Lego Corporate
Finance Limited
力高企業融資有限公司

24 May 2022

To the Independent Board Committee and the Independent Shareholders

Dear Sirs or Madams,

**(1) CONTINUING CONNECTED TRANSACTIONS; AND
(2) MAJOR TRANSACTIONS AND CONTINUING CONNECTED TRANSACTIONS**

INTRODUCTION

We refer to our appointment as the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders in relation to (i) the sale of goods (the "**Agreed Sales**") under the 2023-2025 Master Sales Agreement; (ii) the deposit services (the "**Deposit Services**") under the 2023-2025 Group Financial Services Framework Agreement; and (iii) the loan services (the "**Loan Services**", together with the Agreed Sales and the Deposit Services, the "**Continuing Connected Transactions**") under the 2023-2025 Parent Group Financial Services Framework Agreement and the respective transactions contemplated thereunder (including their proposed annual caps for the three years ending 31 December 2025 (the "**Proposed Annual Caps**")), details of which are set out in the "Letter from the Board" (the "**Letter from the Board**") contained in the circular issued by the Company to the Shareholders dated 24 May 2022 (the "**Circular**"), of which this letter forms part. Terms used in this letter shall have the same meanings as defined in the Circular unless the context otherwise requires.

On 1 April 2019, the Company entered into the Existing Master Sales Agreement, pursuant to which the Group agreed to sell certain materials such as the steering tension rods, track bars, bumpers, the BV series of electric cables, wires and cables, refrigeration machines, copper plates, gas compressors, softwares and raw materials such as steel and gears to the Parent Group. As the Existing Master Sales Agreement will expire on 31 December 2022, the Company renewed the Existing Master Sales Agreement with the Parent Company under the same or similar terms by entering into the 2023-2025 Master Sales Agreement on 7 April 2022.

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On 7 April 2022, the Company and the Finance Company entered into the 2023-2025 Group Financial Services Framework Agreement, pursuant to which, the Finance Company will provide financial services to the Group, including loan services, guarantee services and other financial services and, subject to the approval of the Independent Shareholders, Deposit Services. The Group is not under any obligation to obtain any or all of the financial services provided by the Finance Company and may obtain such financial services based on its business needs.

On 7 April 2022, the Parent Company and the Finance Company entered into the 2023-2025 Parent Group Financial Services Framework Agreement, pursuant to which, the Finance Company will provide financial services to the Parent Group, including deposit services, guarantee services and other financial services and, subject to the approval of the Independent Shareholders, Loan Services. The Finance Company is not under any obligation to provide any or all of the financial services to the Parent Group and may offer such financial services based on its business needs.

As the Parent Company is the Controlling Shareholder of the Company, holding 54.74% equity interest in the Company, the Parent Group is a connected person of the Group under the Listing Rules. The Finance Company, which is owned as to 30% by the Parent Company and 70% by the Company, is an associate of the Parent Company and a subsidiary of the Company, respectively. Therefore, the transactions contemplated under the 2023-2025 Master Sales Agreement, the 2023-2025 Group Financial Services Framework Agreement and the 2023-2025 Parent Group Financial Services Framework Agreement constitute continuing connected transactions of the Company.

As the highest applicable percentage ratios calculated in accordance with Chapter 14A of the Listing Rules in respect of the respective annual caps under the 2023-2025 Master Sales Agreement exceed 5% and such annual caps exceed HK$10,000,000, the 2023-2025 Master Sales Agreement constitutes a non-exempted continuing connected transaction of the Company under Chapter 14A of the Listing Rules and is subject to the reporting, annual review, announcement and Independent Shareholders' approval requirements under the Listing Rules.

As one or more of the applicable percentage ratios calculated in accordance with the Listing Rules in respect of the maximum daily amount of (i) the Deposit Services; and (ii) the Loan Services exceed 5% and their respective annual caps exceed HK$10,000,000, the Deposit Services and Loan Services are subject to the reporting, annual review, announcement and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules. Meanwhile, as one or more of the applicable percentage ratios calculated in respect of the maximum daily deposit amount and the maximum daily loan amount exceed 25%, such transactions also constitute major transactions of the Company under Rule 14.06(3) of the Listing Rules and are subject to the notification, announcement and Shareholders' approval requirements for major transactions under Chapter 14 of the Listing Rules.

The Independent Board Committee, comprising all of the independent non-executive Directors, namely Mr. Lo Wah Wai, Mr. Ren Xiaochang, Mr. Jin Jingyu and Mr. Liu Wei, has been established to advise the Independent Shareholders as to (i) whether the 2023-2025 Master Sales Agreement, the 2023-2025 Group Financial Services Framework Agreement and the 2023-2025 Parent Group Financial Services Framework Agreement (the "**CCT Agreements**") have been entered into in the ordinary and usual course of business of the Group based on normal commercial terms; and (ii) whether the terms of the CCT Agreements and the respective transactions contemplated thereunder, as well as the Proposed Annual Caps, are fair and reasonable so far as the Independent Shareholders are concerned, and are in the interests of the Company and the Shareholders as a whole, and to advise the Independent Shareholders as to whether to vote in favour of the relevant resolutions to be proposed at the AGM to approve the CCT Agreements and the respective transactions contemplated thereunder (including the Proposed Annual Caps). As the Independent Financial Adviser, our role is to give an independent opinion to the Independent Board Committee and the Independent Shareholders in such regard.

As at the Latest Practicable Date, Lego Corporate Finance did not have any relationships or interests with the Company or any other parties that could reasonably be regarded as relevant to the independence of Lego Corporate Finance. In the last two years, there was no engagement between the Group and Lego Corporate Finance. Apart from normal professional fees paid or payable to us in connection with this appointment as the Independent Financial Adviser, no arrangement exists whereby we had received or will receive any fees or benefits from the Company or any other party to the transactions. Accordingly, we consider that we are eligible to give independent advice on the CCT Agreements and the respective transactions contemplated thereunder (including the Proposed Annual Caps).

BASIS OF OUR OPINION

In formulating our opinion and advice, we have relied on (i) the information and facts contained or referred to in the Circular; (ii) the information supplied by the Group and its advisers; (iii) the opinions expressed by and the representations of the Directors and the management of the Group (the "**Management**"); and (iv) our review of the relevant public information. We have assumed that all the information provided and representations and opinions expressed to us or contained or referred to in the Circular were true, accurate and complete in all respects as at the date thereof and may be relied upon. We have also assumed that all statements contained and representations made or referred to in the Circular are true at the time they were made and continue to be true as at the date of the Circular and all such statements of belief, opinions and intention of the Directors and the Management and those as set out or referred to in the Circular were reasonably made after due and careful enquiry. We have no reason to doubt the truth, accuracy and completeness of the information and representations provided to us by the Directors and/or the Management. We have also sought and received confirmation from the Directors that no material facts have been withheld or omitted from the information provided and referred to in the Circular and that all information or representations provided to us by the Directors and the Management are true, accurate, complete and not misleading in all respects at the time they were made and continued to be so until the date of the AGM.

We consider that we have reviewed sufficient information currently available to reach an informed view and to justify our reliance on the accuracy of the information contained in the Circular so as to provide a reasonable basis for our recommendation. We have not, however, carried out any independent verification of the information provided, representations made or opinion expressed by the Management, nor have we conducted any form of in-depth investigation into the business, affairs, operations, financial position or future prospects of the Group, the Finance Company, the Parent Company or any of their respective subsidiaries or associates.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our recommendation in respect to the Continuing Connected Transactions and the Proposed Annual Caps, we have taken into consideration the following principal factors and reasons.

1. Background of the parties involved

a) Background information of the Group

The Group is principally engaged in manufacturing, sales and services of clean energy equipment, high-end smart manufacturing and industrial services.

The following table sets out a summary of the recent financial performance of the Group based on the annual report of the Company for the year ended 31 December 2020 (the "**2020 Annual Report**") and the annual report of the Company for the year ended 31 December 2021 (the "**2021 Annual Report**"), respectively.

	For the year ended 31 December		
	2019	**2020**	**2021**
	RMB' million (audited)	*RMB' million* (audited)	*RMB' million* (audited)
Total operating revenue	5,516.8	6,367.0	7,410.6
Net profit attributable to the Shareholders	184.8	183.0	296.5

For the years ended 31 December 2019 and 2020

The Group's total operating revenue amounted to approximately RMB6,367.0 million for the year ended 31 December 2020, which represents an increase of approximately 15.4% as compared with approximately RMB5,516.8 million for the year ended 31 December 2019. As disclosed in the 2020 Annual Report, such increase was mainly attributable to (i) the increase in the operating revenue generated from the sale of clean energy equipment due to the rising domestic demand for the wind power blades, industrial pumps, and gas compressors; and (ii) the increase in the operating revenue generated from the sale of high-end smart equipment due to the expansion into new markets and news customers for its electronic communications business, which was partially offset by the decrease in the operating revenue generated from the industrial services segment.

For the years ended 31 December 2020 and 2021

The Group's total operating revenue amounted to approximately RMB7,410.6 million for the year ended 31 December 2021, which represents an increase of approximately 16.4% as compared with approximately RMB6,367.0 million for the year ended 31 December 2020. As disclosed in the 2021 Annual Report, such increase was mainly attributable to (i) the increase in the operating revenue generated from the sale of clean energy equipment, which was primarily driven by the acceleration of the dual-carbon economy and the increase in the construction of infrastructure projects; and (ii) the increase in the operating revenue generated from the sale of high-end smart equipment, which was primarily driven by the rapid development of the domestic intelligent manufacturing industry and the expansion of customer base, while it was partially offset by the decrease in operating revenue generated from the industrial services.

The following table sets out a summary of the recent financial position of the Group as extracted from the 2021 Annual Report.

	As at 31 December	
	2020	**2021**
	RMB' million	*RMB' million*
	(audited)	(audited)
Non-current assets	5,885.9	5,885.7
Current assets	10,738.3	10,849.7
Total assets	16,624.2	16,735.4
Non-current liabilities	2,054.5	2,332.0
Current liabilities	7,094.0	6,589.6
Total liabilities	9,148.5	8,921.7
Net assets attributable to the Shareholders	7,021.8	7,348.9

As at 31 December 2021, the Group had (i) non-current assets of approximately RMB5,885.7 million, which mainly comprised (a) property, plant and equipment of approximately RMB2,562.1 million; (b) long-term equity investments of approximately RMB1,207.7 million; and (c) intangible assets of approximately RMB562.0 million; (ii) current assets of approximately RMB10,849.7 million, which mainly comprised (a) accounts receivables of approximately RMB2,517.9 million; (b) cash and cash equivalents of approximately RMB2,178.9 million; and (c) inventories of approximately RMB2,129.1 million; (iii) current liabilities of approximately RMB6,589.6 million, which mainly comprised (a) accounts payable of approximately RMB1,846.6 million; and (b) notes payable of approximately RMB1,176.7 million; and (iv) non-current liabilities of approximately RMB2,332.0 million, which mainly comprised long-term loans of approximately RMB1,968.3 million.

b) Background information of the Parent Group

The Parent Group is principally engaged in automobiles and ancillary automobile business (including special purpose vehicles, compartments and transmission axles), electronic information business and other business.

c) Background information of the Finance Company

The Finance Company is a non-bank financial institution established in January 2013 under the PRC laws and with the approval of the CBRC. It is subject to the regulation of the PBOC and the CBRC. Its principal business is provision of financial services (including but not limited to deposit services, loan services, and guarantee services and other financial services) to the Group and the Parent Group.

2. 2023-2025 Master Sales Agreement

a) Reasons for and benefits of entering into the 2023-2025 Master Sales Agreement

The Group is principally engaged in manufacturing, sales and services of clean energy equipment, high-end smart manufacturing and industrial services. As disclosed in the 2021 Annual Report, the clean energy equipment and high-end smart equipment included, among others, electrical wires and cables, general machinery and steering systems. We have discussed with the Management and were given to understand that the Group has been supplying these products to the Parent Group since 2008.

As disclosed in the Letter from the Board, from the perspective of the Group, the sale of the products to the Parent Group would provide a reliable customer base, a stable income and timely payment for the products sold.

Taking into consideration that (i) the products procured by the Parent Group are the same or similar products that the Group manufactures and sells to other customers, which are the Group's principal business and the Group has been selling the products to the Parent Group historically; (ii) the Group is familiar with the Parent Group's product specifications and has been able to respond quickly and in a cost-efficient manner to any new requirements that the Parent Group may request; (iii) the mutual beneficial relationship between the Group and the Parent Group, which the Agreed Sales provides a reliable customer base and stable income to the Group; and (iv) the Parent Group has proven to have a good track record in settling the trade payables to the Group in a timely manner, we concur with the Management's view that the entering into the 2023-2025 Master Sales Agreement was within the ambit of the businesses currently run by the Group and is therefore conducted in the ordinary and usual course of the business of the Company and is in the interests of the Company and the Shareholders as a whole.

b) Principal terms of the 2023-2025 Master Sales Agreement

The principal terms of the 2023-2025 Master Sales Agreement are set out as follows:

Date:

7 April 2022

Parties:

(i) the Company, as supplier; and

(ii) the Parent Company, as purchaser

Term:

Subject to the approval being obtained from the Independent Shareholders, commencing from 1 January 2023 and expiring on 31 December 2025.

Nature of transaction:

The Group sells supplies, parts, components or materials, finished goods, electrical equipment and components for industrial use (including control valves, parts for steering systems, gears, clutch assemblies and the BV series of electric cables) to the Parent Group.

Payment terms:

The payment terms will be otherwise specified on each separate contract to be entered by both parties on normal commercial terms. The payment terms generally vary from 30 days to 90 days depending on the type and nature of the project, and will make reference to the prevalent payment terms of similar projects in the same industry. Before signing a particular contract under the 2023-2025 Master Sales Agreement by any member of the Group, the financial department, the legal department and the business department, will strictly assess the terms of the contract and make sure the term adhere to the principal terms under the 2023-2025 Master Sales Agreement, are fair and reasonable and are in the interest of the Company and its Shareholders as a whole. If there is no objection to the signing of the contract by the said departments, the contract will be approved according to the decision-making procedure of the Company.

Pricing Basis for the 2023-2025 Master Sales Agreement

As disclosed in the Letter from the Board, the 2023-2025 Master Sales Agreement was entered into in the ordinary and usual course of business of the Group. The terms of the agreement were negotiated on arm's length basis and on normal commercial terms. The pricing or consideration under the 2023-2025 Master Sales Agreement will be determined with reference to:

(i) the market price obtained through prices quoted on websites for the industry (including website of Alibaba (www.1688.com)) or enquiries for market prices from at least two independent third parties (i.e. the price of the same or similar product provided to independent third parties by suppliers other than the Company and its subsidiaries in the same region during the ordinary course of business on normal commercial terms);

(ii) if there is no market price determined by an independent third party, the transaction price between the Group and an independent third party; and

(iii) if none of the above is applicable, cost plus a percentage mark-up (tax-inclusive), which is not less than 15% (i.e. price = cost x (1 + percentage mark-up)), whereas the 15% mark-up is determined based on the average gross margin for similar products of the Group in the past three years.

Apart from the percentage mark-up as stated in the pricing basis (iii) above (which the percentage mark-up for raw materials procured by Chongqing Shengpu Materials Co., Ltd.* (重慶盛普物資有限公司)("**Chongqing Shengpu**") and sold to the Parent Group of 1%, being the handling fee of the Group, was removed in the 2023-2025 Master Sales Agreement due to the business transformation of Chongqing Shengpu), all other principal terms of 2023-2025 Master Sales Agreement are basically the same as the Existing Master Sales Agreement.

As disclosed in the Letter from the Board, all the products sold to the Parent Group are fully competitive products that are open to the market. Therefore, the pricing basis (i) and (ii) were and will be generally adopted in the Existing Master Sales Agreement and the 2023-2025 Master Sales Agreement, except that pricing basis (iii) was and will be adopted for the price of gas compressors (since they are produced for military use and market price is not available) and software (since they are customised in compliance with the need of different customers).

We have discussed with the Management and were given to understand that the pricing basis of cost plus a percentage mark-up (tax inclusive) applies to all connected persons, members of the Group as well as independent third parties. We noted from the 2020 Annual Report and 2021 Annual Report that (1) the Group's segment gross profit margins of (a) electrical wire and cable; (b) general machinery; (c) machinery tools; and (d) material sales amounted to approximately 14.3%, 9.1%, 18.1% and 6.1% for the year ended 31 December 2019, respectively, with an average of approximately 11.9%; (2) the Group's segment gross profit margins of (a) electrical wire and cable; (b) general machinery; (c) machinery tools; and (d) material sales amounted to approximately 15.0%, 19.8%, 19.9% and 4.0% for the year ended 31 December 2020, respectively, with an average of approximately 14.7% ; and (3) the Group's segment gross profit margins of (a) electrical wire and cable; (b) general machinery; (c) machinery tools; and (d) material sales amounted to approximately 7.3%, 21.7%, 17.4% and 9.2% for the year ended 31 December 2021, respectively, with an average of approximately 13.9%.

Having considered that (i) the Group has adopted the 15% mark-up for the three years ended 31 December 2021 and the period is consistent with the duration of the 2023-2025 Master Sales Agreement; (ii) the percentage mark-up (tax inclusive) of not less than 15% applies to all customers of the Group; and (iii) the 15% mark-up is within the range of and above the average of the relevant segment gross profit margins of the Group for each of the three years ended 31 December 2021, we are of the view that the percentage mark-up (tax inclusive) of not less than 15% (including using the average relevant gross margin in the past three years in the basis of the percentage mark-up (tax inclusive)), we are of the view that the percentage mark-up (tax inclusive) of not less than 15% is fairly and reasonably determined.

We have conducted below works to assess the pricing basis of the Agreed Sales according to the four main categories of products.

(a) for control valves and parts for steering systems, we have randomly selected and reviewed three invoices between the Group and the Parent Group for each of the three years ended 31 December 2021. We have compared with the market prices of the products with similar product specifications from two independent third parties obtained through prices quoted on websites for the industry. The selected items are principally the automotive parts. We noted that the prices of the selected items sold to the Parent Group were higher than the market prices of independent third parties;

(b) for wires and cables and the BV series of electric cables, we have randomly selected and reviewed three invoices between the Group and the Parent Group for each of the three years ended 31 December 2021. We have compared with the market prices of the products with similar product specifications from two independent third parties obtained through prices quoted on websites for the industry. The selected items are principally the copper strips, copper wires and cables and fire resistant cables. We noted that the prices of the selected items sold to the Parent Group were higher than market prices of independent third parties;

(c) for refrigeration machines, copper plates, gas compressors, and raw materials such as steel and gears, we have randomly selected and reviewed three invoices between the Group and the Parent Group for each of the three years ended 31 December 2021. We have compared with the market prices of the products with similar product specifications from two independent third parties obtained through prices quoted on websites for the industry. The selected items are principally the steel products. We noted that the prices of the selected items sold to the Parent Group were higher than market prices of independent third parties or the product sold to independent third parties; and

(d) for software, which are customised in compliance with the need of different customers, there are no directly comparable sample contracts entered into with other customers. As such, we have randomly selected and reviewed three contracts associated with the cost breakdowns between the Group and the Parent Group for each of the three years ended 31 December 2021. We noted that the cost structure for software project was principally determined with reference to (i) the hardware procurement cost; (ii) the research and development cost; and (iii) other related costs and expenses incurred during the project period, including but not limited to the logistic cost, the labour cost and the travelling expense. As advised by the Management, the percentage mark-up (tax inclusive) for the selected projects was not less than 15%, which is in line with the pricing basis of the Existing Master Sales Agreement.

We have selected all kinds of items under the 2023-2025 Master Sales Agreement, and have randomly selected and reviewed three invoices between the Group and the Parent Group (the "**Selected Sales Samples**") for each of the three years ended 31 December 2021. We have also reviewed the cost schedules of the Selected Sales Samples provided by the Company, and noted that the percentage mark-up of the Selected Sales Samples were not less than 15% for the three years ended 31 December 2021. We also noted that the prices of the Selected Sales Samples were higher than market prices of the products with similar product specifications of independent third parties quoted from the website of Alibaba (www.1688.com). We consider such review covering the historical period under the Existing Master Sales Agreement on a random sampling basis on all main categories of products of the Group to be sufficient from the independent financial adviser's perspective and nothing has come to our attention that causes us to believe that such invoices did not follow the internal control measures.

In respect of the samples selected in categories (a), (b) and (c) above, we have compared the market prices with similar product specification quoted on the website of Alibaba (www.1688.com), which is a reputable e-commerce platform operated by Alibaba Group Holding Limited. Alibaba Group Holding Limited is a company incorporated in the Cayman Islands with its American depositary shares listed on the New York Stock Exchange (Stock Symbol: BABA) and ordinary shares listed on the Main Board of the Stock Exchange (stock code: 9988). As such, we considered the price quotes from the website of Alibaba can provide a reliable reference for prevailing market prices of products, and is fair and representable.

Given that (i) the above selected items follow the pricing basis of the Existing Master Sales Agreement and the pricing basis of 2023-2025 Master Sales Agreement are in line with the pricing basis of the Existing Master Sales Agreement; and (ii) various internal control measures will be put in place within the Group to ensure it complies with the terms under the 2023-2025 Master Sales Agreement (as further discussed in the section headed "Internal Control Measures" below), we are of the view that the terms offered to the Parent Group under the 2023-2025 Master Sales Agreement are on normal commercial terms, fair and reasonable and in the interests of the Company and the Shareholders as a whole.

c) Proposed Annual Caps of the Agreed Sales

The table below illustrates the historical transaction amount for the sale of products to the Parent Group by the Group for the three years ended 31 December 2021.

	For the year ended 31 December		
	2019	**2020**	**2021**
The annual cap *(RMB in million)*	360.0	344.7	330.0
The actual transaction amount *(RMB in million)*	230.1	221.0	178.4
Utilisation rate *(%)*	63.9	64.1	54.1

The table below illustrates the proposed annual caps of the Agreed Sales for the three years ending 31 December 2025.

	For the year ending 31 December		
	2023	**2024**	**2025**
The proposed annual cap *(RMB in million)*	227.0	220.0	250.0
The Agreed Sales *(Note)* *(RMB in million)*	206.3	199.0	226.8
- the sales of control valves and parts for steering systems for automotive industry	128.5	135.3	159.3
- the sales of wires, cables, refrigeration machines, copper plates, gas compressors, and raw materials and services for railway projects	44.6	47.2	51.0
- the sales of software development and systems	33.2	16.5	16.5

Note: The Agreed Sales is for illustrative purpose only and is estimated by the Management based on the factors below.

We have discussed with the Management and were given to understand that the proposed annual caps of the Agreed Sales are determined mainly based on, among others, the below factors:

(i) The historical transaction amount of the sales transactions

As illustrated in the above table, the actual transaction amount of the sale of products by the Group to the Parent Group were approximately RMB230.1 million, RMB221.0 million and RMB178.4 million for the three years ended 31 December 2021, respectively, with an average transaction amount of approximately RMB209.8 million (the "**Average Historical Amount**"). The relatively low utilisation rate of the annual cap of the Agreed Sales for the year ended 31 December 2021 was mainly due to the decrease in transaction amount for infrastructure projects and railway projects of the Parent Group of approximately RMB25.0 million as a result of different projects' construction phases. We noted that the Average Historical Amount represents approximately 92.4%, 95.4% and 83.9% of the proposed annual caps of the Agreed Sales for the three years ending 31 December 2025, which implied that the Company has taken a reasonable approach in estimating the transaction amounts for the three years ending 31 December 2025.

(ii) The prospects of the Parent Group's automotive industry

We have discussed with the Management and were given to understand that the proposed annual caps of the sale of control valves and parts for steering systems of approximately RMB128.5 million, RMB135.3 million and RMB159.3 million for the three years ending 31 December 2025, respectively, are determined with reference to the sale of control valves and parts for steering systems for the year ended 31 December 2021 which amounted to approximately RMB120.7 million.

As advised by the Management, SAIC-Hongyan, a subsidiary of the Parent Group which contributed the majority amount in the procurement of control valves and parts for steering systems from the Group by the Parent Group for the year ended 31 December 2021, has indicated that it will steadily increase the procurement of control valves and parts for steering systems from the Group for the period from 2023 to 2025 so as to actively respond to the policy of upgrade and updating of the latest national vehicle pollutant emission standard, develop in a rapid manner in the heavy truck industry and accelerate the continuous exploration of commercial vehicles towards new energy.

According to a notice namely 重慶市人民政府辦公廳關於印發重慶市推動製造業高品質發展重點專項實施方案的通知[渝府辦發〔2021〕80號] (The Key Implementation Plan for Promoting High Quality Development of Manufacturing Industry*) published by the Chongqing Municipal People's Government dated 20 August 2021, it indicates that the government is dedicated to promote and accelerate the development of six strategic emerging industries, including digitalisation, advanced energy and intelligent automotive, high-end equipment, new materials, biotechnology and green environment, with the target to reach a total industrial scale of RMB3 trillion by 2025. In view of the above and taking into consideration of the continuing improvement of the advanced automotive technology and the market growth opportunities brought by new energy vehicles, we concur with the Management's view that it is justifiable that the sale of control valves and parts for steering systems to the Parent Group will increase moderately for the three years ending 31 December 2025.

(iii) The opportunities from the existing and potential railway and infrastructure projects for the sale of wires, cables, refrigeration machines, copper plates, gas compressors, and raw materials and services to the Parent Group

We have discussed with the Management and were given to understand that the proposed annual caps of the sale of wires, cables, refrigeration machines, copper plates, gas compressors, and raw materials and services of approximately RMB44.6 million, RMB47.2 million and RMB51.0 million for the three years ending 31 December 2025 have taken into account of, among others, the existing and potential railway projects, including CQ Railway Projects (as defined below).

As disclosed in the Letter from the Board, according to the 14th Five-Year Plan of Chongqing Rail Transit, it is estimated that by 2025, Chongqing will have a rail transit operation network of approximately 600 kilometers, and accelerate the construction of 7 rail transit projects with a total of 123 kilometers under construction, including 重慶軌道交通9號線二期 (Phase II of Chongqing Rail Transit Line 9*) ("**Line 9**") and 重慶軌道交通18號線 (Chongqing Rail Transit Line 18*) ("**Line 18**"). We have discussed with the Management and were given to understand that the Parent Group is expected to undertake projects of Line 9 and Line 18. For carrying out of the said projects, from 2023 to 2025, it is estimated that Chongqing General Industry (Group) Co., Ltd. (the "**CQGI**"), a subsidiary of the Group, will undertake from the Parent Group the project of ventilation and air conditioning in the stations (the "**VAC Project**") for both Line 9 and Line 18, with an estimated contract amount of approximately RMB53 million, and 重慶鴿牌電線電纜有限公司 (Chongqing Pigeon Electric

Wires & Cables Co. Ltd.*) ("**Chongqing Pigeon**"), a subsidiary of the Group, will undertake from the Parent Group the cable project of the track construction project (the "**TC Project**", collectively, the "**CQ Railway Projects**") for both Line 9 and Line 18, with an estimated contract amount of approximately RMB30 million.

We have obtained and reviewed the documents provided by the Company, including, among others, the contracts entered into between (a) CQGI and the Parent Group; and (b) Chongqing Pigeon and the Parent Group in November 2021 and December 2021, respectively, in relation to the VAC Project and the TC Project for Line 9 with a total contract sum of approximately RMB37 million which have already commenced in February 2022. We have discussed with the Management and were given to understand that (a) CQGI and the Parent Group; and (b) Chongqing Pigeon and the Parent Group are expected to enter into the contracts in mid-2022 in relation to the VAC Project and the TC Project for other Chongqing Rail Transit Line(s), which are expected to commence in late 2022 with a total contract sum of approximately RMB90 million. We noted that the total estimated contract sum of the abovementioned projects amounts to approximately RMB127 million and as advised by the Management, the expected contract sum shall be apportioned over 3 to 5 years, depending on the capital of the county and the actual work recognised each year.

Taking into consideration of the aforementioned projects and other upcoming railway and infrastructure opportunities, we concur with the Management's view that, the proposed annual caps of the sale of wires, cables, refrigeration machines, copper plates, gas compressors, and raw materials and services of approximately RMB44.6 million, RMB47.2 million and RMB51.0 million for the three years ending 31 December 2025 are justifiable.

(iv) Business opportunities from the sale of software

We noted that the Group provided the software development and deployment to the Parent Group starting from 2018 which includes the enhancement of production line (the "**Production Line Enhancement**"), asset management system, security system and the business intelligence system maintenance and upgrade (the "**Software Enhancement**").

We have discussed with the Management and were given to understand that the proposed annual caps of the software of approximately RMB33.2 million, RMB16.5 million and RMB16.5 million for the three years ending 31 December 2025, respectively, are mainly determined with reference to, among others, (i) the transaction amount of the software of approximately RMB23.4 million for the year ended 31 December 2021; (ii) the expectation of three Software Enhancement projects with aggregate contract sum of approximately RMB16.2 million for the year ending 31 December 2023; and (iii) the expectation of three Production Line Enhancement projects with aggregate contract sum of approximately RMB17.0 million for the year ending 31 December 2023.

(v) *The increase in price of raw materials*

The supply of raw materials had been disturbed by the pandemic. Following by stimulus policies of the global central bank and the accelerated COVID-19 vaccine rollout, the global economy recovered in line with forecasts and inflation expectations rose along with the implementation of both monetary easing policy and fiscal easing policy in the United States, we noted from the Commodity Market Outlook published by the World Bank Group in October 2021 that, the commodity prices increased significantly in 2021 as compared with that in 2019 and 2020, and are expected to remain volatile due to the impact of expected rising inflation. According to the comprehensive steel price index of the PRC* (中國鋼材價格指數) in 2021 published by the China Iron and Steel Association (中國鋼鐵工業協會) (http://www.chinaisa.org.cn/) on 29 March 2022, we noted that the average price of steel products increased by approximately 27.8% from January 2020 to December 2021.

After considering (i) the historical transaction amount of the sale of products from the Group to the Parent Group for the three years ended 31 December 2021; (ii) the positive market environment as supported by the above-mentioned plan issued by the Chongqing Municipal People's Government; (iii) the Parent Group's indication for the potential demand of control valves and parts for steering systems from the Group for the period from 2023 to 2025; (iv) the projected amount of the Agreed Sales for the three years ending 31 December 2025; and (v) the expected increase in prices of cooper and steel, we are of the view that the proposed annual caps of the Agreed Sales for the three years ending 31 December 2025 are determined based on reasonable estimation after due and careful consideration and are fair and reasonable so far as the Company and the Independent Shareholders are concerned.

Shareholders should note that the proposed annual caps of the Agreed Sales are relating to future events and were estimated based on the assumptions as discussed above which may or may not remain valid for the entire three years ending 31 December 2025, and they do not represent the forecasts of the sales by the Group to the Parent Group, we express no opinion as to how closely the amount of Agreed Sales will correspond with the proposed annual caps of the Agreed Sales.

3. 2023-2025 Group Financial Services Framework Agreement

a) Reasons for and benefits of entering into the 2023-2025 Group Financial Services Framework Agreement

As disclosed in the Letter from the Board, (a) the Finance Company will gradually become the capital settlement center, capital management center, financing support center, capital operation center and information service center of the Group, which would be able to enhance the financial management and control practices, reduce operational risk and consolidate internal resources of the Group; (b) the Finance Company is regulated by the PBOC and the CBRC and is required to provide its services in accordance with the rules and operational requirements of these regulatory authorities. In addition, capital risk could be reduced through the risk management measures; (c) the capital deposited by the Group with the Finance Company will receive interest at a rate not lower than the interest rates for deposits of same nature and under same terms being charged on the Group by other independent commercial banks in the PRC. Such arrangement will enable the Group to increase its interest income more effectively; and (d) the Group is able to obtain loans from the Finance Company at an interest rate not higher than the interest rates for loans of same nature and under same terms being charged on the Group by other independent commercial banks in the PRC, which could effectively lower its financing costs.

We have discussed with the Management and were given to understand that the Group requires Deposit Services from time to time for the depository of cash to earn interest for the facilitation of its business operations. Having considered that (i) the provision of the Deposit Services by the Finance Company to the Group provides the stability and reliability to the Group in view of the long-established business relationship between the Group and the Finance Company; (ii) the terms offered by the Finance Company to the Group shall be no less favourable than those offered by independent third party financial services providers; (iii) the Finance Company is regulated by the PBOC and the CBIRC, which is required to comply with relevant rules and regulations; (iv) the 2023-2025 Group Financial Services Framework Agreement does not preclude the Group from choosing other financial services providers; (v) the mutual beneficial relationship between the Group and the Finance Company; and (vi) the Group may continue to regulate current and future transactions contemplated under a clear framework agreement, we are of the view that the entering into the 2023-2025 Group Financial Services Framework Agreement is fair and reasonable and in the interests of the Company and the Shareholders as a whole.

b) Principal terms of the 2023-2025 Group Financial Services Framework Agreement

The principal terms of the 2023-2025 Group Financial Services Framework Agreement are set out as follows:

Date:

7 April 2022

Parties:

(i) the Company; and

(ii) the Finance Company

Term:

Subject to the approval being obtained from the Independent Shareholders, the terms of Deposit Services under the 2023-2025 Group Financial Services Framework Agreement will become effective from 1 January 2023 and expire on 31 December 2025. The terms of loan services, guarantee services and other financial services under the 2023-2025 Group Financial Services Framework Agreement will become effective from 1 January 2023 and expire on 31 December 2025.

Services:

Pursuant to the 2023-2025 Group Financial Services Framework Agreement, the Finance Company has agreed to provide financial services to the Group, including deposit services, loan services, guarantee services and other financial services.

The Finance Company undertakes under the 2023-2025 Group Financial Services Framework Agreement that the terms of any financial services to be provided by the Finance Company to the Group will not be less favorable than those of similar financial services provided by independent third parties to the Group (subject to no violation of relevant laws and regulations).

The Group is not under any obligation to obtain any or all of the financial services provided by the Finance Company and may obtain such financial services based on its business needs.

Payment terms:

The payment terms will be otherwise specified on each separate contract to be entered by both parties on normal commercial terms.

Pricing standards:

The pricing standards of the Deposit Services provided by the Finance Company are as follows:

Deposit services

The interests of deposits provided by the Finance Company will not be lower than the interest rates for deposits of same nature and under same terms provided to the Group by other independent commercial banks (at least two) in the PRC.

The Company will obtain the interest rates for deposits of same nature and under same terms from at least two banks among the national commercial banks in China or local commercial banks in Chongqing that have business relations with the Company, and compare with the interest rates provided by the Finance Company to the Group for deposits of same nature and under same terms to ensure that the interests the Group will receive on its deposits are in compliance with the above pricing standards for deposit services.

In order to assess the pricing standard of the Deposit Services provided by the Finance Company to the Group, we have obtained and reviewed three deposit contracts/records with highest deposit amount between the Group and the Finance Company for each of the three years ended 31 December 2021. All nine deposit contracts/records obtained covered all types of deposits that the Group had during the three years ended 31 December 2021, being the seven-day call deposits, three-month time deposits, six-month time deposit, twelve-month time deposit and three-year time deposit. We have compared such deposit contracts/records against the then deposit rates with at least two independent commercial banks in the PRC (i.e. one national commercial bank in the PRC and one local commercial bank in Chongqing). We consider such review covering the historical period under the Existing Group Financial Services Framework Agreement on a typical case sampling basis on all kinds of deposits of the Group to be sufficient from the independent financial adviser's perspective and nothing has come to our attention that causes us to believe that such contracts/records did not follow the internal control measures.

We have also reviewed the standard deposit rates promulgated by PBOC, which are set out below:

	Standard deposit rates of PBOC
	% per annum
Call deposits	
7-day	1.35
Time deposits	
3-month	1.10
6-month	1.30
12-month	1.50
3-year	2.75

We noted that the interest rates offered by the Finance Company for the deposits placed by the Group were no less favourable than the then interest rates provided to the Group by other independent commercial banks in the PRC and the standard deposit rates promulgated by PBOC for deposits of similar nature and under similar terms.

Given that (i) the interest rates offered by the Finance Company for the selected deposits placed by the Group for the three years ended 31 December 2021 were no less favourable than the then interest rates provided to the Group by other independent commercial banks in the PRC and the Deposit Services under the 2023-2025 Group Financial Services Framework Agreement follows the above pricing standard; and (ii) various internal control measures will be put in place within the Group to ensure it complies with the terms under the 2023-2025 Group Financial Services Framework Agreement (as further discussed in the section headed "Internal Control Measures" below), we consider that the terms of the Deposit Services under the 2023-2025 Group Financial Service Framework Agreement are on normal commercial terms, fair and reasonable and in the interests of the Company and the Shareholders as a whole.

c) Proposed Annual Caps of the Deposit Services

The table below illustrates (i) the actual historical maximum daily balance of the Group's deposits placed at the Finance Company for the three years ended 31 December 2021; and (ii) the proposed annual caps of the Deposit Services for the three years ending 31 December 2025 under the 2023-2025 Group Financial Services Framework Agreement.

	For the year ended/ending 31 December					
	2019	**2020**	**2021**	**2023**	**2024**	**2025**
The annual cap *(RMB in million)*	3,500.0	3,155.0	3,313.0	3,320.0	3,433.0	3,552.0
Maximum daily deposit balance (including corresponding interest) *(RMB in million)*	1,719.1	1,664.5	2,005.2	–	–	–
Utilisation rate *(%)*	49.1	52.8	60.5	–	–	–

As disclosed in the Letter from the Board, due to the sustained recovery of domestic economy, the Group seized the opportunity of market recovery to actively expand its business, adjust its product structure, transform and upgrade its products, and strengthen its cash flow management. It is estimated that the amount of cash and cash equivalents of the Group will be approximately RMB2,247 million in 2022, with an annual growth rate of 5% at the end of 2023-2025. At the same time, the Group referred to the highest proportion (being 95.8%) of the historical maximum amount of deposits to cash and cash equivalents of the Group in the year from 2019 to 2021 (81.72% in 2019, 95.80% in 2020 and 90.19% in 2021). The monetary funds of the Company and its related enterprises in 2019, 2020 and 2021 were RMB2,095 million, RMB1,738 million and RMB2,223 million respectively; the peak deposits of the Company and its related enterprises in 2019, 2020 and 2021 were RMB1,719 million, RMB1,665 million and RMB2,005 million respectively. In addition, the Group expects that the bank loan of approximately RMB1,060 million will be due every year from 2022 to 2025, and at that time, the Group may prepare to raise cash in advance and temporarily deposit such cash in the Finance Company. It is estimated that the maximum amount of deposits in 2023 will reach approximately RMB3,320.0 million.

We have discussed with the Management and were given to understand that the proposed annual caps of the Deposit Services are determined with reference to (i) the information set out in the Letter from the Board; (ii) the expectation of the Group's capital needs for the period from now up to 31 December 2025; (iii) the financial ability of the Finance Company; and (iv) the historical transaction records of the Deposit Services under the Existing Group Financial Services Framework Agreement.

As advised by the Management, the new funds of approximately RMB1,060 million may be deposited in the Finance Company for a short term (which is expected to be approximately one to two months in order to allow buffer time to ensure the sufficiency of funds for repayment before the maturity of the bank and other borrowings) as a transitional arrangement only to repay its liabilities as the Company would need to gather the funds in advance of the maturity of its bank and/or other borrowings and that the funds will be utilised to repay the borrowings shortly after. As the new funds deposited in the Finance Company would result in an instant increase of the daily balance of deposits of the Finance Company. Therefore, the temporary effect of the new funds on the maximum daily balance of deposits should be taken into consideration and we are of the view that it is justifiable as one of the factors for the determination of the proposed annual caps of the Deposit Services for the three years ending 31 December 2025.

As disclosed in the 2020 Annual Report and the 2021 Annual Report, we noted that the total cash and cash equivalents were approximately RMB2,094.6 million, RMB1,737.5 million and RMB2,178.9 million as at 31 December 2019, 2020 and 2021, respectively, with an average of approximately RMB2,003.7 million (the "**Average Cash Balance**"). Based on the Average Cash Balance and the expected new funds of approximately RMB1,060 million to be raised and deposited to the Finance Company to settle the bank loan which will be due every year from 2022 to 2025, we concur with the Management's view that the proposed annual caps of the Deposit Services of approximately RMB3,320.0 million, RMB3,433.0 million and RMB3,552.0 million for the three years ending 31 December 2025, respectively, are justifiable.

We also noted that total operating revenue of the Group increased from approximately RMB5,516.8 million for the year ended 31 December 2019 to approximately RMB6,367.0 million for the year ended 31 December 2020, representing an increase of approximately 15.4%, and further increased to approximately RMB7,410.6 million for the year ended 31 December 2021, representing an increase of approximately 16.4%, indicating a steady improvement in the business operation of the Company which is believed to be a result of the gradual recovery of the economic situation in the PRC after combating the COVID-19 outbreak. With the effective control of the COVID-19 outbreak, the downstream demands for the Group's products are expected to increase. Accordingly, the Management anticipated that the cash and consequential Deposit Services will increase. In view of the historical growth in the revenue of the Group, we consider that the conservatively estimated annual growth rate of the proposed annual caps of the Deposit Services of 5% for the three years ending 31 December 2025 are justifiable and not excessive.

In light of the above, we are of the view that the proposed annual caps of the Deposit Services for the three years ending 31 December 2025 are determined based on reasonable estimation after due and careful consideration and are fair and reasonable so far as the Company and the Independent Shareholders are concerned.

Shareholders should note that the proposed annual caps of the Deposit Services are relating to future events and were estimated based on assumptions which may or may not remain valid for the entire three years ending 31 December 2025, and they do not represent forecasts of balance of the Deposit Services. Consequently, we express no opinion as to how closely the actual balance of the Deposit Services will correspond with proposed annual caps of the Deposit Services.

4. 2023-2025 Parent Group Financial Services Framework Agreement

a) Reasons for and benefits of entering into the 2023-2025 Parent Group Financial Services Framework Agreement

As disclosed in the Letter from the Board, (a) the entering into the 2023-2025 Parent Group Financial Services Framework Agreement will expand the business scale of the Finance Company, thus benefiting the development of the Finance Company; (b) it will consolidate cash resources, enhance the capital utilisation efficiency and lower the finance cost; (c) it will enlarge the operation scale of the Group, thus enhancing the profitability of the Group; and (d) the Company through its direct 70% equity interest in the Finance Company will be able to share the profits of the Finance Company obtained from the provision of Loan Services and guarantee services under the 2023-2025 Parent Group Financial Services Framework Agreement.

Having considered that (i) the provision of the Loan Services by the Finance Company to the Parent Group provides the revenue stream to the Group; (ii) the terms offered by the Finance Company to the Parent Group shall be no less favourable than those offered by independent third party financial services providers; and (iii) the mutual beneficial relationship between the Parent Group and the Finance Company as well as the Group, we are of the view that the entering into the 2023-2025 Parent Group Financial Services Framework Agreement is fair and reasonable and in the interests of the Company and the Shareholders as a whole.

b) Principal terms of the 2023-2025 Parent Group Financial Services Framework Agreement

The principal terms of the 2023-2025 Parent Group Financial Services Framework Agreement are set out as follows:

Date:

7 April 2022

Parties:

(i) the Parent Company; and

(ii) the Finance Company

Term:

Subject to the approval being obtained from the Independent Shareholders, the terms of Loan Services under 2023-2025 Parent Group Financial Services Framework Agreement will become effective from 1 January 2023 and expire on 31 December 2025. The terms of deposit services, guarantee services and other financial services under 2023-2025 Parent Group Financial Services Framework Agreement will become effective from 1 January 2023 and expire on 31 December 2025.

Services:

Pursuant to the 2023-2025 Parent Group Financial Services Framework Agreement, the Finance Company agreed to provide the financial services to the Parent Group, including deposit services, loan services, guarantee services and other financial services.

The Finance Company is not under any obligation to provide any or all of the financial services to the Parent Group and may provide such financial services based on its business needs.

Payment terms:

The payment terms will be otherwise specified on each separate contract to be entered by both parties on normal commercial terms.

Pricing standards:

The pricing standards of the Loan Services provided by the Finance Company are as follows:

The interest rates for loans provided to the Parent Group by the Finance Company will not be lower than the interest rates for loans of similar nature and under similar terms being charged on the Parent Group by other independent commercial banks (at least two) in the PRC.

The Company will make inquiries to at least two banks among the national commercial banks in the PRC and the local commercial banks in Chongqing that have business relations with the Company in respect of loan services of similar nature and under similar terms with reference to the credit characteristics of the relevant company with the Parent Group, and submit the results to the Finance Company. The Finance Company will then make the final assessments and determine the final interest rates provided to the Parent Group by reference to the Parent Group's business risks, comprehensive returns, capital cost of the Finance Company and regulatory indictors and others factors (although no such other factors are anticipated currently, the Finance Company may take into other factors due to possible changes in the business environment affecting the Finance Company in the future), so as to ensure that the interests of loans provided by the Finance Company to the Parent Group are in compliance with the above pricing standards for Loan Services.

In order to assess the pricing standard of the Loan Services provided to the Parent Group by the Finance Company, we have obtained and reviewed (i) three loan contracts with highest loan amount between the Parent Group and the Finance Company for each of the three years ended 31 December 2021 covering the loan period from one month to 12 months; and (ii) the quotations with two independent commercial banks in the PRC (i.e. one national commercial bank in the PRC and one local commercial bank in Chongqing) for each loan of similar nature. We consider such review covering the historical period under the Existing Parent Group Financial Services Framework Agreement on a typical case sampling basis on the major kinds of loan of the Group to be sufficient from the independent financial adviser's perspective and nothing has come to our attention that causes us to believe that such contracts/ records did not follow the internal control measures. We noted that the interests charged for the Loan Services provided to the Parent Group by the Finance Company were set at such rates equal or not less than the rates offered by the independent third parties.

Given that (i) the interests charged for the selected loans by the Finance Company to the Parent Group for the three years ended 31 December 2021 were set at such rates not less than the rates offered by the independent third parties and the Loan Services under the 2023-2025 Parent Group Financial Services Framework Agreement follows the above pricing standard; and (ii) various internal control measures will be put in place within the Group to ensure it complies with the terms under the 2023-2025 Parent Group Financial Services Framework Agreement (as further discussed in the section headed "Internal Control Measures" below), we consider that the terms of the Loan Services under the 2023-2025 Parent Group Financial Service Framework Agreement are on normal commercial terms, fair and reasonable and in the interests of the Company and the Shareholders as a whole.

c) *Proposed Annual Caps of the Loan Services*

The table below illustrates (i) the actual historical maximum daily balance for the Loan Services provided by the Finance Company for the three years ended 31 December 2021; and (ii) the proposed annual caps of the Loan Services for the three years ending 31 December 2025 under the 2023-2025 Parent Group Financial Services Framework Agreement.

	For the year ended/ending 31 December					
	2019	**2020**	**2021**	**2023**	**2024**	**2025**
The annual cap *(RMB in million)*	3,000.0	2,350.0	2,474.0	2,842.0	2,946.0	3,056.0
Maximum daily loan balance (including corresponding interest) *(RMB in million)*	1,206.5	1,044.1	1,031.4	–	–	–
Utilisation rate *(%)*	40.2	44.4	41.7	–	–	–

We have discussed with the Management and were given to understand that the proposed annual caps of the Loan Services are determined with references to: (a) the data set out in the Letter from the Board; (b) the expectation of the Parent Company's capital needs for the period from now up to 31 December 2025; (c) the financial ability of the Finance Company; and (d) the historical transaction records of the Loan Services.

(i) *The expectation of the Parent Group's capital needs for the three years ending 31 December 2025*

As advised by the Management, the Company has been informed by the Parent Company that the Parent Group's capital needs for each of the three years ending 31 December 2025 is currently estimated to be approximately RMB4,100 million, RMB5,000 million and RMB6,000 million (the "**Capital Needs**"), respectively, which will be used for the projects and business development of the Parent Group. However, as the renewal of the existing debt financing upon maturity of the subsidiaries of the Parent Company is uncertain and the centralisation of the debt financing provided by the Finance Company to the Parent Group may offer more favourable terms than the individual loan from several banks due to the scale of the loan, the Parent Group may need the loan from the Finance Company to satisfy the Capital Needs.

(ii) The upper limit of the loans to the Parent Group for the three years ending 31 December 2025

We have reviewed the historical data of the Parent Company and the Finance Company from 1 January 2019 to 31 December 2021 (the "**Period**") provided by the Company, and noted that the ratio of average daily loans granted to the Parent Company by the Finance Company to the total average daily loans granted by the Finance Company has been approximately 50.0%, 47.1% and 45.6%, with an average of approximately 47.6% (the "**Ratio**") for the three years ended 31 December 2021, respectively. The Parent Company required Loan Services from the Finance Company to cater the capital need for different stages of the projects or business development. The Management considers that the Ratio for the three years ending 31 December 2025 will not be significantly different from the Period as there is no foreseeable material change on the business development and structure of the Group and Parent Group. Therefore, the Management considers to maintain the Ratio as an upper limit for the Loan Services in order to reserve sufficient capital resource for the Group's future projects and business development.

(iii) The expected maximum capital scale of the Finance Company

As disclosed the Letter from the Board, as of 31 December 2022, it is expected that the cash and cash equivalents of the Parent Group will amount to approximately RMB3,967 million and the cash and cash equivalents of the Parent Group will grow gradually at the growth rate of 5% every year in 2023-2025. Considering the increase in registered capital of the Finance Company, it is expected that the maximum inter-bank borrowings (no more than the registered capital) of the Finance Company in 2023-2025 will be RMB1,500 million.

According to 同業拆借管理辦法 (The Measures for the Administration of Interbank Lending*) enacted and promulgated by the PBOC which was effective on 6 August 2007. We noted that the ratio of maximum amount of interbank lending transaction against the registered capital of the finance company of enterprise groups could not be higher than 100%. As such, the interbank lending transaction of the Finance Company would not be higher than RMB1,500.0 million, subject to the increase in registered capital of the Finance Company.

The expected maximum capital capacity of the Finance Company is determined on the basis of assuming the expected cash and cash equivalents of the Parent Group will be fully deposited in the Finance Company and the Finance Company will utilise the maximum inter-bank borrowings of the Finance Company available in 2023- 2025 and based on the above, it is estimated that maximum size of funds of the Finance Company in 2023-2025 will be approximately RMB5,665 million, RMB5,874 million and RMB6,092 million, respectively, and the proposed annual caps of the Loan Services for the three years ending 31 December 2025 are estimated to be approximately RMB2,719.2 million, RMB2,819.5 million and RMB2,924.2 million, respectively, based on the Ratio of approximately 48%.

(iv) The actual historical loan amounts of the Parent Group

Notwithstanding that the utilisation rates of annual caps of the Loan Services were ranged from 40.2% to 44.4% for the three years ended 31 December 2021, we have discussed with the Management and were given to understand that the total maximum daily loan balance of the Parent Group (irrespective of loan services provided by the Finance Company or other independent third parties) had reached as high as approximately RMB5,101 million, RMB6,577 million and RMB7,283 million for the three years ended 31 December 2021, respectively, which represented approximately 170.0%, 279.9% and 294.4% of the corresponding utilisation rates of the annual caps of the Loan Services.

In light of the above, in particular (i) the expected maximum capital scale of the Finance Company; (ii) the capital needs for future projects and business development of the Parent Group; (iii) the maintenance of the Ratio; and (iv) the maximum daily loan balance of the Parent Group (irrespective of loan services provided by the Finance Company or other independent third parties), we are of the view that the proposed annual caps of the Loan Services for the three years ending 31 December 2025 are determined based on reasonable estimation after due and careful consideration and are fair and reasonable so far as the Company and the Independent Shareholders are concerned.

Shareholders should note that the proposed annual caps for Loan Services under the 2023-2025 Parent Group Financial Services Framework Agreement are relating to future events and were estimated based on assumptions which may or may not remain valid for the entire three years ending 31 December 2025, and they do not represent forecasts of balance of the Loan Services. Consequently, we express no opinion as to how closely the actual balance of the Loan Services will correspond with proposed annual caps of the Loan Services.

5. Internal Control Measures

(A) Internal Control of the 2023-2025 Master Sales Agreement

As disclosed in the Letter from the Board, the Company has implemented the following measures regarding its internal control system for the connected transactions to ensure the prices of products sold to the Parent Group by the Group are fair and reasonable:

1. the operation management department of the Company and the relevant subsidiaries will monitor monthly whether the pricing basis of the connected transactions have been complied with;

2. the operation management department of the Company and other subsidiaries in the Group will ensure that the pricing terms and annual caps under the 2023-2025 Master Sales Agreement are complied with in every individual agreement entered into thereunder;

3. the operation management department of the Company will review the implementation of the caps of the connected transactions monthly to ensure the annual caps have been fully complied with; and

4. the audit and risk management committee of the Company will review the implementation of sales and supplies regarding connected transactions monthly.

In this connection, we have obtained and reviewed the relevant monthly records of the operation management department and the audit and risk management committee of the Company, which ensured the prices of products sold to the Parent Group by the Group are fair and reasonable, and complied with the annual caps. We have further reviewed the annual reports of the Company for each of the three years ended 31 December 2021 and noted that (i) the independent non-executive Directors had reviewed the continuing connected transactions of the Company, including the transactions contemplated under the Existing Master Sales Agreement, and confirmed, among other things, such transactions were conducted on normal commercial terms; and (ii) the independent auditors of the Company had also reported on such transactions. Accordingly, we understand the Group has a positive track record in respect of compliance with the Listing Rules.

In view of the above, and the aforementioned internal control procedures will continue to be reviewed by the audit committee of the Company and the auditors of the Group to ensure full compliance with the Listing Rules, we concur with the Management's view that there are adequate internal control procedures and external supervision measures to ensure that the connected transactions will be conducted on normal commercial terms and not prejudicial to the interests of the Company and the Shareholders as a whole.

(B) Internal Control and Risk Management of 2023-2025 Group Financial Services Framework Agreement and 2023-2025 Parent Group Financial Services Framework Agreement

As disclosed in the Letter from the Board, in order to safeguard the interests of the Shareholders, the Group and the Finance Company provide for the following risk management measures:

General measures on pricing terms

The audit and risk management committee of the Company will review the implementation of connected transactions under the 2023-2025 Group Financial Services Framework Agreement and the 2023-2025 Parent Group Financial Services Framework Agreement monthly. The operation management department of the Company and other subsidiaries in the Group will ensure that the pricing terms under the 2023-2025 Group Financial Services Framework Agreement and the 2023-2025 Parent Group Financial Services Framework Agreement are complied with in every individual agreement entered into thereunder.

Measures specific to 2023-2025 Group Financial Services Framework Agreement and 2023-2025 Parent Group Financial Services Framework Agreement

(a) Capital requirement of the Finance Company

Pursuant to the relevant regulations set by the CBRC, financial institutions in the PRC have to comply with certain requirements, which include, among other things, the minimum total capital requirement of a capital adequacy ratio of not less than 10% as set out by the CBRC. Based on the current registered capital of RMB600,000,000 of the Finance Company and that the Finance Company shall provide the financial services not exceeding the proposed annual caps, the Finance Company sets its capital adequacy ratio for the period of 2017 to 2019 at not less than 10%, which is in compliance with relevant provisions of the CBRC. The Finance Company shall maintain the minimum registered capital of RMB300,000,000 in order to satisfy the proposed annual caps. The expected capital adequacy ratio for the period of 2023 to 2025 shall be approximately 26% to 28%. The Finance Company has complied with the relevant provisions of the CBRC.

(b) Internal control of the Finance Company

The establishment of the Finance Company as a non-bank financial institution was authorised by the CBRC, which carries out on-going stringent supervision over the businesses of the Finance Company. The Finance Company is also required to provide regulatory report to the CBRC on a monthly basis.

The Finance Company has established its own credit policies and credit approval procedures for the loan applications, bills discounting services and bills acceptance services, which are designed in accordance with the relevant PBOC and CBRC regulations. Such measures are able to ensure that various financial services provided by the Finance Company shall not exceed the proposed annual caps approved.

The Group has adopted the internal control procedures and corporate governance procedures to monitor the status of the financial conditions of the Finance Company (in the case of Deposit Services, Loan Services, guarantee services and other financial services). The Audit and Risk Management Committee of the Company will review the finance, operation, risk management system and regulatory compliance of the Company monthly, particularly the implementation of connected transactions. The vice chairman of the Board, the chairman of the board of supervisors, and the chief financial officer of the Finance Company are appointed by the Company to effectively supervise and manage the daily operation of the Finance Company. The Finance Company is a non-banking financial institution approved by the CBIRC and the PBOC. It is also under the centralized supervision and guidance of the office of the Board, the risk control, legal and audit department, the planning department, the marketing department, and the finance department to ensure its stable operation. If any omissions are found, the Finance Company will be urged to rectify and comply with the standards.

(c) Qualifications of the Finance Company

The management of the Finance Company has extensive experience in the financial industry where the Group operates and/or financial management. The Finance Company has certain key committees and departments in maintaining the internal control environment and the risk management functions, including, the risk management committee, the loan approval committee and the supervisory committee. The risk management committee of the Finance Company has established the risk management and control strategies and policies, and monitors the implementation of the relevant policies of the Finance Company while the supervisory committee of the Finance Company will ensure the Finance Company's compliance with the relevant rules and regulations, and to monitor its operational activities. The loan approval committee of the Finance Company adopts the method of collective decision-making to provide decision-making suggestions for the development of the credit business of the Finance Company. The main function of the loan approval committee is to listen to the business department's review opinions on the enterprise's credit plan as well as the review opinions of the risk review department. Five committee members with backgrounds in finance, risk control and compliance, finance, and law will independently express their opinions, comprehensively evaluate the operating conditions, default risk, rationality of capital needs, and the risk management and control measures of the Finance Company. Each plan shall be submitted to the general manager for approval.

In respect of the internal control measures for the transactions contemplated under the 2023-2025 Group Financial Services Framework Agreement and the 2023-2025 Parent Group Financial Services Framework Agreement, we noted that the Group has the right, but not an obligation, to use the services of the Finance Company, and the Group has full discretion to use the financial services provided by other financial institutions.

We have also obtained and reviewed the relevant internal control policies which stipulate the procedures to be complied with in conducting connected transactions. We considered that there are adequate internal control measures in place to monitor and ensure that (i) the interest rate for the Group's deposits shall not be lower than the interest rate offered by other independent commercial banks for comparable deposits in the PRC; and (ii) the interest rates for the Parent Group's loans to be charged by the Finance Company shall not be lower than those charged by other independent commercial banks for providing comparable services in the PRC.

Furthermore, we noted that the external auditors of the Group will conduct an annual review on the pricing and the annual caps of the financial services transactions under the 2023-2025 Group Financial Services Framework Agreement and the 2023-2025 Parent Group Financial Services Framework Agreement. The independent non-executive Directors will also conduct an annual review of the implementation and enforcement of the financial services transactions under the 2023-2025 Group Financial Services Framework Agreement and the 2023-2025 Parent Group Financial Services Framework Agreement.

According to Article 34 of the Administrative Measures for Enterprise Group Finance Companies, finance companies operating business shall comply with the following requirements for the ratio of assets to liabilities (the "**Requirements**"):

(1) The capital adequacy ratio shall not be lower than 10%;

(2) The balance of borrowed funds shall not be higher than the total capital;

(3) The guarantee balance shall not be higher than the total capital;

(4) The ratio of short-term securities investment to total capital shall not exceed 40%;

(5) The ratio of long-term investment to total capital shall not be higher than 30%; and

(6) The ratio of self-owned fixed assets to total capital shall not be higher than 20%.

For our due diligence purpose, we have obtained and reviewed the financial statements of the Finance Company as at 31 December 2019 and 2020 and 31 December 2021 provided by the Management, and noted that the financial ratios of the Finance Company were in compliance to the Requirements as follows.

	As at 31 December		
	2019	**2020**	**2021**
Capital adequacy ratio	27.4%	32.4%	30.5%
Balance of borrowed funds ratio	5.8%	–	–
Guaranteed balance ratio	35.7%	49.3%	43.9%
Ratio of short-term securities investment to total capital	–	1.1%	0.1%
Ratio of long-term investment to total capital	–	–	–
Ratio of own fixed assets to total capital	0.3%	0.3%	0.2%

Taking into consideration that the Finance Company has historically complied with the Requirements and risk monitoring indicators prescribed by the CBIRC, we are of the view that the aforementioned internal control measures can jointly and effectively safeguard the interests of the Company, ensure recoverability of the deposits to be placed with the Finance Company.

RECOMMENDATIONS

Having considered the principal factors and reasons as discussed above, we consider that (i) the 2023-2025 Master Sales Agreement, the 2023-2025 Group Financial Services Framework Agreement and the 2023-2025 Parent Group Financial Services Framework Agreement have been entered into in the ordinary and usual course of business of the Group based on normal commercial terms; and (ii) the terms of the 2023-2025 Master Sales Agreement, the 2023-2025 Group Financial Services Framework Agreement and the

2023-2025 Parent Group Financial Services Framework Agreement and the transactions contemplated thereunder, as well as the Proposed Annual Caps, are fair and reasonable so far as the Independent Shareholders are concerned, and are in the interests of the Company and Independent Shareholders as a whole.

Accordingly, we recommend the Independent Shareholders to vote in favour of the relevant resolutions to be proposed at the AGM to approve the 2023-2025 Master Sales Agreement, the 2023-2025 Group Financial Services Framework Agreement and the 2023-2025 Parent Group Financial Services Framework Agreement and the transactions contemplated thereunder (including the Proposed Annual Caps).

Yours faithfully,
For and on behalf of
Lego Corporate Finance Limited

Stanley Ng
Managing Director

Mr. Stanley Ng is a licensed person registered with the Securities and Futures Commission and a responsible officer of Lego Corporate Finance Limited to carry out Type 6 (advising on corporate finance) regulated activity under the Securities and Futures Ordinance (Chapter 571 of the laws of Hong Kong). He has over 15 years of experience in the accounting and investment banking industries.