Huaxin Cement Co., Ltd.

Announcement on Reply to the Letter Related to Regulatory Supervision from Shanghai Stock Exchange

Huaxin Cement Co., Ltd. (hereinafter referred to as the "Company") received the *Regulatory Letter on Relevant Matters of Employee Stock Ownership Plan of Huaxin Cement Co., Ltd.* (S. Z. G. H. [2020] No. 2449) from Shanghai Stock Exchange on August 17, 2020 which required the Company to clarify and explain relevant matters of its Core Employee Stock Ownership Plan.

The Company hereby gives a reply on relevant matters as follows:

I. Please further explain whether the pricing basis and reasonableness of the price at which the Company's repurchased stocks are granted under the Employee Stock Ownership Plan are in compliance with the basic principles of "sole responsibility for own profits and losses and for risks, and same rights and interests as other investors" set out in the *Guidelines on Implementation of Employee Stock Ownership Plans of Listed Companies* and the *Guidelines on Information Disclosure for Employee Stock Ownership Plans of Listed Companies* issued by this Exchange.

Reply:

(I) Pricing basis and reasonableness of the grant price under the Employee Stock Ownership Plan

1. Terms on the grant price under the Employee Stock Ownership Plan

It is agreed in the 2020-2022 Core Employee Stock Ownership Plan of Huaxin Cement Co., Ltd. (Draft) that "The stocks under this Plan (including Plan A and Plan B) will be granted through non-trading transfer or any other means permitted by laws and regulations at no transfer price and without capital contribution in the form of the stocks repurchased by the Company, that is to say, the stocks granted hereunder will be deemed as the incentive remunerations prepaid by the Company." According to this provision, it seems that the stocks granted under the Plan are acquired by the target grantees "at no price", while in fact, the incentives are granted to the participating employees at a reasonable incentive cost, i.e. the incentive remunerations prepaid by the Company.

2. Pricing basis of the grant price under the Employee Stock Ownership Plan

The pricing scheme for the grant price under the Plan is developed by the Company based on the experience in implementing the previous stock incentive plan by referring to relevant policies and cases of listed companies and taking into account of existing industry competition and actual situation of the Company. In addition, such pricing scheme has experienced through demonstration by the Board of Directors of the Company, and is finalized by the Board of Directors of the Company after considering the opinions expressed by employees at the Meeting of Employee Representatives and consulting with employees.

3. Pricing reasonableness of the grant price under the Employee Stock Ownership Plan

(1) The Employee Stock Ownership Plan serves as an important tool to retain key talents, arouse the enthusiasm of employees and maintain the Company's competitive advantages.

The Company, as a leading enterprise in the industry and a foreign-owned listed company, has been always highlighting employee incentives and cultivation. Mid- and long-term incentive plans of the Company are not only an indispensable part of its employee compensation structure but also an important measure to retain its key employees. The Employee Stock Ownership Plan, which is incentive-oriented, is developed by the Company based on the existing industry competition and its own actual situation, and is deemed as an important tool to retain key employees, arouse the enthusiasm of employees and maintain competitive advantages of the Company.

(2) The pricing scheme developed for the Employee Stock Ownership Plan is based on the Company's experience and lessons in the previous stock incentive plan

The exercise price under the stock incentive plan of the Company in 2013 was RMB14.7/per share. Although performance evaluation objectives were achieved by the Company, the fluctuations and continued stock price downturn in the secondary market led to failure of the target grantees in exercise and unsatisfactory outcome of incentive and further weakened the enthusiasm of the target grantees. An employee stock ownership plan is designed to be an effective supplement to the existing employee compensation structure and to tightly tie the interests of employees with the interests of the company and its shareholders. If the grant price is not favourable enough, the interests of employees will be unlikely enhanced to a certain extent and may give rise to below-expected outcome of incentive.

(3) The Employee Stock Ownership Plan has taken the capital contribution ability of participating employees into consideration

Many of the employees participating in the Employee Stock Ownership Plan are young, with limited savings and limited capital contribution ability in consideration of their burdens in paying living expenses, housing-related expenses and other costs. If a high grant price is determined under the Employee Stock Ownership Plan, some key employees will be subject to heavy financial pressure and ruled out of the Plan. Therefore, in order to ensure expected outcome of incentive, the Employee Stock Ownership Plan has fully taken into consideration of capital contribution ability of the target grantees.

(4) Challenging performance objectives and a long lock-up period are made in place to ensure the interests of the Company and its shareholders

The stocks under the Plan seem to be acquired by the target grantees “at no price”, while in fact, those stocks are granted as the incentive remunerations prepaid by the Company to the target grantees based on the principle of matching incentives and restraints once the target grantees accomplish the performance evaluation objectives set by the Company. The Company has set challenging performance evaluation objectives, specifically including annual and milestone performance evaluation objectives, to tightly tie the interests of the Company and its shareholders with the interests of its employees, which means that participating employees will not be granted stocks until they accomplish the objectives. Furthermore, in order to effectively avoid short-swing trading, the stocks granted under the Employee Stock Ownership Plan are subject to a lock-up period of 2-4 years, indicating that the target grantees will not acquire the stocks granted to them and have those stocks unlocked until they have served the Company for no less than 3-5 years and have accomplished the established performance objectives. The challenging performance objectives and a long lock-up period made in place for the Employee Stock Ownership Plan are conducive to retaining key employees, fully mobilizing enthusiasm of employees, realizing the sustainable development of the Company and enhancing the interests of the Company and its shareholders.

(5) The pricing scheme under the Employee Stock Ownership Plan is developed by referring to relevant cases of listed companies

The relevant cases in the securities market since 2019 in which stocks are transferred at a low price for the purpose of employee stock ownership plans:

No.	Stock Code	Stock Abbreviation	Announcement Date	Stock Source	Pricing Basis	Closing Price on the Announcement Date

1	603056.SH	Deppon Express	May 19, 2020	Repurchase	RMB0.00/share	RMB15.03/share
2	300469.SZ	Information Development	April 27, 2020	Repurchase	RMB1.00/share	RMB14.65/share
3	002123.SZ	Montnets Group	October 14, 2019	Repurchase	RMB0.00/share	RMB18.51/share
4	002555.SZ	37 Interactive Entertainment	June 19, 2019	Repurchase	RMB0.00/share	RMB13.15/share
5	300393.SZ	Jolywood	March 26, 2019	Repurchase	RMB1.00/share	RMB21.26share
6	603678.SH	Torch Electron	February 1, 2019	Repurchase	RMB0.00/share	RMB16.20/share

(II) The Employee Stock Ownership Plan complies with the basic principles of “sole responsibility for own profits and losses and for risks, and same rights and interests as other investors”

First of all, key employees of the Company participating in the Employee Stock Ownership Plan will not hold the stocks granted to them in the Company unless they meet the requirements on length of service in the Company and endeavor to accomplish and have accomplished the established performance evaluation indicators. Secondly, the stocks granted to the participating employees of the Employee Stock Ownership Plan are deemed as “incentive remunerations prepaid” to them; if the performance evaluation indicators under the Employee Stock Ownership Plan are not accomplished, the holders under the Plan will not be entitled to the corresponding stock rights and interests and the stocks will be repurchased by the Company at a zero price upon the end of the performance evaluation period. Thirdly, the stocks held under the Employee Stock Ownership Plan are subject to a lock-up period of 24 to 48 months after the performance indicators are accomplished and the stocks are vested, during which the holders will solely bear the risk of stock price decline. The above arrangements not only simulate the enthusiasm of key employees but also ensure the same rights and interests of key employees as other investors since key employees have to make diligent efforts to improve their performance and accomplish their performance evaluation objectives and are also subject to the risk of stock price fluctuations. Therefore, the Employee Stock Ownership Plan complies with the basic principles of “sole responsibility for own profits and losses and for risks, and same rights and interests as other investors”.

In summary, the pricing scheme under the Employee Stock Ownership Plan is reasonable and conducive to the sustainable development of the Company as a listed company, and is in compliance with the basic principles of “sole responsibility for own profits and losses and for risks, and same rights and interests as other investors” since such pricing scheme is developed based on the Company’s experience in implementing the 2013 Stock Incentive Plan by taking into full consideration of the industry, business and talent demand of the Company, outcome of incentive and interests of the Company’s shareholders, referring to relevant similar cases of listed companies, and proposing challenging performance evaluation criteria, a longer lock-up period and requirements on length of service.

II. The Employee Stock Ownership Plan is mainly intended to promote the sustainable, healthy and long-term development of the Company and attract, motivate and retain key employees of the Company. The performance evaluation indicators set out in the Plan include earnings per share, return on invested capital and operating cash flow during the evaluation year. Please clarify and explain whether relevant performance evaluation matches with the zero-price grant and is helpful to realize the purposes of the Employee Stock Ownership Plan.

Reply:

(I) About whether relevant performance evaluation matches with the zero-price grant

The Employee Stock Ownership Plan is developed by the Company to support the implementation of the 2020-2025 “Milestone” Development Strategy Plan of the Company and establish and improve the benefit-sharing mechanism targeting at employees and shareholders of the Company. The Employee Stock Ownership Plan contains two parts, i.e. Plan A and Plan B, of which Plan A is a long-term incentive plan associated with the Company’s annual performance evaluation and Plan B is a long-term incentive plan associated with the Company’s milestone performance evaluation.

The performance evaluation indicators under Plan A include Earning Per Share (EPS), Return on Invested Capital (ROIC) and Operating Cash Flow (OCF), which represent evaluation indicators of profitability, operating efficiency and operating quality respectively and are determined and announced by the Board of Directors every year based on development requirements of the Company and its shareholders. Those evaluation indicators specifically contain thresholds, standards and challenging goals, which means that the specific incentive quota depends on the accomplishment of performance indicators. If accomplishment rate of the performance indicators is 80% compared with the performance target, an incentive quota of 37.5% will apply; if accomplishment rate is less than 80%, no incentive quota will apply; if the accomplishment rate exceeds 110%,an incentive quota of up to 150% will apply. Moreover, individual performance evaluation coefficient is calculated based on the results of individual performance evaluation and is no more than 1.0.

If the Company's comprehensive performance valuation result under Plan A fails to reach the threshold, the corresponding stocks will be repurchased by the Company at a zero price upon the end of the performance evaluation period and be further re-granted to those employees qualified as holders under the Plan within the statutory period or directly cancelled, in which case all cash dividends and other benefits (if any) obtained prior to such re-grant or cancellation shall be owned by the Company.

Performance evaluation under Plan B focuses on the milestone performance target, i.e. Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA) (evaluation value: E) with a performance evaluation period from 2020 Fiscal Year to 2022 Fiscal Year, and will be conducted upon the issue of the Company's 2022 annual audit report. Unlocking ratio will be determined by the Board of Directors according to the performance evaluation results. The unlocking under Plan B is subject to two preconditions: (1) the milestone threshold requirements are met during the performance evaluation period (E × 80%); the cash conversion rate of any year during the performance evaluation period is not less than 65%; and, there is no audit report in which any adverse opinion or disclaimer of opinion is made during the performance evaluation period. Cash conversion rate = operating free cash flow ÷ EBITDA, wherein operating free cash flow = operating cash flow - maintenance capital expenditure – interest expense; (2) unlocking ratios are determined according to the accomplishment rate of "milestone" performance targets from 2020 to 2022. Unlocking is not available if the accomplishment rate of performance targets is less than 80%.

In summary, comprehensive performance evaluation indicators are established for the Employee Stock Ownership Plan, which means that the target grantees are unable to acquire and unlock the stocks granted to them until performance indicators of the Company are met with the help of the key employees as role models or the stocks granted will be repurchased by the Company at a zero price and cancelled according to law if the indicators are not met. Since the stocks are not granted to the target grantees at a zero consideration but as the incentive remunerations prepaid to the target grantees, and corresponding accounting costs will be incurred by the Company as a result, the performance evaluation indicators established match with the grant price. Therefore, accomplishment of the performance evaluation indicators established under the Employee Stock Ownership Plan will most benefit the Company's investors and will be conducive to a balance of interests among employees and employees of the Company, reflecting the principle of "matching incentives and restraints".

(II) About whether relevant performance evaluation solutions are helpful to realize the purposes of the Employee Stock Ownership Plan

Key employees are a valuable asset of the Company as well as an important force strengthening its competitive advantages. The Employee Stock Ownership Plan will help to retain and motivate nearly 800 key employees of the Company to further serve the Company, bear performance pressure and costs of potential job opportunities and share the risk of fluctuations in the secondary market. The Employee Stock Ownership Plan ties the interests of employees with the interests of shareholders on the basis of the principle of "matching incentives and constraints", further ensuring the accomplishment of the Company's strategic goals and performance evaluation indicators.

In summary, the performance evaluation indicators under the Employee Stock Ownership Plan are established by the Company by taking into account of past performance of the Company, development trends of peers and fierce industry competition. In light of challenging performance evaluation requirements of the Company, stock disposal options in case of failure to live up to performance objectives and a long lock-up period, Employee Stock Ownership Plan, in the long run, can effectively avoid short-swing trading and is conducive to promoting the sustainable, healthy and long-term development of the Company, attracting, motivating and retaining key employees and enhancing the interests of the Company and its shareholders.

III. Please further clarify and explain the stock-based payment to be recognized in connection with the Employee Stock Ownership Plan, and relevant accounting treatment of and the impacts on the Company's business performance of the payment.

Reply:

(I) Accounting treatment

Stock-based payment means a transaction in which a company grants equity instruments or bears the liabilities recognized based on equity instruments in order to acquire the services provided by its employees and other persons. The underlying stocks under the Employee Stock Ownership Plan are deemed as a consideration paid to key employees for their corresponding length of service in the Company, which falls within the definitions of stock-based payment.

As stipulated in the *Accounting Standards for Enterprises No.11 – Stock-based Payment*, with respect to the stock-based payment settled based on equity that is made in exchange for certain length of service of employees and is not exercisable until the services during the waiting period are completed or the established performance conditions are met, the services obtained in the current period should be included in relevant costs or expenses and capital reserve on each balance sheet date during the waiting period based on the best estimates on the number of exercisable equity instruments and according to fair value of equity instruments on the grant date.

All expenses arising out of or in connection with the Employee Stock Ownership Plan will be amortized and included in relevant costs and expenses during the lock-up period according to applicable accounting principles and standards, while corresponding capital reserve will be increased. The expenses to be amortized will be recognized upon transfer of the underlying stocks under the Employee Stock Ownership Plan. The Company will timely fulfill its obligation of information disclosure according to the rules and regulations of the Exchange.

(II) Estimated stock-based payment to be recognized

All costs relating to stock-based payment of the Employee Stock Ownership Plan are under control and have little impacts on business performance of the Company. Assuming the Stock-based payment Agreement will be duly approved on August 31, 2020, RMB125 million and RMB400 million, totaling RMB525 million, are expected to be granted for the first time under Plan A and Plan B, respectively. The sum will be amortized by the Company during the waiting period, temporarily taking no account of personnel change and excess performance, with the expected amortization schedule from 2020 to 2025 shown as follows:

Monetary unit: RMB ten thousand

Grant Phase	Amount Granted	September – December,	2021	2022	2023	2024

		2020				
A-1.1	4,125	589	1768	1768		
A-2.1	4,125	413	1238	1238	1238	
A-3	4,250	327	981	981	981	981
B-0	40,000	3077	9231	9231	9231	9231
Total costs amortized	52,500	4,406	13,217	13,217	11,449	10,212

(III) Controllable impacts on business performance of the Company

According to the estimated stock-based payments to be recognized as shown in the table above, the stock-based payment to be amortized each year represents no more than 1.6% of total profits in 2019 (RMB8.716 billion), which is controllable and will unlikely have material adverse impacts on business performance of the Company.

Hereby announce.

Board of Directors

Huaxin Cement Co., Ltd.

August 22, 2020