 10.3) exceeds the value of the consideration offered by Shaoxing to Shenhua (\$nil), and we have therefore concluded that Resolution 5 is not fair.

###### Assessment of Reasonableness

The lower facility limit imposed by the Second Supplementary Loan Agreement acts to reduce the risks faced by Shenhua.

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<sup>1</sup> Throughout this report we have used an exchange rate of A\$1.00:RMB5.00

## 5. Structure of this Report

This report is divided into the following sections:

| <b>Section</b>  |  | <b>Page</b> |
|-----------------|--|-------------|
| 6               | Purpose of the Report  | 5           |
| 7               | Shenhua – Key Information  | 9           |
| 8               | Related Party Loan   | 12          |
| 9               | Evaluation of the First Supplementary Loan Agreement                                       | 15          |
| 10              | Evaluation of the Second Supplementary Loan Agreement                                      | 17          |
| 11              | Assessment as to Fairness  | 18          |
| 12              | Assessment as to Reasonableness  | 19          |
| 13              | Conclusion as to Fairness and Reasonableness of the Proposed<br>Related Party Transactions | 20          |
| 14              | Financial Services Guide   | 21          |
| <b>Appendix</b> |  |             |
| A               | Sources of Information   | 23          |
| B               | Declarations, Qualifications and Consents  | 24          |

## 6. Purpose of the Report

6.1 This report has been prepared to meet the following regulatory requirements:

- **Corporations Act 2001 – Chapter 2E**

Section 208 of the Corporations Act 2001 (“the Act”) states that a public company must obtain approval from the company’s members if it gives a financial benefit to a related party unless the giving of the benefit falls within the scope of one of the exceptions set out in Sections 210 to 216 of the Act.

Section 210 of the Act states that member approval is not needed to give a financial benefit on terms that:

- (a) would be reasonable in the circumstances if the public company or entity and the related party were dealing at arm’s length; or
- (b) are less favourable to the related party than the terms referred to in paragraph (a) above.

Section 228 of the Act defines ‘related parties’ as:

- (a) directors of the public company;
- (b) directors (if any) of an entity that controls the public company;
- (c) if the public company is controlled by an entity that is not a body corporate – each of the persons making up the controlling entity;
- (d) spouses and de facto spouses of the persons referred to in paragraphs (a) to (c) above.

- **ASIC Regulatory Guides**

This report has been prepared in accordance with ASIC Regulatory Guides and more particularly:



**RG 76 – Related Party Transactions**

- RG 76.104 To ensure that members are provided with sufficient information to assess a proposed related party transaction and decide how to vote, it may be necessary for entities to include a valuation from an independent expert with a notice of meeting for member approval under Ch 2E or Pt 5C.7 where:
- (a) the financial benefit is difficult to value;
  - (b) the transaction is significant from the point of view of the entity (see RG 76.112); or
  - (c) the non-interested directors do not have the expertise or resources to provide independent advice to members about the value of the financial benefit.
- RG 76.106 Independent valuation advice on a proposed related party transaction can help members better understand and assess the proposal and make an informed decision about how to vote. Independent valuation advice can also play an important part in maintaining investor confidence in the management of the entity.
- RG 76.108 There is no express requirement in Ch 2E for an independent expert report to be obtained for provision to members with a notice of meeting. However, we encourage independent expert reports to be obtained and sent to members with the accompanying explanatory material in the circumstances set out in RG 76.104.
- RG 76.109 In our view, under Ch 2E and directors' duties, directors have a general obligation to include information about the value of a financial benefit in a notice of meeting for member approval of a related party benefit. The directors' fiduciary duty of disclosure generally requires notices of meeting for approval of asset sales or acquisitions to include the material information necessary for members to assess whether a transaction is for a fair price, and whether the terms and conditions are onerous or disadvantageous: see *Sunraysia* at 635.
- RG 76.110 The economic and commercial considerations addressed in the examples in s219(2) would often require directors to provide information about the value of the benefit.
- RG 76.111 In some cases, a notice of meeting for approval of a related party benefit could include information about the value of the financial benefit in the form of advice from the non-interested directors. However, given the complexities and inherent conflicts of interest involved in many related party transactions, it is sometimes more appropriate for an entity to commission an independent expert to give an opinion on the proposed transaction.
- RG 76.112 A transaction can be significant from the point of view of an entity – so that an independent expert report may be necessary (see RG 76.104(b)) – for reasons other than the dollar value involved. For example, a transaction may be considered to be significant if it involves a change of business activities or strategic direction, the replacement of the full board, substantial dilution of existing members, or if it is very complex.
- RG 76.113 Regulatory Guide 111 Content of expert reports (RG 111) provides guidance on the content of expert reports for related party and other transactions and how experts should assess related party transactions.

**RG 111 – Content of Expert Reports**

- RG 111.52 Experts who are asked to prepare a report for the following transactions should comply with RG 111.53–RG 111.63:
- (a) a transaction with a related party that requires member approval under Ch 2E.
- RG 111.53 When analysing related party transactions, it is important that an expert focuses on the substance of the related party transaction, rather than the legal mechanism. For example, where a related party transaction is made up of a number of separate components, the expert should consider the overall effect of the related party transaction.
- RG 111.54 Where the related party transaction is one component of a broader transaction or a series of transactions involving non-related parties (such as a control transaction), the expert should carefully consider what level of analysis of the related party aspect is required: see also RG 111.4. In this consideration, the expert should bear in mind whether the report has been sought to ensure that members are provided with sufficient information to decide whether to approve giving a financial benefit to the related party as well as the broader transaction.
- RG 111.55 Generally, ASIC expects an expert who is asked to analyse a related party transaction to express an opinion on whether the transaction is ‘fair and reasonable’ from the perspective of non-associated members. This analysis is specifically required where the report is also intended to accompany meeting materials for member approval of an asset acquisition or disposal under ASX Listing Rule 10.1.
- RG 111.56 Where an expert assesses whether a related party transaction is ‘fair and reasonable’ (whether for the purposes of Ch 2E or ASX Listing Rule 10.1), this should not be applied as a composite test—that is, there should be a separate assessment of whether the transaction is ‘fair’ and ‘reasonable’, as in a control transaction. An expert should not assess whether the transaction is ‘fair and reasonable’ based simply on a consideration of the advantages and disadvantages of the proposal, as we do not consider this provides members with sufficient valuation information. See Regulatory Guide 76 Related party transactions (RG 76) at RG 76.106–RG 76.111 for further details.
- RG 111.57 A proposed related party transaction is ‘fair’ if the value of the financial benefit to be provided by the entity to the related party is equal to or less than the value of the consideration being provided to the entity. This comparison should be made:
- (a) assuming a knowledgeable and willing, but not anxious, buyer and a knowledgeable and willing, but not anxious, seller acting at arm’s length; and
- RG 111.59 In valuing the financial benefit given and the consideration received by the entity, an expert should take into account all material terms of the proposed transactions.
- RG 111.60 A proposed related party transaction is ‘reasonable’ if it is ‘fair’. It might also be ‘reasonable’ if, despite being ‘not fair’, the expert believes there are sufficient reasons for members to vote for the proposal.

RG 111.61 If an expert concludes that a related party transaction is not fair, but reasonable, it should clearly explain the meaning of this opinion, why the expert has reached this conclusion, and the significance of the conclusion to the decision to be made by security holders (e.g. what it might mean for the security holders' decision-making): see also RG 111.16–RG 111.17.

RG 111.62 When deciding whether a proposed transaction is 'reasonable', factors that an expert might consider include:

- (a) the financial situation and solvency of the entity, including the factors set out in RG 111.26, if the consideration for the financial benefit is cash;
- (b) opportunity costs;
- (c) the alternative options available to the entity and the likelihood of those options occurring;
- (d) the entity's bargaining position;
- (e) whether there is selective treatment of any security holder, particularly the related party;
- (f) any special value of the transaction to the purchaser, such as particular technology or the potential to write off outstanding loans from the target; and
- (g) the liquidity of the market in the entity's securities.

## 6.2 General

The terms "fair" and "reasonable" are not defined in the Act, however guidance as to the meaning of these terms is provided by ASIC in Regulatory Guide 111. For the purpose of this report, we have defined them as follows:

- |                |   |  |
|----------------|---|--|
| Fairness       | - | the Proposed Related Party Transactions are "fair" if the value of the benefit received by the related party pursuant to each transaction is equal to or less than the value of the consideration offered by the related party in relation to each transaction.  |
| Reasonableness | - | the Proposed Related Party Transactions are "reasonable" if they are fair. They may also be "reasonable" if, despite not being "fair" but after considering other significant factors, shareholders should vote in favour of the Proposed Related Party Transactions in the absence of a superior proposal being received. |

What is fair and reasonable for the Shenhua Non-Associated Shareholders should be judged in all the circumstances of the proposal.

The methodology that we have used to form an opinion as to whether each of the Proposed Related Party Transactions is fair and reasonable, is summarised as:

- (i) In determining whether the Proposed Related Party Transactions are fair, we have:
  - a) assessed the value of the related party benefit that may be received by Shaoxing as a result of both the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement;

- b) assessed the value of the consideration offered by Shaoxing to Shenhua pursuant to the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement; and
  - c) compared the results of a) and b) above.
- (ii) In determining whether the Proposed Related Party Transactions are reasonable, we have analysed and considered the advantages and disadvantages of the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement.
- (iii) In determining whether the Proposed Related Party Transactions are fair and reasonable to the Shenhua Non-Associated Shareholders, we have considered and concluded upon the results of (i) and (ii) above.

## 7. Shenhua - Key Information

### 7.1 Background

Shenhua was incorporated on 2 December 2008 and its shares were listed on the ASX on 30 July 2009.

The Shenhua Group is one of the leading home textile manufacturers in China. Established in 1999, the operating arm of the Group's business, Shenhua Textile (based in Shaoxing, China), manufactures fabric wall coverings, decorative cloth, sofa fabrics and finished goods (including curtains and drapery, table cloths, cushions and bedding) for both domestic and export customers.

The directors in office at the date of this report are:

| Director           | Position                        |
|--------------------|---------------------------------|
| Ms Xiaohong, Chen  | Chairman                        |
| Mr Philip Widjaya  | Executive and Managing Director |
| Ms Lijuan, Wang    | Executive Director              |
| Mr James Yong, Wan | Non-Executive Director          |
| Mr Pierre Lau      | Non-Executive Director          |

Whilst Shenhua's shares are listed on the ASX, trading in Shenhua's shares was suspended by the ASX on a number of occasions in the recent past, as detailed below:

#### **1 October 2014 to 11 November 2014**

Trading was suspended as from 1 October 2014 due to late lodgment of Shenhua's annual financial statements.

#### **2 March 2015 to 23 March 2015**

Trading was suspended as from 2 March 2015 due to late lodgment of Shenhua's Half Yearly report.

#### **28 August 2015 to 14 September 2015**

Trading was suspended as from 28 August 2015 due to non-payment of listing fees. Trading was reinstated after payment of the listing fees.

#### **1 October 2015 to 7 March 2016**

Trading was suspended as from 1 October 2014 due to late lodgment of Shenhua's annual financial statements.

## 7.2 Share Capital

Shenhua has 125,857,000 ordinary fully paid shares on issue. There are no options or other equity instruments on issue that are convertible into ordinary shares.

## 7.3 Statements of Financial Position

Shenhua's audited statements of financial position as at 30 June 2014 and 2015 and the reviewed statements of financial position as at 31 December 2015 were as follows:

| Consolidated Statement of Financial Position | 31/12/13<br>Reviewed<br>\$000's | 30/06/14<br>Audited<br>\$000's | 30/06/15<br>Audited<br>\$000's | 31/12/15<br>Reviewed<br>\$000's |
|--|---------------------------------|--------------------------------|--------------------------------|---------------------------------|
| <b>Current Assets</b>                        |                                 |                                |                                |                                 |
| Cash & cash equivalent                       | 39,635                          | 48,464                         | 39,273                         | 45,421                          |
| Trade receivables                            | 19,494                          | 14,331                         | 12,306                         | 14,518                          |
| Advances to related party - Shaoxing         | 63,655                          | 80,272                         | 6,414                          | 7,389                           |
| Advances to suppliers                        | 2,324                           | 2,884                          | 1,813                          | 2,118                           |
| Inventories                                  | 12,144                          | 6,038                          | 8,059                          | 6,937                           |
| Other current assets                         | 220                             | 206                            | -                              | -                               |
| Land use rights                              | 282                             | -                              | -                              | -                               |
| <b>Total Current Assets</b>                  | <b>137,754</b>                  | <b>152,195</b>                 | <b>67,865</b>                  | <b>76,383</b>                   |
| <b>Non Current Assets</b>                    |                                 |                                |                                |                                 |
| Other financial assets                       | 688                             | 642                            | 798                            | 788                             |
| Advances to related party - Shaoxing         | -                               | -                              | 88,185                         | 62,837                          |
| Property, plant & equipment                  | 15,135                          | 13,050                         | 16,295                         | 15,466                          |
| Land use rights                              | 9,645                           | 9,134                          | 62,183                         | 60,922                          |
| <b>Total Non Current Assets</b>              | <b>25,468</b>                   | <b>22,826</b>                  | <b>167,461</b>                 | <b>140,013</b>                  |
| <b>Total Assets</b>                          | <b>163,222</b>                  | <b>175,021</b>                 | <b>235,326</b>                 | <b>216,396</b>                  |
| <b>Current Liabilities</b>                   |                                 |                                |                                |                                 |
| Trade & other payables                       | 21,766                          | 22,639                         | 55,090                         | 36,890                          |
| Borrowings                                   | 15,113                          | 14,104                         | 17,532                         | 17,205                          |
| Notes payable                                | 39,938                          | 57,339                         | 56,998                         | 53,777                          |
| Current tax liabilities                      | 3,416                           | 1,486                          | 2,811                          | 3,193                           |
| <b>Total Current Liabilities</b>             | <b>80,233</b>                   | <b>95,568</b>                  | <b>132,431</b>                 | <b>111,065</b>                  |
| <b>Total Liabilities</b>                     | <b>80,233</b>                   | <b>95,568</b>                  | <b>132,431</b>                 | <b>111,065</b>                  |
| <b>Net Assets</b>                            | <b>82,989</b>                   | <b>79,453</b>                  | <b>102,895</b>                 | <b>105,331</b>                  |
| <b>Equity</b>                                |                                 |                                |                                |                                 |
| Issued capital                               | 38,439                          | 38,439                         | 38,439                         | 38,439                          |
| Reserves                                     | (4,761)                         | (11,736)                       | 18,558                         | 16,913                          |
| Retained earnings                            | 49,311                          | 52,750                         | 45,898                         | 49,256                          |
| <b>Total Equity</b>                          | <b>82,989</b>                   | <b>79,453</b>                  | <b>102,895</b>                 | <b>104,608</b>                  |

Source: Shenhua's 2015 Annual Report and 31 December 2015 Half Year Report

## 7.4 Operating Performance

Shenhua's audited consolidated statements of profit or loss and other comprehensive income for the financial years ended 30 June 2014 and 2015 and the reviewed consolidated statements of profit or loss and other comprehensive income for the six month period to 31 December 2015 were as follows:

| <b>Statement of Profit or Loss<br/>and Other Comprehensive Income</b>                  | <b>Audited<br/>Year Ended<br/>30-Jun-14<br/>\$000's</b> | <b>Audited<br/>Year Ended<br/>30-Jun-15<br/>\$000's</b> | <b>Reviewed<br/>Half Year Ended<br/>31-Dec-15<br/>\$000's</b> |
|--|---|---|---|
| <b>Revenue</b>   |   |   |   |
| Sales revenue  | 84,335  | 73,888  | 32,924  |
| Cost of sales  | (69,239)  | (62,160)  | (28,477)  |
| Gross profit   | 15,096  | 11,728  | 4,447   |
| Other revenue  | 413   | 637   | 4,730   |
| Interest revenue   | 974   | 6,524   | <b>Note 1</b>   |
| Distribution costs   | (721)   | (675)   | (511)   |
| Administration costs   | (4,357)   | (8,668)   | (2,822)   |
| Provision for stock obsolescence   | -   | -   | (430)   |
| Finance costs  | (991)   | (4,834)   | (863)   |
| Other expenses   | -   | -   | (18)  |
| <b>Profit before income tax expense</b>  | 10,414  | 4,712   | 4,533   |
| <b>Income tax benefit/(expense)</b>  | (3,016)   | (3,277)   | (1,172)   |
| <b>Profit after income tax expense</b>   | 7,398   | 1,435   | 3,361   |
| <b>Other Comprehensive Income</b>  |   |   |   |
| Exchange differences on translation of foreign operations                              | (2,738)   | 23,895  | (1,645)   |
| <b>Total comprehensive income for the period attributable to members of the parent</b> | 4,660   | 25,330  | 1,716   |

Source: Shenhua's 2015 Annual Report and 31 December 2015 Half Year Report

**Note 1:** The Half Year financial statements do not disclose separately interest revenue, rather interest revenue is included as part of Other revenue

## 7.5 Cash Flow Statements

Shenhua's audited cash flow statements for the financial years ended 30 June 2014 and 2015 and the reviewed cash flow statements for the six-month period to 31 December 2015 were as follows:

| <b>Statement of Cash Flows</b>                   | <b>Audited<br/>Year Ended<br/>30-Jun-14<br/>\$000's</b> | <b>Audited<br/>Year Ended<br/>30-Jun-15<br/>\$000's</b> | <b>Reviewed<br/>Half Year Ended<br/>31-Dec-15<br/>\$000's</b> |
|--|---|---|---|
| <b>Cash Flows from Operating Activities</b>      |   |   |   |
| Receipts from customers                          | 94,810  | 80,357  | 30,556  |
| Payments to suppliers and employees              | (67,621)  | (67,705)  | (26,349)  |
| Interest received                                | 974   | 1,104   | 599   |
| Finance costs                                    | (991)   | (4,653)   | (1,115)   |
| Income tax paid                                  | (3,278)   | (2,311)   | (35)  |
| <b>Net cash from operating activities</b>        | <b>23,894</b>   | <b>6,792</b>  | <b>3,656</b>  |
| <b>Cash Flows from Investing Activities</b>      |   |   |   |
| Purchase of non-current assets                   | -   | (18,160)  | (21,664)  |
| Disposal of financial assets                     | -   | 257   | -   |
| Related party loan interest                      | -   | 5,420   | 4,076   |
| Related party loan principal                     | (63,671)  | -   | 23,178  |
| Receipts from related parties                    | -   | 5,180   | -   |
| <b>Net cash used in investing activities</b>     | <b>(63,671)</b>   | <b>(7,303)</b>  | <b>5,590</b>  |
| <b>Cash Flows from Financing Activities</b>      |   |   |   |
| Proceeds from borrowings                         | -   | -   | (106)   |
| Dividends paid                                   | (11)  | (6,441)   | -   |
| Proceeds/(Repayment) of notes payable            | 19,099  | (14,276)  | (2,501)   |
| Decrease in related party receivable             | -   | -   | 177   |
| <b>Net cash provided by financing activities</b> | <b>19,088</b>   | <b>(20,717)</b>   | <b>(2,430)</b>  |
| <b>Net increase/(decrease) in cash held</b>      | <b>(20,689)</b>   | <b>(21,228)</b>   | <b>6,816</b>  |
| <b>Cash at beginning of the financial year</b>   | <b>71,360</b>   | <b>48,464</b>   | <b>39,273</b>   |
| <b>Net foreign exchange differences</b>          | <b>(2,207)</b>  | <b>12,037</b>   | <b>(668)</b>  |
| <b>Cash at end of the financial year</b>         | <b>48,464</b>   | <b>39,273</b>   | <b>45,421</b>   |

Source: Shenhua's 2015 Annual Report and 31 December 2015 Half Year Report

## 8. Related Party Loan

### 8.1 The Loan Agreement

On 15 October 2014 Shenhua and Shaoxing entered into a loan agreement, that was effective as of 30 June 2014. The key terms of the Loan Agreement were:

|                   |                                   |
|-------------------|-----------------------------------|
| Principal limit:  | RMB 466,693,297                   |
| Type of facility: | Line of credit                    |
| Interest rate:    | 6% per annum, payable bi-annually |
| Loan termination: | 30 June 2022                      |

The loan was secured over assets of Shaoxing and Zhejiang Binhai Metal Products Co Ltd ("BHMP"). We understand that assets provided as security comprise of land, building and production facilities. The secured amount has been based on Directors' estimate of value. Some estimates have been supported by independent valuations, however these were conducted in 2012. The security position is summarised below:

| Obligor  | Description of Security Assets  | Secured Amount RMB'000 | Notes | Independent Valuation of Security RMB'000 |
|----------|---|------------------------|-------|---|
| BHMP     | 112,968m2 of land at Binhai Industry District, Shao Xing                    | 58,150                 | 1     | 42,880                                    |
| BHMP     | Building in No. 90 Binhai Industry District, Shao Xing                      | 80,470                 | 2     | 41,400                                    |
| BHMP     | Medium plate production line located in Binhai Industry District, Shao Xing | 209,490                | 3     |   |
| Shaoxing | 15,255 m2 of land located in Pu Dong Xia Village, Shao Xing                 | 8,260                  | 3     |   |
| Shaoxing | Slip proof mat production lines for 1.5 and 3.0 metre width products        | 77,990                 | 3     |   |
| Shaoxing | Building located in Pu Dong Xia Village, Shao Xing                          | 15,050                 | 3     |   |
|          |   | <u>449,410</u>         |       | <u>84,280</u>                             |

**Notes:**

- 1 valuation only covers 71,480 m2 of land. Balance of land of 41,488 m2 was not independently valued.
- 2 There is a substantial difference between the valuation and the amount secured, however at the date of valuation the property was only partially constructed.
- 3 No independent valuations have been sighted for these assets.

As can be seen from the above, the principal limit of RMB 466,693,297 was only supported by assets with an estimated value of RMB 449,410,000 and there is limited evidence as to the arms-length value of these assets.

The above securities are registered, however the registrations expire on 26 November 2016.

The contract included the following repayment schedule:



| Repayment Schedule | Principal Repaid<br>RMB'000 | Interest Paid<br>RMB'000 | Total Payable<br>RMB'000 | Principal Owing<br>RMB'000 |
|--------------------|-----------------------------|--------------------------|--------------------------|----------------------------|
| 1/7/14 to 30/6/15  | 50,000                      | 28,000                   | 78,000                   | 416,693                    |
| 1/7/15 to 30/6/16  | 70,000                      | 25,000                   | 95,000                   | 346,693                    |
| 1/7/16 to 30/6/17  | 90,000                      | 20,800                   | 110,800                  | 256,693                    |
| 1/7/17 to 30/6/18  | 110,000                     | 15,400                   | 125,400                  | 146,693                    |
| 1/7/18 to 30/6/19  | 146,690                     | 8,800                    | 155,490                  | 3                          |
| <b>Total</b>       | <b>466,690</b>              | <b>98,000</b>            | <b>564,690</b>           |                            |

Given that the loan facility is a line of credit and can therefore be re-drawn, the repayment schedule is inconsistent with the actual loan agreement, however the existence of the repayment schedule indicates an intention for the loan balance to be reduced over time.

## 8.2 Conduct of the Loan Agreement

As explained in Section 8.1 above, the principal limit as per the loan agreement was RMB 466,693,297, being the loan balance as at 30 June 2014.

In spite of the above limit, we understand that the loan balance reached RMB 615,671,821 as at 30 April 2015. As such the loan balance was at various stages well above the agreed limit.

Note 7 to Shenhua's 30 June 2015 financial statements disclosed that the loan balance outstanding was RMB 442,463,192 at that date. As can be seen from the repayments schedule, the balance should not have exceeded RMB 416,693,000 at 30 June 2015 (and the loan balance was in fact reduced below this limit subsequent to 30 June 2015).

On 26 November 2015 the parties entered into the First Supplementary Loan Agreement. The First Supplementary Loan Agreement modified the original agreement. The changes were limited to:

Principal limit: RMB 666,693,297 (an increase of RMB 200,000,000)  
Interest rate: 5.22% per annum, payable bi-annually (previously 6.00%)

Whilst there was no change to the period of the facility or its security, the First Supplementary Loan Agreement includes a revised repayment schedule. The revised schedule is:

| Repayment Schedule | Principal Repaid<br>RMB'000 | Interest Paid<br>RMB'000 | Total Payable<br>RMB'000 | Principal Owing<br>RMB'000 |
|--------------------|-----------------------------|--------------------------|--------------------------|----------------------------|
| 1/7/15 to 31/12/15 | 15,000                      | -                        | 15,000                   | 427,460                    |
| 1/1/16 to 30/6/16  | 15,000                      | -                        | 15,000                   | 412,460                    |
| 1/7/16 to 31/12/16 | 20,000                      | -                        | 20,000                   | 392,460                    |
| 1/1/17 to 30/6/17  | 20,000                      | -                        | 20,000                   | 372,460                    |
| 1/7/17 to 31/12/17 | 30,000                      | -                        | 30,000                   | 342,460                    |
| 1/1/18 to 30/6/18  | 30,000                      | -                        | 30,000                   | 312,460                    |
| 1/7/18 to 31/12/18 | 35,000                      | -                        | 35,000                   | 277,460                    |
| 1/1/19 to 30/6/19  | 35,000                      | -                        | 35,000                   | 242,460                    |
| 1/7/19 to 31/12/19 | 40,000                      | -                        | 40,000                   | 202,460                    |
| 1/1/20 to 30/6/20  | 40,000                      | -                        | 40,000                   | 162,460                    |
| 1/7/20 to 31/12/20 | 40,000                      | -                        | 40,000                   | 122,460                    |
| 1/1/21 to 30/6/21  | 40,000                      | -                        | 40,000                   | 82,460                     |
| 1/7/21 to 31/12/21 | 40,000                      | -                        | 40,000                   | 42,460                     |
| 1/1/22 to 30/6/22  | 42,460                      | -                        | 42,460                   | -                          |
| <b>Total</b>       | <b>442,460</b>              | <b>-</b>                 | <b>442,460</b>           |                            |

As can be seen from the above, the repayment schedule did not include any interest component. Again, given that the facility remained a line of credit that could be re-drawn, the exact purpose of the repayment schedule is unclear, other than that the existence of the repayment schedule indicates an intention for the loan balance to be reduced over time.

It should also be noted that at 31 October 2015 (the last month end before the First Supplementary Loan Agreement was entered into), the loan balance inclusive of interest had reduced to approximately RMB 396 million so it is also unclear as to why the facility limit was increased to RMB 666,693,297.

As per the 31 December 2015 reviewed financial statements of Shenhua, the balance outstanding had further reduced to RMB 332,664,749.

## **9. Evaluation of the First Supplementary Loan Agreement – Resolution 4**

### **9.1 The Resolution and its Impact**

Shareholders are being asked to approve the following resolution:

“That, for the purpose of Section 208 of the Corporations Act and for all other purposes, the Shareholders approve and ratify the Company and the Lender entering into and complying with the terms of the First Supplementary Loan Agreement dated 26 November 2015 between Shaoxing Shenhua Textile Co. Ltd, as Lender, Shaoxing Shenhua Decoration Co. Ltd, as Borrower, and Zhejiang Binhai Metal Products Co. Ltd, as Guarantor, in accordance with the terms and conditions set out in the Explanatory Statement.”

We understand that the First Supplementary Loan Agreement is a valid agreement entered into between two Chinese companies. The Directors of Shenhua have stated in the Explanatory Memorandum to which this report is an attachment that “in the event that Shareholder approval is not obtained, the Board will review the status and terms of the First Supplementary Loan Agreement and consider alternative proposals that could be accepted by Shareholders and provide further information and seek further Shareholder approval as necessary”.

Based on the above, we cannot advise shareholders as to the alternate proposal(s) that may emerge. Nevertheless we comment below on a number of aspects of the facility.

### **9.2 Facility Limit**

The First Supplementary Loan Agreement increased the facility limit to RMB 666,693,297 (\$133.3 million), even though the balance of the loan account at the date of entering into the First Supplementary Loan Agreement was approximately RMB 396 million (\$79.2 million).

The loan balance at 31 December 2015, as per the reviewed financial statements, was RMB 332,664,749 (\$70,225,528). This means that the undrawn limit under the facility was approximately \$63.0 million (\$133,300,000 - \$70,225,528).

As can be seen from the statement of financial position in Section 7.3 above, Shenhua had borrowings of \$17,205,000 and notes payable of \$53,777,000 at 31 December 2015. This is a total interest bearing debt of \$70,982,000. The statement of financial position also shows that Shenhua had cash holdings of \$45,421,000 at that date.

Shenhua's 30 June 2015 financial statements show that \$36,838,000 of the then total cash balances of \$39,273,000 was pledged as security against notes payable. On this basis we consider that the bulk of the cash balance of Shenhua is not available to be drawn down pursuant to the facility.

The 30 June 2015 financial statements also disclose that Shenhua had Land Use Rights with a net book value of \$62,183,000, however \$45,132,880 of this amount was pledged as security for Shenhua's borrowings.

Based on the above analysis, we are not satisfied that Shenhua has sufficient funds available to it or has sufficient borrowing capacity to be able to advance up to \$63.0 million, being the undrawn amount under the facility.

### **9.3 Loan Security**

The First Supplementary Loan Agreement did not alter the loan security arrangements despite increasing the facility limit. As can be seen from the information set out in Section 8.1 above, the security received by Shenhua was valued by the directors of Shenhua in October 2014 at RMB 449,410,000 (approximately \$90 million). Whilst at least one of the assets secured was under construction and its value is likely to have increased since that date, we have not seen any evidence that the value of the secured assets is sufficient to cover the full limit of the facility of RMB 666,693,297 (\$133.3 million).

Based on the loan balance at 31 December 2015, of RMB 332,664,749 (\$70,225,528), the security position appears to be sufficient, however in the absence of current market valuations of the assets that have been pledged as security, we are unable to make a conclusive assessment as to the adequacy of the loan security.

We have also noted that the security registration is due to expire on 26 November 2016, however we have been verbally advised by management that the security renewal process is in progress.

### **9.4 Interest Rate**

The First Supplementary Loan Agreement reduced the interest on the facility from 6.00% per annum to 5.22% per annum, a reduction of 0.78%. The monetary impact of this reduction over the remaining term of the loan facility depends on the amount drawn down pursuant to the facility. As we are not able to predict the actual amount that will be drawn down at any point in time, we have prepared two scenarios. These are explained below:

#### **Scenario 1**

This scenario shows the interest saving to Shaoxing on the assumption that the loan balance will remain at the actual level as at 31 October 2015 (RMB396,000,000) (being the last month end prior to the First Supplementary Loan Agreement being entered into).

#### **Scenario 2**

This scenario shows the interest saving to Shaoxing on the assumption that the loan balance at the date of entering into the First Supplementary Loan Agreement was the actual balance as at 31 October 2015 and the loan balance thereafter will reduce in accordance with the repayment schedule attached to the First Supplementary Loan Agreement.

The calculations of the interest savings as per the above scenarios are:

|                         | Scenario1<br>RMB'000 | Scenario 2<br>RMB'000 |
|-------------------------|----------------------|-----------------------|
| 26/11/15 to 31/12/15    | 396,000              | 396,000               |
| 1/1/16 to 30/6/16       | 396,000              | 381,000               |
| 1/7/16 to 31/12/16      | 396,000              | 361,000               |
| 1/1/17 to 30/6/17       | 396,000              | 341,000               |
| 1/7/17 to 31/12/17      | 396,000              | 311,000               |
| 1/1/18 to 30/6/18       | 396,000              | 281,000               |
| 1/7/18 to 31/12/18      | 396,000              | 246,000               |
| 1/1/19 to 30/6/19       | 396,000              | 211,000               |
| 1/7/19 to 31/12/19      | 396,000              | 171,000               |
| 1/1/20 to 30/6/20       | 396,000              | 131,000               |
| 1/7/20 to 31/12/20      | 396,000              | 91,000                |
| 1/1/21 to 30/6/21       | 396,000              | 51,000                |
| 1/7/21 to 31/12/21      | 396,000              | 11,000                |
| 1/1/22 to 30/6/22       | 396,000              | -                     |
| Interest rate reduction | 0.78%                | 0.78%                 |
| Interest saving         | <b>20,382</b>        | <b>10,394</b>         |
| Interest saving \$'000  | <b>\$ 4,076</b>      | <b>\$ 2,079</b>       |

As can be seen from the above table, the interest saving arising from the First Supplementary Loan Agreement lies in a range of RMB 10,394,000 and RMB 20,382,000, or \$2.1 million to \$4.1 million. It should be noted that this benefit will arise over the period between 26 November 2015 and 30 June 2022. We have not attempted to assess the net present value of the benefit due to the uncertainties inherent in the calculations. Furthermore some of the interest savings have already accrued to Shaoxing since the date of the First Supplementary Loan Agreement and will continue to accrue until such time as the agreement is altered.

It should also be noted that neither of the above scenarios deals with the possibility that the facility may be re-drawn up to the facility limit agreed pursuant to the First Supplementary Loan Agreement, as this possibility has been superseded by the Second Supplementary Loan Agreement. Furthermore, as observed in Section 9.2, we do not believe that Shenhua has sufficient funds available for it to be able to advance funds up to the facility limit.

## 10. Evaluation of the Second Supplementary Loan Agreement – Resolution 5

### 10.1 The Resolution and its Impact

Shareholders are being asked to approve the following resolution:

“That, for the purpose of Section 208 of the Corporations Act and for all other purposes, the Shareholders approve and ratify the Company and the Lender entering into and complying with the terms of the Second Supplementary Loan Agreement dated 1 April 2016 between Shaoxing Shenhua Textile Co. Ltd, as Lender, Shaoxing Shenhua Decoration Co. Ltd, as Borrower, and Zhejiang Binhai Metal Products Co. Ltd, as Guarantor, in accordance with the terms and conditions set out in the Explanatory Statement.”

We understand that the Second Supplementary Loan Agreement is a valid agreement entered into between two Chinese companies. The Directors of Shenhua have stated in the Explanatory Memorandum to which this report is an attachment that “in the event that Shareholder approval is not obtained, the Board will review the status and terms of the Second Supplementary Loan Agreement and consider alternative proposals that could be accepted by Shareholders and provide further information and seek further Shareholder approval as necessary”.

Based on the above, we cannot advise shareholders as to the alternate proposal(s) that may emerge.

## 10.2 Facility Limit

The Second Supplementary Loan Agreement reduced the facility limit effective 1 April 2016 to RMB 386,693,297 (\$77.3 million). This is a reduction of RMB 280 million (\$56.0 million) compared to the increased limit granted pursuant to the First Supplementary Loan Agreement. All other provisions of the facility remain unaffected.

## 10.3 Interest Rate

Whilst the Second Supplementary Loan Agreement does not alter the interest rate charged on the facility (from that agreed to in the First Supplementary Loan Agreement), by reducing the limit of the facility to RMB 386,693,297, it reduced the potential interest saving to Shaoxing resulting from the First Supplementary Loan Agreement. In Section 9.4 we set out two scenarios that quantify the potential saving to Shaoxing. Set out below is an identical table to that presented in Section 9.4, except that in Scenario 1 we have reduced the outstanding balance to the limit imposed by the Second Supplementary Loan Agreement (for the sake of simplicity we have adjusted the loan balance as from 1 July 2016 rather than from 1 April 2016).

The calculations of the interest savings as per the above scenarios are:

|                         | <b>Scenario1</b> | <b>Scenario 2</b> |
|-------------------------|------------------|-------------------|
|                         | <b>RMB'000</b>   | <b>RMB'000</b>    |
| 26/11/15 to 31/12/15    | 396,000          | 396,000           |
| 1/1/16 to 30/6/16       | 396,000          | 381,000           |
| 1/7/16 to 31/12/16      | 386,693          | 361,000           |
| 1/1/17 to 30/6/17       | 386,693          | 341,000           |
| 1/7/17 to 31/12/17      | 386,693          | 311,000           |
| 1/1/18 to 30/6/18       | 386,693          | 281,000           |
| 1/7/18 to 31/12/18      | 386,693          | 246,000           |
| 1/1/19 to 30/6/19       | 386,693          | 211,000           |
| 1/7/19 to 31/12/19      | 386,693          | 171,000           |
| 1/1/20 to 30/6/20       | 386,693          | 131,000           |
| 1/7/20 to 31/12/20      | 386,693          | 91,000            |
| 1/1/21 to 30/6/21       | 386,693          | 51,000            |
| 1/7/21 to 31/12/21      | 386,693          | 11,000            |
| 1/1/22 to 30/6/22       | 386,693          | -                 |
| Interest rate reduction | 0.78%            | 0.78%             |
| Interest saving         | <b>19,946</b>    | <b>10,394</b>     |
| Interest saving \$'000  | <b>\$ 3,989</b>  | <b>\$ 2,079</b>   |

As can be seen from the above table, the interest saving arising from the Second Supplementary Loan Agreement lies in a range of RMB 10,394,000 and RMB 19,946,000, or \$2.1 million to \$4.0 million. It should be noted that this benefit will arise over the period between 26 November 2015 and 30 June 2022.

## 11. Assessment as to Fairness

### 11.1 Definition of Fairness

In Section 6.2 we concluded that the Proposed Related Party Transactions are "fair" if the value of the benefit received by Shaoxing is equal to or less than the value of the consideration offered by Shaoxing to Shenhua.

## 11.2 Resolution 4

As the original loan agreement set the interest rate at 6.00% per annum for the term of the facility with no provision to adjust the rate up or down, we regard the interest saving as a result of the reduction in the interest rate pursuant to the First Supplementary Loan Agreement as the benefit received by Shaoxing. In Section 9.4 we assessed the value of this interest saving to be in a range of RMB 10,394,000 and RMB 20,382,000, or \$2.1 million to \$4.1 million over the life of the loan.

The First Supplementary Loan Agreement did not provide any consideration to Shenhua for agreeing to lower the rate of interest.

As the value of the benefit received by Shaoxing (estimated to be in a range of \$2.1 million to \$4.1 million) exceeds the value of the consideration offered by Shaoxing to Shenhua (\$nil), we have concluded that Resolution 4, which seeks the approval of the First Supplementary Loan Agreement, **is not fair**.

## 11.3 Resolution 5

Resolution 5 seeks approval of the Second Supplementary Loan Agreement. The Second Supplementary Loan Agreement:

- reduced the facility limit; and
- reconfirmed the interest rate as being 5.22% per annum.

As can be seen from Section 11.2 above, pursuant to the First Supplementary Loan Agreement Shaoxing received a benefit, the value of which we estimated to be in a range of \$2.1 million to \$4.1 million.

In Section 10.3 above we estimated that the interest saving arising from the Second Supplementary Loan Agreement lies in a range of \$2.1 million to \$4.0 million.

The above analysis shows that the effect of the Second Supplementary Loan Agreement was to reduce the benefit that Shaoxing may receive from a range of \$2.1 million to \$4.1 to a range of \$2.1 million to \$4.0 million without any additional cost to Shenhua.

As explained in Section 3.1, Resolutions 4 and 5 are not interdependent, meaning that shareholders are free to approve or not approve either or both resolutions. In the event that shareholders approve Resolution 4, we have concluded that the Second Supplementary Loan Agreement does not deal with issues that give rise to a measurement of fairness as the reduction in the interest rate to 5.22% per annum would have already been approved by Resolution 4.

On the other hand, should shareholders reject Resolution 4, the effect of Resolution 5 will be to effectively reduce the interest rate from 6.00% per annum to 5.22% per annum. In this scenario the benefit received by Shaoxing (estimated to be in a range of \$2.1 million to \$4.0 million – Section 10.3) exceeds the value of the consideration offered by Shaoxing to Shenhua (\$nil), and we have therefore concluded that Resolution 5, which seeks approval of the Second Supplementary Loan Agreement, **is not fair**.

## 12. Assessment as to Reasonableness

### 12.1 Approach to the Assessment of Reasonableness

We understand that both the First and Second Supplementary Loan Agreements are valid agreements the terms of which have already commenced to operate, however the Directors of Shenhua have stated that in the event that Shareholder approval is not obtained, the Board will review the status and terms of both agreements and consider alternative proposals that could be accepted by Shareholders. As we do not know what terms and conditions may be involved in any alternative proposal, we have assessed reasonableness by considering the general commercial impact on Shenhua of the original loan, as amended by the First and Second Supplementary Loan Agreements.

## 12.2 Resolution 4

- In Section 11.2 we concluded that Resolution 4 is not fair.
- As can be seen from Shenhua's statement of financial position (Section 7.3), at 31 December 2015 its total interest bearing debt was \$70,982,000, comprising of borrowings (\$17,205,000) and Notes payable (\$53,777,000). At that date the loan to Shaoxing stood at \$70,225,528. This means that if the loan was to be repaid in full, Shenhua would be debt free. Repayment of Shenhua's interest bearing debt would release its cash deposits that are held as security against the Notes payable. This would enable Shenhua to return surplus cash to shareholders, or reinvest the cash in Shenhua's existing business or new activities. Whilst we cannot speculate as to the returns that an alternate investment may generate, in our experience a public company would seek a higher return from any investment than the 5.22% that it currently receives from Shaoxing.
- The First Supplementary Loan Agreement lowered the interest rate from 6.00% per annum to 5.22% per annum. Our research revealed that the People's Bank of China cut its benchmark one-year lending rate to 4.35% per annum on 23 October 2015. The benchmark one-year lending rate was at 6.00% per annum at the time the original agreement was entered into. As such the rate charged to Shaoxing has improved in comparison to the benchmark rate since the inception of the loan.
- In Section 8.1 we set out the original security of the loan. The table shows that the total security value was RMB 449,410,000. The First Supplementary Loan Agreement formally increased the facility limit to RMB 666,693,297 without the provision of any additional security. The limit has subsequently been reduced by the Second Supplementary Loan Agreement.
- We have been advised that Shenhua currently pays interest on the Notes at the People's Bank of China benchmark one-year lending rate, which is currently 4.35% per annum. These funds have effectively been on-lent to Shaoxing and Shenhua earns a margin of 0.87% (5.22% - 4.35%) on the loan. Given our comments in Section 9.3 in relation to the security position, the margin is a risk premium for Shenhua "lending" its balance sheet strength to Shaoxing. Whilst the size of the risk premium is a matter of judgment, in our view the premium is not sufficient.

## 12.3 Resolution 5

- In Section 11.3 we concluded that if shareholders approve Resolution 4, Resolution 5 does not give rise to an issue of fairness, however if shareholders reject Resolution 4, then we also concluded that Resolution 5 is not fair.
- The Second Supplementary Loan Agreement reduced the facility limit. This acts to reduce the risks faced by Shenhua.

## 13. Conclusion as to Fairness and Reasonableness of the Proposed Related Party Transactions

### 13.1 Resolution 4

After reviewing the results of our assessment of the fairness of the First Supplementary Loan Agreement set out in Section 11.2 and after considering the 'other considerations' set out in Section 12.2, we consider that Resolution 4 **is not fair and not reasonable**.

### 13.2 Resolution 5

After reviewing the results of our assessment of the fairness of the Second Supplementary Loan Agreement set out in Section 11.3 and after considering the 'other considerations' set out in Section 12.3, we consider that Resolution 5:

**is reasonable** provided shareholders approve Resolution 4; and

**is not fair and not reasonable** if shareholders reject Resolution 4.



## **14. Financial Services Guide**

### **14.1 Financial Services Guide**

This Financial Services Guide provides information to assist retail and wholesale investors in making a decision as to their use of the general financial product advice included in the above report.

### **14.2 DMR Corporate**

DMR Corporate holds Australian Financial Services Licence No. 222050, authorizing it to provide general financial product advice in respect of securities to retail and wholesale investors.

### **14.3 Financial Services Offered by DMR Corporate**

DMR Corporate prepares reports commissioned by a company or other entity ("Entity"). The reports prepared by DMR Corporate are provided by the Entity to its members.

All reports prepared by DMR Corporate include a description of the circumstances of the engagement and of DMR Corporate's independence of the Entity commissioning the report and other parties to the transactions.

DMR Corporate does not accept instructions from retail investors. DMR Corporate provides no financial services directly to retail investors and receives no remuneration from retail investors for financial services. DMR Corporate does not provide any personal retail financial product advice directly to retail investors nor does it provide market-related advice to retail investors.

### **14.4 General Financial Product Advice**

In the reports, DMR Corporate provides general financial product advice. This advice does not take into account the personal objectives, financial situation or needs of individual retail investors.

Investors should consider the appropriateness of a report having regard to their own objectives, financial situation and needs before acting on the advice in a report. Where the advice relates to the acquisition or possible acquisition of a financial product, an investor should also obtain a product disclosure statement relating to the financial product and consider that statement before making any decision about whether to acquire the financial product.

### **14.5 Independence**

At the date of this report, none of DMR Corporate, Derek M Ryan nor Mr Paul Lom has any interest in the outcome of the Proposed Transactions, nor any relationship with Shenhua, Shaoxing, Mr Widjaya or any of their associates.

Drafts of this report were provided to and discussed with an Independent Director of Shenhua. Certain changes were made to factual statements in this report as a result of the reviews of the draft reports. There were no alterations to the methodology, valuations or conclusions that have been formed by DMR Corporate.

DMR Corporate and its related entities do not have any shareholding in or other relationship with Shenhua or Shaoxing that could reasonably be regarded as capable of affecting its ability to provide an unbiased opinion in relation to the Proposed Transaction.

DMR Corporate had no part in the formulation of the Proposed Transaction. Its only role has been the preparation of this report.

DMR Corporate considers itself to be independent in terms of Regulatory Guide 112 issued by ASIC on 30 March 2011.



#### **14.6 Remuneration**

DMR Corporate is entitled to receive a fee of approximately \$22,000 for the preparation of this report. With the exception of the above, DMR Corporate will not receive any other benefits, whether directly or indirectly, for or in connection with the making of this report.

#### **14.7 Complaints Process**

As the holder of an Australian Financial Services Licence, DMR Corporate is required to have suitable compensation arrangements in place. In order to satisfy this requirement DMR Corporate holds a professional indemnity insurance policy that is compliant with the requirements of Section 912B of the Act.

DMR Corporate is also required to have a system for handling complaints from persons to whom DMR Corporate provides financial services. All complaints must be in writing and sent to DMR Corporate at the above address.

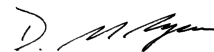
DMR Corporate will make every effort to resolve a complaint within 30 days of receiving the complaint. If the complaint has not been satisfactorily dealt with, the complaint can be referred to the Financial Ombudsman Service Limited – GPO Box 3, Melbourne Vic 3000.

Yours faithfully

**DMR Corporate Pty Ltd**



**Paul Lom**  
Director



**Derek Ryan**  
Director

**Shenhua International Limited****Sources of Information**

- Draft Notice of General Meeting and draft Explanatory Memorandum which this report accompanies;
- Audited financial statements of Shenhua for the financial year ended 30 June 2015;
- Reviewed financial statements of Shenhua for the Half Year ended 31 December 2015;
- Shenhua's announcements to the ASX since 1 July 2014;
- Copies of the original loan agreement, the First Supplementary Loan Agreement and the Second Supplementary Loan Agreement;
- Unaudited financial statements of Shaoxing and BHMP for the financial year ended 31 December 2015;
- an excel spreadsheet showing the movement in the loan to Shaoxing for the period 1 July 2014 to 31 December 2015;
- research on the benchmark lending rates in China; and
- Discussions with a Director of Shenhua.

**Declarations, Qualifications and Consents****1. Declarations**

This report has been prepared at the request of the directors of Shenhua to comply with Section 208 of the Act and to inform the Non-Associated Shareholders in respect of the Proposed Transactions. It is not intended that this report should serve any purpose other than as an expression of our opinion as to whether or not the Proposed Transactions are fair and reasonable.

This report has also been prepared in accordance with the Accounting Professional and Ethical Standards Board professional standard APES 225 – Valuation Services.

The procedures that we performed and the enquiries that we made in the course of the preparation of this report do not include verification work nor constitute an audit in accordance with Australian Auditing Standards.

**2. Qualifications**

Mr Derek M Ryan and Mr Paul Lom, directors of DMR Corporate prepared this report. They have been responsible for the preparation of many expert reports and are involved in the provision of advice in respect of valuations, takeovers and capital reconstructions and reporting on all aspects thereof.

Mr Ryan has had over 40 years experience in the accounting profession and he is a Fellow of the Institute of Chartered Accountants in Australia and an accredited Business Valuation Specialist. He has been responsible for the preparation of many expert reports and is involved in the provision of advice in respect of valuations, takeovers and capital reconstructions and reporting on all aspects thereof.

p

Mr Lom is a Fellow of the Institute of Chartered Accountants in Australia, an accredited Business Valuation Specialist and a Registered Company Auditor with more than 35 years experience in the accounting profession. He was a partner of KPMG and Touche Ross between 1989 and 1996, specialising in audit. He has extensive experience in business acquisitions, business valuations and privatisations in Australia and Europe.

**3. Consent**

DMR Corporate consents to the inclusion of this report in the form and context in which it is included in the Explanatory Memorandum.




**Shenhua International Limited**  
ACN 134 436 730


## LODGE YOUR VOTE

 **ONLINE**  
[www.linkmarketservices.com.au](http://www.linkmarketservices.com.au)

 **BY MAIL**  
Shenhua International Limited  
C/- Link Market Services Limited  
Locked Bag A14  
Sydney South NSW 1235 Australia

 **BY FAX**  
+61 2 9287 0309

 **BY HAND**  
Link Market Services Limited  
1A Homebush Bay Drive, Rhodes NSW 2138; or  
Level 12, 680 George Street, Sydney NSW 2000

 **ALL ENQUIRIES TO**  
Telephone: +61 1300 554 474



**X99999999999**

## PROXY FORM

I/We being a member(s) of Shenhua International Limited and entitled to attend and vote hereby appoint:

### APPOINT A PROXY

☐ **the Chairman of the Meeting (mark box)**

**OR** if you are **NOT** appointing the Chairman of the Meeting as your proxy, please write the name of the person or body corporate you are appointing as your proxy

or failing the person or body corporate named, or if no person or body corporate is named, the Chairman of the Meeting, as my/our proxy to act on my/our behalf (including to vote in accordance with the following directions or, if no directions have been given and to the extent permitted by the law, as the proxy sees fit) at the Annual General Meeting of the Company to be held at **2:00pm on Wednesday, 30 November 2016 at Level 1, 67 Greenhill Road, Wayville, Adelaide, South Australia** (the **Meeting**) and at any postponement or adjournment of the Meeting.

**Important for Resolution 4:** If the Chairman of the Meeting is your proxy, either by appointment or by default, and you have not indicated your voting intention below, you expressly authorise the Chairman of the Meeting to exercise the proxy in respect of Resolution 4, even though the Resolution is connected directly or indirectly with the remuneration of a member of the Company's Key Management Personnel (**KMP**).

**The Chairman of the Meeting intends to vote undirected proxies in favour of each item of business.**

### VOTING DIRECTIONS

**Proxies will only be valid and accepted by the Company if they are signed and received no later than 48 hours before the Meeting. Please read the voting instructions overleaf before marking any boxes with an ☒.**

#### Resolutions

|   | For                      | Against                  | Abstain*                 |                                       | For                      | Against                  | Abstain*                 |
|---|--------------------------|--------------------------|--------------------------|---------------------------------------|--------------------------|--------------------------|--------------------------|
| 1 Re-election of Director – Yong Wan      | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | 5 Second supplementary loan agreement | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 2 Re-election of Director – Xiaohong Chen | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |                                       |                          |                          |                          |
| 3 Adoption of Remuneration Report         | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |                                       |                          |                          |                          |
| 4 First supplementary loan agreement      | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |                                       |                          |                          |                          |



\* If you mark the Abstain box for a particular Item, you are directing your proxy not to vote on your behalf on a show of hands or on a poll and your votes will not be counted in computing the required majority on a poll.

### SIGNATURE OF SHAREHOLDERS – THIS MUST BE COMPLETED

Shareholder 1 (Individual)

Joint Shareholder 2 (Individual)

Joint Shareholder 3 (Individual)

Sole Director and Sole Company Secretary

Director/Company Secretary (Delete one)

Director

This form should be signed by the shareholder. If a joint holding, either shareholder may sign. If signed by the shareholder's attorney, the power of attorney must have been previously noted by the registry or a certified copy attached to this form. If executed by a company, the form must be executed in accordance with the company's constitution and the *Corporations Act 2001* (Cth).

**SHU PRX1601C**



## HOW TO COMPLETE THIS SHAREHOLDER PROXY FORM

### YOUR NAME AND ADDRESS

This is your name and address as it appears on the Company's share register. If this information is incorrect, please make the correction on the form. Shareholders sponsored by a broker should advise their broker of any changes. **Please note: you cannot change ownership of your shares using this form.**

### APPOINTMENT OF PROXY

If you wish to appoint the Chairman of the Meeting as your proxy, mark the box in Step 1. If you wish to appoint someone other than the Chairman of the Meeting as your proxy, please write the name of that individual or body corporate in Step 1. A proxy need not be a shareholder of the Company.

### DEFAULT TO CHAIRMAN OF THE MEETING

Any directed proxies that are not voted on a poll at the Meeting will default to the Chairman of the Meeting, who is required to vote those proxies as directed. Any undirected proxies that default to the Chairman of the Meeting will be voted according to the instructions set out in this Proxy Form, including where the Resolution is connected directly or indirectly with the remuneration of KMP.

### VOTES ON ITEMS OF BUSINESS – PROXY APPOINTMENT

You may direct your proxy how to vote by placing a mark in one of the boxes opposite each item of business. All your shares will be voted in accordance with such a direction unless you indicate only a portion of voting rights are to be voted on any item by inserting the percentage or number of shares you wish to vote in the appropriate box or boxes. If you do not mark any of the boxes on the items of business, your proxy may vote as he or she chooses. If you mark more than one box on an item your vote on that item will be invalid.

### APPOINTMENT OF A SECOND PROXY

You are entitled to appoint up to two persons as proxies to attend the Meeting and vote on a poll. If you wish to appoint a second proxy, an additional Proxy Form may be obtained by telephoning the Company's share registry or you may copy this form and return them both together.

To appoint a second proxy you must:

- (a) on each of the first Proxy Form and the second Proxy Form state the percentage of your voting rights or number of shares applicable to that form. If the appointments do not specify the percentage or number of votes that each proxy may exercise, each proxy may exercise half your votes. Fractions of votes will be disregarded; and
- (b) return both forms together.

### SIGNING INSTRUCTIONS

You must sign this form as follows in the spaces provided:

**Individual:** where the holding is in one name, the holder must sign.

**Joint Holding:** where the holding is in more than one name, either shareholder may sign.

**Power of Attorney:** to sign under Power of Attorney, you must lodge the Power of Attorney with the registry. If you have not previously lodged this document for notation, please attach a certified photocopy of the Power of Attorney to this form when you return it.

**Companies:** where the company has a Sole Director who is also the Sole Company Secretary, this form must be signed by that person. If the company (pursuant to section 204A of the *Corporations Act 2001*) does not have a Company Secretary, a Sole Director can also sign alone. Otherwise this form must be signed by a Director jointly with either another Director or a Company Secretary. Please indicate the office held by signing in the appropriate place.

### CORPORATE REPRESENTATIVES

If a representative of the corporation is to attend the Meeting the appropriate "Certificate of Appointment of Corporate Representative" should be produced prior to admission in accordance with the Notice of Meeting. A form of the certificate may be obtained from the Company's share registry or online at [www.linkmarketservices.com.au](http://www.linkmarketservices.com.au).

### LODGEMENT OF A PROXY FORM

This Proxy Form (and any Power of Attorney under which it is signed) must be received at an address given below by **2:00pm on Monday, 28 November 2016**, being not later than 48 hours before the commencement of the Meeting. Any Proxy Form received after that time will not be valid for the scheduled Meeting.

Proxy Forms may be lodged using the reply paid envelope or:



#### ONLINE

[www.linkmarketservices.com.au](http://www.linkmarketservices.com.au)

Login to the Link website using the holding details as shown on the Proxy Form. Select 'Voting' and follow the prompts to lodge your vote. To use the online lodgement facility, shareholders will need their "Holder Identifier" (Securityholder Reference Number (SRN) or Holder Identification Number (HIN) as shown on the front of the Proxy Form).



#### BY MOBILE DEVICE

Our voting website is designed specifically for voting online. You can now lodge your proxy by scanning the QR code adjacent or enter the voting link [www.linkmarketservices.com.au](http://www.linkmarketservices.com.au) into your mobile device. Log in using the Holder Identifier and postcode for your shareholding.

#### QR Code



To scan the code you will need a QR code reader application which can be downloaded for free on your mobile device.



#### BY MAIL

Shenhua International Limited  
C/- Link Market Services Limited  
Locked Bag A14  
Sydney South NSW 1235  
Australia



#### BY FAX

+61 2 9287 0309



#### BY HAND

delivering it to Link Market Services Limited\*  
1A Homebush Bay Drive  
Rhodes NSW 2138  
  
or  
  
Level 12  
680 George Street  
Sydney NSW 2000

\* During business hours (Monday to Friday, 9:00am–5:00pm)

**IF YOU WOULD LIKE TO ATTEND AND VOTE AT THE ANNUAL GENERAL MEETING, PLEASE BRING THIS FORM WITH YOU.  
THIS WILL ASSIST IN REGISTERING YOUR ATTENDANCE.**