



SOMERLEY CAPITAL LIMITED

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1 November 2024

To: The Independent Board Committee and the Independent Shareholders

Dear Sirs,

RENEWAL OF CONTINUING CONNECTED TRANSACTIONS IN RELATION TO THE 2024-2026 OFFSHORE SUPPLY FRAMEWORK AGREEMENT AND THE 2024-2026 TOBACCO LEAF PRODUCTS EXPORT AGENCY AGREEMENTS

INTRODUCTION

We refer to our appointment as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in relation to 2024 – 2026 Renewed Agreements, including the 2024-2026 Offshore Supply Framework Agreement and the 2024-2026 Tobacco Leaf Products Export Agency Agreements, and the respective transactions contemplated thereunder (including the Proposed Caps). Details of the 2024 – 2026 Renewed Agreements are set out in the circular issued by the Company to the Shareholders dated 1 November 2024 (the “Circular”), of which this letter forms part. Unless the context otherwise requires, capitalised terms used in this letter shall have the same meanings as those defined in the Circular.

As stated in the letter from the Board contained in the Circular, the 2021-2024 Offshore Supply Framework Agreements and the 2021-2024 Tobacco Leaf Products Export Agency Agreements will expire 16 November 2024. As the Company intends to continue to enter into the transactions of similar nature after expiry of the 2021-2024 Offshore Supply Framework Agreements and the 2021-2024 Tobacco Leaf Products Export Agency Agreements, on 10 October 2024, the Company entered into (i) the 2024-2026 Offshore Supply Framework Agreement with CTI North America in respect of procurement transactions in the Tobacco Leaf Products Import Business; and (ii) the 2024-2026 Tobacco Leaf Products Export Agency Agreements with each of the relevant counterparties in the Agency Business in the Sales of Tobacco Leaf Products that are entities under CNTC, on the same terms and conditions of the 2021-2024 Offshore Supply Framework Agreements and the 2021-2024 Tobacco Leaf Products Export Agency Agreements (save for the term and renewal of the respective agreements), respectively, for a term from 17 November 2024 and expiring on 31 December 2026.



CTIG is a controlling shareholder of the Company directly holding approximately 72.29% of the total issued share capital of the Company as at the Latest Practicable Date. CNTC is the sole shareholder of CTIG. CTI North America and each of the relevant counterparties in the Agency Business in the Sales of Tobacco Leaf Products are subsidiaries and/or associates of CNTC, and is therefore a connected person of the Company under the Listing Rules. Accordingly, the transactions contemplated under each of the 2024-2026 Renewed Agreements will constitute continuing connected transactions of the Company pursuant to Chapter 14A of the Listing Rules.

The transactions contemplated under the 2024-2026 Offshore Supply Framework Agreement and the transactions contemplated under the 2024-2026 Tobacco Leaf Products Export Agency Agreements are aggregated for the purpose of Rule 14A.81 of the Listing Rules on the basis that these transactions are conducted with counterparties that are associates of CNTC and are parties who are connected with one another. As one or more of the applicable percentage ratios in relation to the transactions contemplated under the 2024-2026 Offshore Supply Framework Agreement and the transactions contemplated under the 2024-2026 Tobacco Leaf Products Export Agency Agreements, on an aggregated basis, exceed 5%, the transactions contemplated under the 2024-2026 Offshore Supply Framework Agreement and the transactions contemplated under the 2024-2026 Tobacco Leaf Products Export Agency Agreements together with the Proposed Caps will be subject to announcement, annual review, circular (including independent board committee's and independent financial adviser's opinions and recommendations) and Independent Shareholders' approval requirements.

The Independent Board Committee comprising all the independent non-executive Directors, namely CHOW Siu Lui, WANG Xinhua, QIAN Yi and HE Junhua, has been established to advise the Independent Shareholders on the 2024-2026 Renewed Agreements and the respective transactions contemplated thereunder (including the Proposed Caps) as to whether the terms of such agreements and the transactions contemplated thereunder are fair and reasonable, on normal commercial terms or better, and in the interests of the Company and the Shareholders as a whole, and how to vote. We, Somerley Capital Limited, have been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in the same regard.

During the past two years, we have acted as an independent financial adviser to the Company in relation to the review of the continuing connected transactions of the Company for the years ended 31 December 2022 and 2023, and the six months ended 30 June 2022, 2023 and 2024 (as disclosed in the Company's interim reports for the six months ended 30 June 2022, 2023 and 2024 and the Company's annual reports for the year ended 31 December 2022 and 2023 (collectively, the **"Financial Reports"**). The past engagements were limited to providing independent advisory services to the Company, for which we received normal professional fees relevant to such type of engagements. Accordingly, we do not consider the past engagements would affect our independence to act as the independent financial adviser to the Company under the current engagement.

We are not associated with the Company, CTIG, CNTC, CTI North America and each of the relevant counterparties in the Agency Business in the Sales of Tobacco Leaf Products or their respective core connected persons, close associates or associates (all as defined under the Listing Rules) and accordingly are considered eligible to give independent advice on the above matters. Apart from normal professional fees payable to us in connection with this or similar appointments, no arrangement exists whereby we will receive any fees or benefits from the Company, CTIG, CNTC, CTI North America and each of the relevant counterparties in the Agency Business in the Sales of Tobacco Leaf Products or their respective core connected persons, close associates or associates.



In formulating our opinion, we have reviewed, among other things, the 2024-2026 Offshore Supply Framework Agreement, the 2024-2026 Tobacco Leaf Products Export Agency Agreements, the Financial Reports, the Prospectus and the information as set out in the Circular. We have also discussed with the management of the Group (the “**Management**”) regarding the business of the Group and the prospect of conducting the transactions contemplated under the 2024-2026 Renewal Agreements.

We have relied on the information and facts supplied, and the opinions expressed, by the Directors and the Management and have assumed that they are true, accurate and complete. We have also sought and received confirmation from the Directors that no material facts have been omitted from the information supplied and opinions expressed to us. We have no reason to believe that any material information has been withheld from us, or to doubt the truth or accuracy of the information provided. We have relied on such information and consider that the information we have received is sufficient for us to reach an informed view. We have not, however, conducted any independent investigation into the business and affairs of the Group, nor have we carried out any independent verification of the information supplied.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In formulating our opinion and recommendation, we have considered the principal factors and reasons set out below:

(1) Information of the parties

The Company

As at the Latest Practicable Date, the Company is principally engaged in the following businesses: (i) export of tobacco leaf products to Southeast Asia, Hong Kong, Macau, Taiwan and European Region; (ii) import of tobacco leaf products to the Chinese Mainland from origin countries or regions around the world (other than from sanctioned countries and regions); (iii) export of cigarettes to the Exclusive Operating Regions and New Designated Regions from CNTC Group directly or through distributors; (iv) export of new tobacco products to the global market (except the Chinese Mainland); and (v) procurement, processing, sale of tobacco leaves and procurement of agricultural materials inherent to tobacco production in the Republic of Brazil and from the Republic of Brazil to regions around the world (except the Chinese Mainland).

Set out below is a summary of the Company’s financial information for the years ended 31 December 2022 and 2023 and the six months ended 30 June 2023 and 2024.

	For the six months ended 30 June		For the year ended 31 December	
	2024	2023	2023	2022
	(HK\$ million)			
Revenue	8,704.0	7,744.0	11,836.2	8,324.2
Profit for the period/year attributable to equity shareholders of the Company	643.3	457.0	598.8	374.9



	As at 30 June 2024	As at 31 December 2023	2022
		(HK\$ million)	
Net assets	3,143.5	2,695.3	2,237.6

For the year ended 31 December 2023, the Group's revenue increased by approximately 42.2% to approximately HK\$11,836.2 million from that of approximately HK\$8,324.2 million for the year ended 31 December 2022. The increase was mainly driven by the growth in (i) the Tobacco Leaf Products Import Business; (ii) the export of cigarettes to the Exclusive Operating Regions and New Designated Regions from CNTC Group directly or through distributors (the **"Cigarettes Export Business"**); and (iii) the procurement, processing, sale of tobacco leaves and procurement of agricultural materials inherent to tobacco production in Republic of Brazil and from Republic of Brazil to regions around the world (except the Chinese Mainland). For the year ended 31 December 2023, profit for the year attributable to equity shareholders of the Company increased by approximately 59.7% to approximately HK\$598.8 million from that of approximately HK\$374.9 million for the year ended 31 December 2022. The increase was mainly driven by the growth in revenue and interest income.

For the six months ended 30 June 2024, the Group's revenue increased by approximately 12.4% to approximately HK\$8,704.0 million from that of approximately HK\$7,744.0 million for the six months ended 30 June 2023. Profit attributable to equity shareholders of the Company increased by approximately 40.8% to approximately HK\$643.3 million from that of approximately HK\$457.0 million for the six months ended 30 June 2023. Such increase was mainly driven by the growth in the Tobacco Leaf Products Import Business, the Cigarettes Export Business and the Tobacco Leaf Products Export Business.

Net assets of the Group continued to increase from approximately HK\$2,237.6 million as at 31 December 2022 to approximately HK\$2,695.3 million as at 31 December 2023, and further increased to approximately HK\$3,143.5 million as at 30 June 2024.

CNTC

CNTC is an enterprise incorporated in the PRC on 15 December 1983, and the sole shareholder of CTI and CTIG and the ultimate controlling shareholder of the Company, CTI North America and the relevant counterparties in the Agency Business in the Sales of Tobacco Leaf Products. CNTC is wholly owned by the State Council of the PRC. CNTC and its subsidiaries are the only entities under the State tobacco monopoly regime of the PRC to engage in the production, sale, and import and export businesses of tobacco monopoly commodities in the PRC.



CTI North America

CTI North America is a company incorporated in the State of North Carolina, the United States, on 16 July 2012. As at the Latest Practicable Date, CTI North America is an indirectly wholly-owned subsidiary of CNTC through CTIG and principally engaged in contract farming of tobacco leaves and procurement, processing, warehousing and export of raw tobacco as well as procurement of tobacco leaf products.

Relevant counterparties in the Agency Business in the Sales of Tobacco Leaf Products

Bang Kang Cigarette Factory, Myanmar is a joint venture company incorporated in the Republic of the Union of Myanmar in December 1999. As at the Latest Practicable Date, Bang Kang Cigarette Factory, Myanmar is owned as to 50% by CNTC through Chongqing Tobacco Investment Management Co., Ltd.* (重慶市煙草投資管理有限公司) and 50% by Hein Yun Virginia Tobacco Industries Co., Ltd. and principally engaged in the production, processing and sales of cigarettes. As at the Latest Practicable Date, Hein Yun Virginia Tobacco Industries Co., Ltd. is a company incorporated in the Republic of the Union of Myanmar in 2019 and principally engaged in the production, sales, import and export of tobacco products.

Golden Leaf (Macau) Tobacco's Manufacturing Ltd. is a limited liability company incorporated in Macau in December 1992. As at the Latest Practicable Date, Golden Leaf (Macau) Tobacco's Manufacturing Ltd. is an indirectly wholly owned subsidiary of CNTC through CNTC Guangdong Company* (中國煙草總公司廣東省公司) (as to 26%), Golden Tobacco International Limited (金葉煙草國際有限公司) (as to 19%) and China Tobacco Guangdong Industrial Co., Ltd.* (廣東中煙工業有限責任公司) (as to 55%) and principally engaged in the production and sales of cigarettes.

Hong Kong Hongta International Tobacco Company Limited is a limited liability company incorporated in Hong Kong on 9 December 1998. As at the Latest Practicable Date, Hong Kong Hongta International Tobacco Company Limited is owned as to 70% by CNTC through Hongta Tobacco (Group) Co., Ltd.* (紅塔煙草(集團)有限責任公司) (as to 55%) and Yunnan Tobacco International Co., Ltd.* (雲南煙草國際有限公司) (as to 15%) and 30% by Yanlord International Investment Co., Ltd. and principally engaged in the production of tobacco products. As at the Latest Practicable Date, Yanlord International Investment Co., Ltd. is a company incorporated in the British Virgin Islands on 13 May 1998 and principally engaged in holding investment.

Lao-China Hongta Good Luck Tobacco Co., Ltd. is a limited liability company incorporated in Lao People's Democratic Republic in 1992. As at the Latest Practicable Date, Lao-China Hongta Good Luck Tobacco Co., Ltd. is owned as to 91% by CNTC through Hongta Tobacco (Group) Co., Ltd.* (紅塔煙草(集團)有限責任公司) and principally engaged in the farming of tobacco leaves and production, processing and sales of tobacco leaf products and cigarettes.

Viniton Group Co., Ltd. is a limited liability company incorporated in the Kingdom of Cambodia on 12 May 1993. As at the Latest Practicable Date, Viniton Group Co., Ltd. is owned as to 80% by CNTC through China Tobacco Guangdong Industrial Co., Ltd.* (廣東中煙工業有限責任公司) and principally engaged in the production of tobacco products and production, processing, sales and export of cigarettes.

For further details of the relevant counterparties in the Agency Business in the Sales of Tobacco Leaf Products, please refer to the letter from the Board contained in the Circular.



(2) **Procurement transactions in the Tobacco Leaf Products Import Business**

(a) ***Principal terms of the 2024-2026 Offshore Supply Framework Agreement***

Set out below are the principal terms of the 2024-2026 Offshore Supply Framework Agreement:

Date

10 October 2024

Parties

- (i) The Company; and
- (ii) CTI North America

Term

Period from 17 November 2024 to 31 December 2026. Upon expiration, the parties may negotiate to extend the term of such agreement after arm's length negotiation.

Subject matter

Procurement of certain tobacco leaf products, primarily including tobacco leaf, stem, scrap, reconstituted tobacco and cut tobacco, by the Company from CTI North America as part of the Tobacco Leaf Products Import Business.

Pricing policy

The Procurement Price is negotiated between the parties on an arm's length basis, taking into consideration factors including current international market condition, relationship with the relevant suppliers, past procurement prices, product quality and annual production volume. Specifically, the Procurement Price comprises: (i) suppliers' costs of raw materials; (ii) applicable premium or discount in relation to product quality and the corresponding market status of a particular grade of tobacco leaf products; and (iii) suppliers' costs associated with exchange rate (suppliers procure tobacco leaves from local tobacco farmers with local currency but sell processed tobacco leaves to the Company in U.S. dollars).

We have obtained and reviewed, on random basis, transaction documents of ten procurement transactions in the Tobacco Leaf Products Import Business under the 2021-2024 Offshore Supply Framework Agreement entered into between the Group and connected person suppliers and compared them to those entered into between the Group and independent third-party suppliers for similar products (the "**Procurement Samples**"). Based on our review of the Procurement Samples and as advised by the Management, the transactions conducted under the 2021-2024 Offshore Supply Framework Agreements,



including the Procurement Samples, adopted the same transaction procedures and the same set of standard transaction documents including, but not limited to, contracts, invoices and customs documents. We also note that the Procurement Samples adhered to the pricing policy as mentioned above and the pricing of transactions with the connected person suppliers were, after taking into account product quality and market status of the products, comparable to those of the independent third-party suppliers. Accordingly, the pricing of the relevant transactions carried out under the 2021-2024 Offshore Supply Framework Agreements are considered no less favourable than those offered to the Group by independent third parties.

For further details of the principal terms of the 2024-2026 Offshore Supply Framework Agreement, please refer to the letter from the Board contained in the Circular.

(b) Reasons for and the benefits of entering into the 2024-2026 Offshore Supply Framework Agreement

As stated in the letter from the Board contained in the Circular, the Company conducts the Tobacco Leaf Products Import Business in its ordinary course of business, which includes (i) procurement transactions with CTI North America in the Tobacco Leaf Products Import Business and (ii) sales transactions with CTI. The Company has a long-term and stable tobacco leaf products procurement relationship with CTI North America in respect of procurement transactions in the Tobacco Leaf Products Import Business, which is the offshore subsidiary of CNTC strategically located in preferred tobacco leaf products planting zones. It has been an important overseas supplier to CNTC entities over the years. Pursuant to the No. 60 Notice, the Company exclusively engages in the Tobacco Leaf Products Import Business, and CTI North America in the procurement transactions in the Tobacco Leaf Products Import Business sells its tobacco leaf products to CTI through the Company. Therefore, the Company needs to carry on transactions with CTI North America in respect of procurement transactions in the Tobacco Leaf Products Import Business in connection with tobacco leaf products import to CTI, and the Company believes that the 2024-2026 Offshore Supply Framework Agreement is consistent with and important to its business and commercial objectives.

The Company expects the 2024-2026 Offshore Supply Framework Agreement will bring the following benefits to the Group: (i) they enable the Group to comply with the regulatory requirements in China, including those under the No. 60 Notice, as explained above; (ii) the long-term and stable tobacco leaf products procurement relationship between the Group and the relevant counterparties in the procurement transactions in the Tobacco Leaf Products Import Business can help the Group to further develop its business in the future; and (iii) the 2024-2026 Offshore Supply Framework Agreement can help the Group to satisfy the domestic market demand of tobacco leaf products from overseas. The Board does not consider there to be any material disadvantage to the Group in relation to the 2024-2026 Offshore Supply Framework Agreement and the transactions contemplated thereunder.



As stated in the Prospectus, the tobacco industry in the PRC is regulated by the state tobacco monopoly regime of the PRC prescribed by the Tobacco Monopoly Law and the Implementation Measures, in accordance to which the production, sale, import and export of tobacco monopoly commodities in the PRC are subject to state monopoly under law (the “**State Monopoly Regime**”). Accordingly, the Company was established to be the designated offshore platform for capital markets operation and international business expansion for CTIG, which is a wholly-owned subsidiary of CNTC. Therefore, being the exclusive entity for the Tobacco Leaf Products Import Business, the Company conducts the procurement transactions of imported tobacco leaf products with both connected and independent overseas suppliers as its ordinary course of business.

Having considered the above and the nature of the tobacco industry in the PRC, we concur with the Directors that entering into the 2024-2026 Offshore Supply Framework Agreement is important to the Group’s business and in the interests of the Company and the Shareholders as a whole.

(3) The Agency Business in the Sales of Tobacco Leaf Products

(a) Principal terms of the 2024-2026 Tobacco Leaf Products Export Agency Agreements

Set out below are the principal terms of the 2024-2026 Tobacco Leaf Products Export Agency Agreements:

Date

10 October 2024

Parties

The Company and each of the entities under CNTC below:

- (i) Bang Kang Cigarette Factory, Myanmar;
- (ii) Golden Leaf (Macau) Tobacco’s Manufacturing Ltd.;
- (iii) Hong Kong Hongta International Tobacco Company Limited;
- (iv) Lao-China Hongta Good Luck Tobacco Co., Ltd.; and
- (v) Vinton Group Co., Ltd.

Term

Period from 17 November 2024 to 31 December 2026. Upon expiration, the parties may negotiate to extend the term of such agreement after arm’s length negotiation.



Subject matter

The Company acts as an agent for entities under CNTC in certain sale transactions of certain tobacco leaf products, primarily including tobacco leaf, stem, scrap, reconstituted tobacco and cut tobacco, as part of the Tobacco Leaf Products Export Business.

Price policy

The rate of commission charged by the Company in connection with the transactions under the 2024-2026 Tobacco Leaf Products Export Agency Agreements is determined based on the resources devoted by the Company in connection with such transactions and varies according to the unit price of the relevant tobacco leaf products. The Company generally charges a higher commission rate for the tobacco leaf products carrying lower unit price and vice versa to derive reasonable profit. These transactions are conducted in the ordinary and usual course of business on normal commercial terms (or terms that are better to the Group). The Group currently expect to receive a commission of not less than 1% for tobacco leaf products (excluding cut tobacco) and less than 1% for cut tobacco, respectively, of the contract amount as revenue in such transactions. For cut tobacco, the minimum commission rate that the Group expects to receive is 0.25% of the selling price. The minimum commission rate is determined based on the gross margin that the Group expects to generate from the sale of such products, which is (i) 0.25% for the blended cut tobacco, cut tobacco and expanded cut tobacco with a unit price of US\$20,000 per metric ton or above, and (ii) 0.5% for the blended cut tobacco, cut tobacco and expanded cut tobacco with a unit price below USD20,000 per metric ton, respectively.

We have obtained and reviewed, on random basis, nine transaction documents of transactions entered into between the Company and independent third-party where the Group acted as an agent during the term of the 2021-2024 Tobacco Leaf Products Export Agency Agreements and compared with the relevant transactions entered into between the Company and connected person (the “Agency Samples”). All the Agency Samples were in relation to the sales of cut tobacco. We understood from the Management that during the term of the 2021-2024 Tobacco Leaf Products Export Agency Agreements, the majority of the transactions conducted between the Group and entities under CNTC pursuant to the 2021-2024 Tobacco Leaf Products Export Agency Agreements were related to cut tobacco, and all transactions entered into between the Group and independent third-party where the Group acted as an agent were in relation to cut tobacco. Based on our review of the Agency Samples and as advised by the Management, the transactions conducted under the 2021-2024 Tobacco Leaf Products Export Agency Agreements, including the Agency Samples, adopted the same transaction procedures and the same set of standard transaction documents including, but not limited to, contracts, invoices and customs documents. We also note that Agency Samples adhered to the pricing policy as mentioned above and the commission rate charged to connected person was comparable to those charged to the independent third parties. Accordingly, the pricing of the relevant transactions carried out in relation to cut tobacco under the 2021-2024 Tobacco Leaf Products Export Agency Agreements are considered no less favourable than those offered to the Group by independent third parties. For tobacco leaf products other than cut tobacco, despite the Group had no comparable



transactions with independent third parties, (i) the Group charged a higher commission rate of not less than 1% which generates higher revenue to the Group, and (ii) adopted the same transaction procedures and the same set of standard transaction documents as those for cut tobacco. Taking into account the above, we consider the principal terms of the transactions to be conducted pursuant to the 2024-2026 Tobacco Leaf Products Export Agency Agreements are on normal commercial terms, are fair and reasonable and in the interest of the Company and the Shareholders as a whole.

For further details of the principal terms of the 2024-2026 Tobacco Leaf Products Export Agency Agreements, please refer to the letter from the Board contained in the Circular.

(b) Reasons for and benefits of entering into the 2024-2026 Tobacco Leaf Products Export Agency Agreements

As stated in the letter from the Board contained in this Circular; pursuant to No. 60 Notice, after the Reorganization Completion Date, export of tobacco leaf products by entities under CNTC to Southeast Asia, Taiwan, Hong Kong and Macau shall be exclusively conducted through the Company. Certain tobacco leaf product suppliers, being the Company's connected persons, historically sold a small volume of tobacco leaf products to their long-term customers in such areas. After the Reorganization Completion Date, such tobacco leaf product suppliers continue to negotiate all terms of sales including prices, quantities and grades of tobacco leaf products with such customers directly, while the Group acts as an agent in such transactions and receives a commission for the services it provides in connection with such transactions.

The Company expects the 2024-2026 Tobacco Leaf Products Export Agency Agreements will bring the following benefits to the Group: (i) they enable the Group to comply with the regulatory requirements in China, including those under the No. 60 Notice, as explained above; (ii) the long-term and stable tobacco leaf products procurement relationship between the Group and the relevant counterparties in the Agency Business in the Sales of Tobacco Leaf Products can help the Group to further develop its business in the future; and (iii) the 2024-2026 Tobacco Leaf Products Export Agency Agreements can help the Group to generate more revenue by satisfying the overseas demand of tobacco leaf products in the global market. The Board does not consider there to be any material disadvantage to the Group in relation to the 2024-2026 Tobacco Leaf Products Export Agency Agreements and the respective transactions contemplated thereunder.

As discussed in the sub-section (2) (b) headed "Reasons for and the benefits of entering into the 2024-2026 Offshore Supply Framework Agreement" above, the tobacco industry in the PRC is heavily regulated and subject to the State Monopoly Regime. As such, being the exclusive entity for the Tobacco Leaf Products Export Business, the Company operates the agency business in the sales of tobacco leaf products as its ordinary course of business. Therefore, we consider it fair and reasonable for the entering into the 2024-2026 Tobacco Leaf Products Export Agency Agreements in order to carry out business and trading activities as mentioned above.



(4) Internal control measures

As disclosed in the letter from the Board contained in the Circular, the Company has adopted, among others, the following internal control measures (the “**Internal Control Measures**”) for the 2024-2026 Renewed Agreements and the respective transactions contemplated thereunder:

- (i) In relation to the procurement transactions in the Tobacco Leaf Products Import Business, the Company’s management team has considered sample products, price quotes and performance of various suppliers, including reviewing and comparing information from the Company’s historical and ongoing procurement transactions with independent third party suppliers, in order to ensure that tobacco leaf products to be procured from the relevant counterparties in the procurement transactions in the Tobacco Leaf Products Import Business will be made on normal commercial terms or better to the Company. Various contracts and transaction documents with independent third party suppliers have also been, and will continue to be, reviewed and considered by the Company’s management team when determining the terms of the tobacco leaf products procurement transactions under the 2024-2026 Offshore Supply Framework Agreement, to ensure that such principals and terms are consistent with those set out in the Company’s contracts with other third party suppliers. In particular, the Company’s management will review and consider at least two sets of contracts and transaction documents with independent third party suppliers to ensure that the principals and terms of the 2024-2026 Offshore Supply Framework Agreement are fair and reasonable, on normal commercial terms or better.
- (ii) In relation to the Agency Business in the Sales of Tobacco Leaf Products, when determining the commission the Company received from the sales of tobacco leaf products, the Company’s management team has considered, and will continue to consider, the resources the Company devotes to the business and the unit prices of the tobacco leaf products under such agency business. In addition, historical commissions the Company received from the sales of tobacco leaf products, including those received from independent third parties, have been reviewed and used as reference when setting the pricing policies and terms of the Agency Business in the Sales of Tobacco Leaf Products contemplated under the 2024-2026 Tobacco Leaf Products Export Agency Agreements. In particular, (i) in respect of cut tobacco, the Company’s management will review and consider historical commissions under at least two sets of contracts and transaction documents with independent third parties, and (ii) in respect of tobacco leaf products other than cut tobacco, charge a higher commission rate of not less than 1% in line with the Company’s pricing policy to derive reasonable profit, as well as adopt the same transaction procedures and standard transaction documents as those for cut tobacco, to ensure that the principals and terms of the 2024-2026 Tobacco Leaf Products Export Agency Agreements are fair and reasonable, on normal commercial terms or better.
- (iii) The Company has established the Connected Transactions Control Committee, which currently consists of four Directors, the majority of whom are independent non-executive Directors and the chairman being an independent non-executive Director, to review the pricing policies and principal terms of continuing connected transactions contemplated under the 2024-2026 Renewed Agreements.



- (iv) The Company will engage an independent financial adviser to review the continuing connected transactions contemplated under the 2024-2026 Renewed Agreements. The independent financial adviser will confirm in the Company's interim and annual reports whether such transactions were entered into (i) in the ordinary and usual course of business of the Company; (ii) on normal commercial terms or better to the Company; and (iii) according to the 2024-2026 Renewed Agreements on their respective terms that are fair and reasonable and in the interests of the Shareholders as a whole.
- (v) The independent non-executive Directors and external auditors of the Company will review the continuing connected transactions contemplated under the 2024-2026 Renewed Agreements on a regular basis.
- (vi) The Company has formulated internal guidelines (the "**Internal Guidelines**"), which provide relevant pricing policies for procurement of tobacco leaf products and agency commission of tobacco leaf products, respectively, as well as price negotiation procedures for the procurement of tobacco leaf products from overseas suppliers. In addition, the Company has put in place an internal policy (the "**Internal Policy**") to ensure fairness and reasonableness of the connected transactions to be conducted.

For further details of the Internal Control Measures, please refer to the letter from the Board contained in the Circular.

We have obtained and reviewed the Internal Policy and the Internal Guidelines in relation to the procurement transactions in the Tobacco Leaf Products Import Business and the Agency Business in the Sales of Tobacco Leaf Products, which require, among other things, regular reviews by the Connected Transactions Control Committee, independent non-executive Directors and auditors of the Company. Furthermore, based on our review of the Procurement Samples and the Agency Samples as discussed in the sections above, we noted that the Group had adhered to the aforementioned Internal Control Measures, in particular, the principal terms of the Procurement Samples and the Agency Samples were generally in line with those set out in at least two contracts and transaction documents entered between the Group and independent third parties. In view of the above, we consider the Internal Control Measures provide a safeguard to the interests of the Company and the Shareholders as a whole.



(5) **The Proposed Caps**

(a) *The 2024-2026 Offshore Supply Framework Agreement*

The following sets forth the historical transaction amounts of the continuing connected transactions under the 2021-2024 Offshore Supply Framework Agreements and the utilisation rates of the existing annual caps for the periods indicated below.

	For the year ended		For the period from
	31 December		1 January
	2022	2023	2024 to
	(HK\$ million)		16 November
			2024
Historical transaction amounts	139.90	249.10	329.20 ^(Note)
Existing annual caps	444.60	466.90	490.20
Utilisation rates	31.47%	53.35%	67.16% ^(Note)

Note: The historical transaction amount and utilisation rate for the period from 1 January 2024 to 16 November 2024 is based on historical transaction amount for the period from 1 January 2024 to the Latest Practicable Date.

As stated in the letter from the Board contained in the Circular, after the expiry of the Offshore Supply Framework Agreements on 28 November 2021 and up to 31 December 2021, the Group had not conducted any transaction of similar nature with the parties to the Offshore Supply Framework Agreements. Based on our discussion with the Management, the relatively low utilisation rates of the annual caps for the year ended 31 December 2022 and 2023 were mainly due to (i) the slower than expected growth in procurement price of tobacco leaf products; and (ii) the lower than expected procurement volume as a result of seasonal fluctuations in crops production.



Set out below are the proposed annual caps for the continuing connected transactions contemplated under the 2024-2026 Offshore Supply Framework Agreement for the period from 17 November 2024 to 31 December 2024 and for the two years ending 31 December 2025 and 2026, respectively.

	Proposed annual caps		
	For the		
	period from		
	17 November		
	2024 to	For the year ending	
	31 December	31 December	
	2024	2025	2026
	<i>(HK\$ million)</i>		
Procurement transactions in the Tobacco			
Leaf Products Import Business	301.18	1,210.91	1,332.00

As set out in the letter from the Board in the Circular, the proposed annual caps under the 2024-2026 Offshore Supply Framework Agreement were determined with reference to the following factors:

- historical procurement volumes during 2021-2024 and average procurement prices in 2024;
- CTI North America proactively expands its product source, leading to a substantial increase in its market share, which is expected to result in a substantial increase in the volume of finished tobacco strips to be procured from CTI North America;
- an expected increase in the price of finished tobacco strips procured from CTI North America, considering prices in the international tobacco leaf products market;
- in addition to finished tobacco strips procured from CTI North America in the past, the Company also expects to procure from CTI North America cigar leaf tobacco starting from the end of 2024. A portion of such cigar leaf tobacco is expected to be shipped in 2024. Taking into account that (a) the unit price of cigar leaf tobacco is substantially higher than that of finished tobacco strips, generally by four to five times of the unit price of finished tobacco strips; and (b) shipping schedules of the cigar leaf tobacco may be brought forward or delayed, requiring a buffer for the potential transaction amounts crossing over year ends, the Company expects a significant rise in the transaction amount of tobacco leaf products procured from CTI North America in 2025 and 2026; and
- a 10% annual progressive growth rate from the proposed annual caps in 2025 to 2026, as the Company expects a stable increase in the amount of finished tobacco strips and cigar leaf tobacco to be procured from CTI North America.



Based on our discussion with the Management and the underlying calculation in formulating the proposed annual caps under the 2024-2026 Offshore Supply Framework Agreement, we noted that the substantial increase in the proposed annual caps for the year ending 31 December 2025 and 2026 as compared to the existing annual caps under the 2021-2024 Offshore Supply Framework Agreements is mainly attributable to (i) the expected increase in procurement volume of finished tobacco strips; and (ii) the fact that the Group expects to procure from CTI North America cigar leaf tobacco starting from the end of 2024. We understand from the Management that the unit price for cigar leaf tobacco is substantially higher than that of finished tobacco strips, being one of the major products procured from CTI North America by the Group under the 2021-2024 Offshore Supply Framework Agreements.

For the period from 17 November 2024 to 31 December 2024, the Group estimated 700 tonnes of cigar leaf tobacco to be shipped from CTI North America with an average procurement price of US\$55,162 per tonne. The estimated volume is based on the indicated demand of cigar leaf tobacco provided to the Company from its Tobacco Leaf Products Import Business customers, which was in turn based on the expected market demand for cigar leaf tobacco, taking into account the price and quality of cigar leaf tobacco offered by CTI North America. The estimated procurement price is based on the quotation provided by CTI North America.

For the year ending 31 December 2025, the Group estimated to procure 8,000 tonnes of finished tobacco strips from CTI North America. As advised by the Management, the procurement of finished tobacco strips from CTI North America is expected to substantially increase in 2025 as compared to that in 2024 considering that CTI North America proactively expands its product source, leading to a substantial increase in its market share. On the other hand, the average procurement price of finished tobacco strips from CTI North America is expected to increase in 2025 in view of the intensifying impacts from extreme weather, which reduces production and supply. The Group further estimated to procure around 1,000 tonnes of cigar leaf tobacco from CTI North America in 2025 at the same average procurement price during the period from 17 November 2024 to 31 December 2024. The estimated procurement volume of cigar leaf tobacco of the Group from CTI North America in 2025 is based on the indicated demand of cigar leaf tobacco provided to the Company from its Tobacco Leaf Products Import Business customers, which was in turn based on the expected market demand for cigar leaf tobacco, taking into account the price and quality of cigar leaf tobacco offered by CTI North America. Taking into account the uncertainty in shipping arrangement, which depends on the timing of completion of the manufacturing of tobacco leaf products, which in turn may vary according to the crop season of tobacco leaves, subject to climate and other cultivating conditions, the Group had included buffers in the annual caps to cater for the possible delay in completion of the manufacturing process and/or shipment for the procurement order made in previous year.



For the year ending 31 December 2026, the Group expected the transaction amount for the procurement of tobacco leaf products from CTI North America to increase by 10% from that in 2025. As advised by the Management, the Group expects a stable increase in the amount of finished tobacco strips and cigar leaf tobacco to be procured from CTI North America. Based on the financial reports of the Group, we noted that the revenue from the Group's Tobacco Leaf Products Import Business recorded a 3-year compounded annual growth rate (CAGR) of approximately 81.5% from 2020 to 2023 and continued to record a growth of approximately 5.5% for the six months ended 30 June 2024 as compared to the corresponding period in 2023. Given the significant historical growth of the Group's Tobacco Leaf Products Import Business, we consider the expected 10% growth rate is reasonable.

Based on the above, we are of the view that the proposed annual caps under the 2024-2026 Offshore Supply Framework Agreement were determined based on reasonable estimation and after due and careful consideration. Taking into account (i) the long-term and stable tobacco leaf products procurement relationship between the Group and CTI North America; (ii) the transactions pursuant to the 2024-2026 Offshore Supply Framework Agreement will be conducted on normal commercial terms; and (iii) the 2024-2026 Offshore Supply Framework Agreement can help the Group to satisfy the domestic market demand of tobacco leaf products from overseas, we are of the view that the proposed annual caps are fair and reasonable so far as the Independent Shareholders are concerned.

(b) The 2024-2026 Tobacco Leaf Products Export Agency Agreements

The following sets forth the historical transaction amounts of the continuing connected transactions under the 2021-2024 Tobacco Leaf Products Export Agency Agreements and the utilisation rates of the existing annual caps for the periods indicated below.

	For the period from 17 November 2021 to 31 December 2021	For the year ended 31 December 2022 (HK\$ million)	2023	For the period from 1 January to 16 November 2024
Historical transaction amounts	0.10	0.50	0.40	0.80 ^(Note)
Existing annual caps	0.40	3.00	3.30	3.60
Utilisation rates	25.00%	16.67%	12.12%	22.22% ^(Note)

Note: The historical transaction amount and utilisation rate for the period from 1 January 2024 to 16 November 2024 is based on historical transaction amount for the period from 1 January 2024 to the Latest Practicable Date.



Based on our discussion with the Management, the relatively low utilisation rates of the annual cap in 2021 to 2023 under the 2021-2024 Tobacco Leaf Products Export Agency was mainly due to the decrease in demand from overseas market of the Tobacco Leaf Products Export Business as a result of (i) the influence of the COVID-19 pandemic; and (ii) the decrease in supplies of marketable tobacco leaves. In 2024, despite the gradually diminished impacts of the COVID-19 pandemic, a significant portion of tobacco leaf products order that have a relatively higher margin were scheduled for shipment in the fourth quarter of 2024, resulting in the lower than expected transaction amounts for the nine months ended 30 September 2024.

Set out below are the proposed annual caps for the commission to be received by the Company in connection with the transactions under the 2024-2026 Tobacco Leaf Products Export Agency Agreements as part of the Agency Business in the Sales of Tobacco Leaf Products for the period from 17 November 2024 to 31 December 2024 and for the two years ending 31 December 2025 and 2026, respectively.

	Proposed annual caps		
	For the period from 17 November 2024 to 31 December 2024	For the year ending 31 December 2025 2026	
		<i>(HK\$ million)</i>	
Commission to be received by the Company in connection with the transactions under the 2024-2026 Tobacco Leaf Products Export Agency Agreements as part of the Agency Business in the Sales of Tobacco Leaf Products	2.08	5.44	5.98

As set out in the letter from the Board in the Circular, the proposed annual caps under the 2024-2026 Tobacco Leaf Products Export Agency Agreements were determined taken into account:

- historical transaction amounts during 2021-2024;
- the Company's current orders received from customers under the Agency Business in the Sales of Tobacco Leaf Products, which has increased substantially in 2024 as compared to past years;
- having communicated with customers, their expected demand for the tobacco leaf products is expected to rise, which will result in an increase in the amount of commission that are expected to receive in the period from 17 November 2024 to 31 December 2026;



- the increase in the unit price of the relevant tobacco leaf products, leading to higher amounts of commission that the Company is expected to receive;
- a 10% annual progressive growth rate from the proposed annual caps in 2025 to 2026, as the Company expects a stable increase in the amount of relevant tobacco leaf products to be exported; and
- fluctuation of international currency exchange rates.

As advised by the Management, the proposed annual cap for the continuing connected transactions contemplated under the 2024-2026 Tobacco Leaf Products Export Agency Agreements (in terms of commission) for the period from 17 November 2024 to 31 December 2024 was determined based on the contracted amount of tobacco leaf products that were expected to be delivered before the year ending 31 December 2024 of approximately HK\$126.3 million.

The proposed annual caps under the 2024-2026 Tobacco Leaf Products Export Agency Agreements (in terms of commission) for the year ending 31 December 2025 was determined based on the discussion between the Group and each of the entities under CNTC of the 2024-2026 Tobacco Leaf Products Export Agency Agreements. As an agent, the Group obtained the estimated contract volume and contract sum to be entered into with each of the entities under CNTC for 2025, the Group then projected the expected commission to be received from acting as an agent for such transactions based on the pricing policies of the 2024-2026 Tobacco Leaf Products Export Agency Agreements according to the type, contract amount and selling price of the products.

For the year ending 31 December 2026, the Company expects the commission to be received by the Company as part of the Agency Business in the Sales of Tobacco Leaf Products to increase by 10% from that in 2025. As advised by the Management, the Group expects a stable increase in the amount of relevant tobacco leaf products to be exported. Based on the financial reports of the Group, we noted that the revenue from the Group's Tobacco Leaf Products Export Business recorded a 3-year CAGR of approximately -5.1% from 2020 to 2023 and recorded a growth of approximately 23.0% for the six months ended 30 June 2024 as compared to the corresponding period in 2023. As stated in the annual reports of the Company for the years ended 31 December 2022 and 2023, the decline in revenue from Tobacco Leaf Products Export Business during 2022 and 2023 was mainly due to (i) the decrease in supplies of marketable tobacco leaves for export; and (ii) the increase in tobacco taxes. Against such backdrop, as stated in the 2024 Interim Report, the Group achieved growth in the segment through efforts in organising marketable sources of tobacco leaves and optimisation of pricing strategies and enhancement of service levels. Given the recent performance of the Group's Tobacco Leaf Export Business, we consider the expected 10% growth rate is reasonable.



Based on the above, we are of the view that the proposed annual caps under the 2024-2026 Tobacco Leaf Products Export Agency Agreements were determined based on reasonable estimation and after due and careful consideration. Taking into account (i) the long-term and stable tobacco leaf products procurement relationship between the Group and entities under CNTC; (ii) the transactions pursuant to the 2024-2026 Tobacco Leaf Products Export Agency Agreements will be conducted on normal commercial terms; and (iii) the 2024-2026 Tobacco Leaf Products Export Agency Agreements can help the Group to generate more revenue by satisfying the overseas demand of tobacco leaf products in the global market, we are of the view that the proposed annual caps are fair and reasonable so far as the Independent Shareholders are concerned.

OPINION AND RECOMMENDATION

Having considered the above principal factors and reasons, we consider that (i) the entering into the 2024-2026 Renewed Agreements are in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole; and (ii) the terms of the 2024-2026 Renewed Agreements (including the Proposed Caps thereof) are on normal commercial terms and fair and reasonable so far as the Independent Shareholders are concerned. Accordingly, we advise the Independent Board Committee to recommend, and we ourselves recommend, the Independent Shareholders to vote in favour of the resolutions in relation to the 2024-2026 Renewed Agreements at the EGM.

Yours faithfully,
for and on behalf of
SOMERLEY CAPITAL LIMITED

Calvin Leung
Director

Mr. Calvin Leung is a licensed person registered with the Securities and Futures Commission of Hong Kong and a responsible officer of Somerley Capital Limited, which is licensed under the SFO to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities. He has over 20 years of experience in the corporate finance industry.