

3 December 2024

*To the Independent Board Committee and the Independent Shareholders*

Dear Sirs,

## RENEWAL OF CONTINUING CONNECTED TRANSACTIONS

### INTRODUCTION

We refer to our engagement to advise the Independent Board Committee and the Independent Shareholders in respect of the terms of the Continuing Connected Transactions 2025-2027 and the Proposed Caps, particulars of which are set out in the letter from the Board (the “**Letter from the Board**”) of the circular to the Shareholders dated 3 December 2024 (the “**Circular**”) and in which this letter is reproduced. Unless the context requires otherwise, capitalised terms used in this letter shall have the same meanings as given to them under the definitions section of the Circular.

As set out in the Letter from the Board, on 18 October 2024, (a) the Company entered into the Brilliance China Sale Agreement 2025-2027 with Brilliance China; and (b) Mianyang Xincheng, a wholly-owned subsidiary of the Company, entered into the Xinhua Combustion Engine Purchase Agreement 2025-2027 with Xinhua Combustion Engine, as to the continued conduct of the Continuing Connected Transactions 2022-2024 for the three financial years commencing from 1 January 2025 to 31 December 2027.

As at the Latest Practicable Date, each of Brilliance China and Wuliangye was interested in 400,000,000 and 400,000,000 Shares, representing approximately 31.20% and 31.20% of the issued share capital of the Company, respectively. Accordingly, each of Brilliance China and Xinhua Combustion Engine (being a non wholly-owned subsidiary of Wuliangye) is a connected person of the Company under Rule 14A.07(1) of the Listing Rules.

As one or more of the applicable percentage ratios under Rule 14.07 of the Listing Rules for the Continuing Connected Transactions 2025-2027 are, on an annual basis, over 5%, the Continuing Connected Transactions 2025-2027 are subject to reporting, announcement, annual review and Independent Shareholders’ approval requirements as set out in Chapter 14A of the Listing Rules.

The Independent Board Committee comprising all of the independent non-executive Directors, namely Mr. Chi Guohua, Mr. Wang Jun and Ms. Dong Yan, has been formed to advise the Independent Shareholders as to (i) the Continuing Connected Transactions 2025-2027; and (ii) the Proposed Caps. We have been appointed to advise the Independent Board Committee and the Independent Shareholders in this regard.

As at the Latest Practicable Date, we were not connected with the Group, Brilliance China, Xinhua Combustion Engine and Wuliangye or, where applicable, any of their respective substantial shareholders, directors or chief executives, or any of their respective subsidiaries or associates pursuant to Rule 13.84 of the Listing Rules. During the last two years, there has been no other engagement entered into between the Company and us. We are therefore considered suitable to give independent advice to the Independent Board Committee and the Independent Shareholders regarding the Continuing Connected Transactions 2025-2027 and the Proposed Caps.

Apart from normal professional fees payable to us by the Company in connection with this appointment, no arrangement exists whereby we will receive any fees or benefits from the Company or the directors, chief executive and substantial shareholders of the Company, the Group, Brilliance China, Xinhua Combustion Engine and Wuliangye or any of their respective subsidiaries or associates that could reasonably be regarded as relevant to our independence. Accordingly, we consider that we are independent to act as the Independent Financial Adviser pursuant to Rule 13.84 of the Listing Rules.

In formulating our opinion, we have relied on the accuracy of the information and representations contained in the Circular and have assumed that all information and representations made or referred to in the Circular were true at the time they were made and continued to be true as at the Latest Practicable Date. We have also relied on our discussion with the management of the Company regarding the Group, including the information and representations contained in the Circular. We have also assumed that all statements of belief, opinion and intention made by the Directors and management of the Company in the Circular were reasonably made after due enquiry. We consider that we have reviewed sufficient information to reach an informed view, to justify our reliance on the accuracy of the information contained in the Circular and to provide a reasonable basis for our advice, among other things, (i) automobile sales plan of Brilliance China for the three years ending 31 December 2027 (the “**Sales Plan**”); (ii) list of estimated purchases of engine components of the Group for the three years ending 31 December 2027 (the “**Purchase Plan**”); (iii) samples of historical transactions and corresponding invoices of the comparable products under the Brilliance China Sale Agreement 2022-2024 during the two years ended 31 December 2023 and the ten months ended 31 October 2024; (iv) samples of quotations of the comparable products under the Xinhua Combustion Engine Purchase Agreement 2022-2024 during the two years ended 31 December 2023 and the ten months ended 31 October 2024; and (v) internal control policies adopted for the Continuing Connected Transactions 2025-2027.



We have no reason to suspect that any material facts have been omitted or withheld from the information contained or opinions expressed in the Circular nor to doubt the truth, accuracy and completeness of the information and representations provided to us by the Directors and management of the Company. We have not, however, conducted an independent in-depth investigation into the business and affairs of the Group, Brilliance China, Xinhua Combustion Engine and Wuliangye and their respective controlling shareholder(s) and associates; nor have we carried out any independent verification of the information supplied.

## **THE CONTINUING CONNECTED TRANSACTIONS 2025-2027 AND THE PROPOSED CAPS**

### **Principal factors and reasons considered**

In arriving at our opinion regarding the Continuing Connected Transactions 2025-2027 and the Proposed Caps, we have considered the following principal factors and reasons:

#### **1. Background of and reasons for the Continuing Connected Transactions 2025-2027 and the Proposed Caps**

The Group is principally engaged in the development, manufacture and sales of automotive engines for passenger vehicles and light duty commercial vehicles and manufacture of engine parts and components of the passenger vehicles in the PRC.

As stated in the 2021 Announcement, (i) the Company and Brilliance China entered into the Brilliance China Sale Agreement 2022-2024 for the supply by the Group to the Brilliance China Group of various types of engines and engine components; and (ii) Mianyang Xincheng entered into the Xinhua Combustion Engine Purchase Agreement 2022-2024 with Xinhua Combustion Engine for the purchase from Xinhua Combustion Engine of various gasoline and diesel engine components such as crankshafts, exhaust manifolds, cylinder chambers and cylinder heads.

As the above-mentioned framework agreements will expire on 31 December 2024 and the parties wish to continue the relevant transactions (i.e. the Brilliance China Sale Agreement 2022-2024 and the Xinhua Combustion Engine Purchase Agreement 2022-2024) upon expiry of the relevant framework agreements, the parties entered into the Brilliance China Sale Agreement 2025-2027 and the Xinhua Combustion Engine Purchase Agreement 2025-2027.

As disclosed in the Letter from the Board, in the ordinary course of business of the Group, the Group purchases various types of engine components from the Wuliangye Group for production of the Group's engines. The Group sells engines produced by it to the Brilliance China Group. In particular, engine components supplied by the Wuliangye Group are produced based on specifications provided by the Group and used for the production of engines of the Group or for sale to customers of the Group for repair and maintenance purposes.

Based on our review of the Sales Plan and the Purchase Plan provided by the Group and our discussion with the management of the Company, we understand that the Group sells its engines, produced with engine components under the Purchase Plan, to the Brilliance China Group for use in manufacturing light commercial vehicles. Such engines are developed and produced according to the specification required by the Brilliance China Group and the Group sells R-series engines and D-series engines to the Brilliance China Group for use in manufacturing light commercial vehicles, which broadens the customer base and increases the demand for these types of engines.

As advised by the management of the Company, the specification of automotive components is usually tailor-made for specific brands of vehicles of particular automotive manufacturers due to confidentiality and control over the core production technologies and assurance, and the same type of automotive component of an automotive manufacturer would usually be used in various models of vehicles. We understand that due to the fact that safety is of the utmost importance of a vehicle, an automotive manufacturer would either produce the required engines and engine components on its own or source those engines and engine components from its entrusted suppliers. It is common for an automotive manufacturer to build a long-term business relationship with a particular engine and engine component supplier whose products have been repeatedly tested and proven to meet the requirement and specification by the automotive manufacturer.

In view that the specification of engines and engine components is usually tailor-made for specific brands of vehicles of particular automotive manufacturers and the same model of engine or engine component of an automotive manufacturer would usually be used in various models of vehicles, it is more efficient to produce engines and engine components to suit certain automotive manufacturers' requirements and specification.

The Group has been part of the Brilliance China Group before its listing and has been an important engine supplier of the Brilliance China Group for long in respect of their vehicles manufactured (namely light commercial vehicles, sedans, SUVs and MPVs). Considering the extensive business operations of the Brilliance China Group, the entering into of the Brilliance China Sale Agreement 2025-2027 could allow the Group to secure a source of revenue through the transactions to be conducted thereunder, and, on the other hand, allow the Group to leverage on the reputations of the Brilliance China Group and its brands, resulting in attracting potential customers which may in turn enhance returns to the Shareholders.



On the other hand, the Group has been procuring engine components from Xinhua Combustion Engine for over 10 years. Since the Group has been purchasing certain engine components for its manufacturing operation from Xinhua Combustion Engine over the years, the close relationship between the Group and Xinhua Combustion Engine allows the Group to secure stable supply of engine components for its operation. The long-term supply relationship has allowed Xinhua Combustion Engine to develop thorough understanding of the technical requirements and specifications required by the Group and become familiar with the production cycle and operation needs of the Group. Additionally, the close proximity of the production facilities of the Group and Xinhua Combustion Engine, which are both located in Mianyang City and connected by a straight driveway that enables efficient logistics and quick response times. These factors collectively contribute to ensuring timely supply of engine components which (i) could meet the necessary quality and standards as required by the Group; and (ii) could minimise any disruptions to the Group's existing business operations.

Based on the above, we consider that it is fair and reasonable and in the interests of the Company and the Shareholders as a whole for the Group to enter into the Brilliance China Sale Agreement 2025-2027 and the Xinhua Combustion Engine Purchase Agreement 2025-2027 in order to continue the ongoing (i) sales transactions with the Brilliance China Group to secure stable source of revenue for the Group; and (ii) purchase transactions with Xinhua Combustion Engine to secure a stable supply of engine components for the onward manufacturing of engines of the Group.

## 2. Industry overview

The growth of production and sales of automobiles have shown resilience in recent years despite challenges such as high inventories and fluctuating consumer confidence. According to the statistics in the 2023 Automotive Industry Economic Operation Report\* (2023年汽車工業經濟運行報告) as released by National Bureau of Statistics of China<sup>Note 1</sup>, approximately 30.1 million new vehicles were sold in 2023 in the PRC, reflecting a growth of approximately 9.9% compared to previous years. According to the analysis released by the China Association of Automobile Manufacturers<sup>Note 2</sup>, during the first six months in 2024, vehicle sales volumes and production reached approximately 14.0 million units and approximately 13.9 million units, marking 6.1% and 4.9% increase year-over-year, respectively. The continuing increase in sales and production of vehicles indicates a healthy recovery from the previous pandemic-induced downturn. An industry report by credit rating agency S&P Global Inc. released in April 2024<sup>Note 3</sup> further introduced that the growth

\* for identification purposes only

Notes:

1. Please refer to the link below for the 2023 Automotive Industry Economic Operation Report\*: <http://lwzb.stats.gov.cn/pub/lwzb/bztt/202405/W020240527578179613545.pdf>
2. Please refer to the link below for the analysis the China Association of Automobile Manufacturers: [www.caam.org.cn/chn/5/cate\\_39/con\\_5236464.html](http://www.caam.org.cn/chn/5/cate_39/con_5236464.html)
3. Please refer to the link below for the industry report by S&P Global Inc.: <https://www.spglobal.com/ratings/en/research/pdf-articles/240429-china-auto-margin-pressure-heightens-101596837#:~:text=China's%20domestic%20light%20vehicle%20sales,from%20over%2030%25%20last%20year.&text=S%26P%20Global%20Inc.>

trajectory of vehicle industry in the PRC is expected to continue into the years of 2024 and 2025, with projections indicating an increase in domestic light vehicle sales by 2% to 3% and electric vehicle sales by 15% to 20% annually.

On the other hand, the Chinese government has implemented policies aimed at supporting the growth of automobile market. In March 2024, fourteen ministries including the Ministry of Commerce (商務部) of the PRC launched a national-wide “old-for-new” program, the Action Plan for Promoting Large-scale Equipment Renewals and Consumer Goods Trade-ins (《推動消費品以舊換新行動方案》)(the “Action Plan”)<sup>Note 4</sup>, which has revised auto loan policies to allow financial institutions to offer loans with down payment ratios potentially reaching 100%, facilitating “zero down payment” purchases for both traditional internal combustion engine vehicles and new energy vehicles. Subsequently in May 2024, the Ministry of Finance (財政部) of the PRC supported and substantialised the Action Plan by allocating approximately RMB11.2 billion for auto trade-in subsidies in 2024 through the release of the Central Government Pre-Allocated Fund Budget for the 2024 Auto Trade-in Subsidy<sup>Note 5</sup> (《2024年汽車以舊換新補貼中央財政預撥資金預算》), with emphasis on the importance of trade-in programs for older vehicles with lower emission standards. In terms of performance indicators, the annual scrapped car recycling volume is 3.78 million vehicles. The auto loan policies allowing “zero down payment” and the issuance of the subsidy fund with target volume of scrapped car may provide solid financial support that promotes the growth of the automobile market.

With a view to enhancing environmental standards, under the Action Plan, by 2025, passenger cars with emission standards of China III (中國第三階段汽車排放標準) and below are planned to be phased out at an accelerated pace. The Chinese government aims to increase the recycling of scrapped automobiles by 50% by 2025 and 100% by 2027, comparing to the level of recycling in 2023. This strategy encourages consumers to trade older vehicles in for newer models that comply with stricter emissions regulations.

Notes:

4. Please refer to the link below for the Action Plan:

[https://www.gov.cn/zhengce/zhengceku/202404/content\\_6945069.htm](https://www.gov.cn/zhengce/zhengceku/202404/content_6945069.htm)

5. Please refer to the link below for the release of the auto trade-in subsidy:

[https://www.gov.cn/zhengce/zhengceku/202406/content\\_6955282.htm](https://www.gov.cn/zhengce/zhengceku/202406/content_6955282.htm)



Moreover, the overseas market opportunity for Chinese vehicle components in developing countries is expanding, driven by regional demands. In Africa, there is growing demand for affordable and high-quality vehicles, while in the Middle East, the market is increasingly focused on mid to high-end new energy vehicles equipped with intelligent features and autonomous driving capabilities. According to Naamsa<sup>Note 6</sup>, the Automotive Business Council in South Africa, the number of imported Chinese vehicles surged from about 11,000 units in 2019 to over 39,000 units in 2023, which represents a growth rate exceeding 200% within a few years, driven by Chinese brands' increasing competitiveness, against established American and Japanese automakers well-known for offering affordable mass-market vehicles, through lower prices and improved quality perceptions among consumers. Apart from the growth in Africa, Chinese automakers have also made progress in the Middle East automotive market. According to the latest data from the General Administration of Customs of the PRC<sup>Note 7</sup>, in the first half of 2024, China's passenger vehicle exports to the Middle East region reached 420,000 units, representing a year-on-year growth of 46.2%, making it China's largest export destination for automobiles during this period. As reported by China Daily<sup>Note 8</sup>, a national English newspaper in the PRC, this growth in vehicle exports is accompanying with collaboration by local manufacturers in overseas market with Chinese automakers to develop domestic production facilities and led to Chinese automakers to expand their presence in Africa and the Middle East, with developments across key markets such as South Africa, Morocco, Egypt and Ethiopia. For instance, BAIC Group, a major Chinese state-owned automaker, made investment of 226 million United States Dollars for its first phase construction of a plant in South Africa with the first vehicle being assembled in 2018 and the construction was fully completed in 2023<sup>Note 9</sup>. Another notable development is the expansion of Changan Automobile, a leading Chinese automaker, where it has accumulated sales exceeding 400,000 units in Africa and the Middle East markets and established its largest global flagship store in Saudi Arabia<sup>Note 10</sup>. The leading Chinese automaker planned to collaborate with local business partners to enhance its regional presence through the establishment of spare parts centers and technical support facilities, while accelerating operational localisation including financial services and logistics distribution networks to ensure efficient after-sales support and service delivery. These developments in Chinese vehicle exports and manufacturing presence in Africa and the Middle East markets demonstrate the growing opportunities for engine and engine components suppliers to support both local production and after-market service needs in these regions.

Notes:

6. Please refer to the link below for the data:

<https://www.voanews.com/a/in-the-fast-lane-chinese-car-imports-grow-in-south-africa/7809451.html>

7. Please refer to the link below for the data:

<https://finance.sina.com.cn/stock/re/news/cn/2024-10-30/doc-incukean0819036.shtml>

8. Please refer to the link below for the report:

<https://www.chinadailyhk.com/hk/article/592584>

9. Please refer to the link below for the information:

<https://baic.co.za/about-us.html>

10. Please refer to the link below for the information:

<https://www.globalchangan.com/newsroom/changans-journey-30-years-in-the-middle-east-and-africa-embarking-on-a-new-chapter.html>

With the stable growth of the Chinese passenger vehicle market and the supportive policies of the government in encouraging consumption in the automobile industry, the automobile industry is continuing its recovery subsequent to the pandemic situation and demand in the end-products of the automakers is growing. We consider that the recovering local demand in the PRC and the expanding opportunities in the overseas markets with growing regional demands, particularly in developing regions, may in turn result in an increasing demand for engines and engine components from the Group.

The Company plans to capitalise on the expanding growth potential in developing regions, by strategically collaborating with long-standing Chinese automaker business partners. By leveraging these established relationships, the Company aims to become a preferred supplier of engines and engine components for local vehicle manufacturing and after-sales services in these markets. This strategic approach will enable the Company to tap into the growing demand for affordable, high-quality automotive components in the developing regions. The Company expects to commence exporting its products to these markets in the coming years, with a targeted export launch in the financial year ended 31 December 2025 (“FY2025”). This timeline allows for further market research, product customisation, and the optimisation of distribution channels and local networks for exportation. The Company’s export initiative, strategically aligned with the expanding presence of Chinese automotive products in developing countries, positions it to capture the opportunities in the overseas markets.

In light of this observed growth in demand for engines and engine components, the Group is of view that the entering into of the Brilliance China Sale Agreement 2025-2027 and the Xinhua Combustion Engine Purchase Agreement 2025-2027 help position the Group to capitalise on the positive market trend and ensure a stable supply chain to meet the anticipated product demand.

### 3. The Existing Caps and historical transaction amounts

Based on information provided by the Company, we summarise in the following table (i) the Existing Caps of the Continuing Connected Transactions 2022-2024 for each of the three financial years ending 31 December 2024; and (ii) the actual transaction amounts for the two years ended 31 December 2023 and the ten months ended 31 October 2024.

Continuing Connected Transactions 2022-2024	Major type of products	For the financial year ended 31 December 2022		For the financial year ended 31 December 2023		For the financial year ending 31 December 2024	For the ten months ended 31 October 2024
		Existing Cap (RMB'000)	Actual total transaction amount (RMB'000)	Existing Cap (RMB'000)	Actual total transaction amount (RMB'000)	Existing Cap (RMB'000)	Actual total transaction amount (RMB'000)
1. Sales of engines and engine components to the Brilliance China Group	Engines and engine components	409,000	764 <sup>#</sup>	504,000	–	421,000	–
Utilisation rate			0.2%		0.0%		0.0% (On an annualised basis)
2. Purchases of engine components from Xinhua Combustion Engine	Engine components	111,700	36,941	142,100	55,618	128,700	59,942
Utilisation rate			33.1%		39.1%		55.9% (On an annualised basis)

<sup>#</sup> This actual transaction amount relates to sale of engines only. There was no sale of engine components by the Group to the Brilliance China Group for the financial year ended 31 December 2022.



*Continuing Connected Transactions 2022-2024*

The utilisation rates of the Existing Caps in respect of the Brilliance China Sale Agreement 2022-2024 were approximately 0.2%, 0.0% and 0.0% for the two years ended 31 December 2023 and the ten months ended 31 October 2024 on an annualised basis, respectively. The utilisation rates of the Existing Caps in respect of the Xinhua Combustion Engine Purchase Agreement 2022-2024 were approximately 33.1%, 39.1% and 55.9% for the two years ended 31 December 2023 and the ten months ended 31 October 2024 on an annualised basis, respectively.

Based on our discussion with the management of the Company, the low utilisation rates of the Existing Caps in respect of the Brilliance China Sale Agreement 2022-2024 for the two years ended 31 December 2023 and the ten months ended 31 October 2024 was mainly due to the suspension of production of certain series of Jinbei light commercial vehicles by Renault Brilliance Jinbei Automotive Company Limited (“RBJAC”) (formerly within the Brilliance China Group) due to cashflow issues, where such Jinbei light commercial vehicles required engines produced by the Group.

As discussed in the Letter from the Board, in 2022, the Group only sold a few engines to the Brilliance China Group in connection of its after-sale services. In January 2023, RBJAC was officially declared bankrupt and began to undergo reorganisation (the “Reorganisation”). The Reorganisation was completed in mid-2024, and Jinbei (Shenyang) Automotive Co., Ltd. (the entity within the Brilliance China Group which has taken up the manufacture of Jinbei light commercial vehicles) is working towards resumption of production. Therefore, other than the minimal sale of engines in 2022 as mentioned above, there were no sales of engines and engine components to the Brilliance China Group during the two years ended 31 December 2023 and ten months ended 31 October 2024.

The low utilisation rates of the Existing Caps in respect of the Xinhua Combustion Engine Purchase Agreement 2022-2024 for the two years ended 31 December 2023 and the ten months ended 31 October 2024 were mainly attributable to (i) the reduction in demand for the engines from the Brilliance China Group, as part of the engine components to be acquired from Xinhua Combustion Engine is for the production of such types of engines to be sold to the Brilliance China Group, leading to the reduction in the utilisation rates by around 50% in the two years ended 31 December 2023 and ten months ended 31 October 2024; and (ii) the reduction in overall demand for the engines from the remaining manufacturers and thus the need to acquire engine components from Xinhua Combustion Engine due to supply chain disruptions and reduced consumer demand under lasting economic effects of COVID-19 pandemic, leading to the reduction in the utilisation rates by around 20% and around 10% in the year ended 31 December 2022 and 2023, respectively.

Supported by the PRC's recovering economic activity, there was increased engine sales to manufacturers other than the Brilliance China Group during the ten months ended 31 October 2024. Such increased sales contributed to the improvement in the utilisation rate for the Group's purchase of engine components from Xinhua Combustion Engine of approximately 39.1% for the year ended 31 December 2023 to an annualised utilisation rate of approximately 55.9% for the ten months ended 31 October 2024.

The suspension of production by the Brilliance China Group since 2022, due to the Reorganisation, had negative impact to both the Group's sales of engine to the Brilliance China Group and the Group's purchase of engine components from Xinhua Combustion Engine during the two years ended 31 December 2023 and the ten months ended 31 October 2024. Following the completion of the Reorganisation in the first half of 2024 and the planned resumption of Jinbei light commercial vehicle production in the FY2025, the Group's sales of engines to the Brilliance China Group is expected to recover gradually in the coming years.

#### 4. Pricing policy

- *The pricing policy for the Brilliance China Sale Agreement 2025-2027*

Pursuant to the Brilliance China Sale Agreement 2025-2027, the Group agreed to sell engines to the Brilliance China Group on terms which are no less favourable than the terms which can be obtained by the Group from independent third parties customers for selling products of comparable quality, quantity and specification for a term of three years commencing from 1 January 2025 and ending on 31 December 2027 (both dates inclusive) which shall be renewable for an additional term of three years subject to fulfillment of all necessary statutory and regulatory requirements including but not limited to any applicable requirement under the Listing Rules. The price for the engines to be sold to the Brilliance China Group is determined by reference to the prevailing market price of the same type of engines that can be sold to independent third party customers on normal commercial terms or better in the ordinary course of business. In determining the prevailing market price of the engines, we noted that the Group will make reference to the selling prices of engines of comparable quality, quantity and specifications to other independent third party customers.



To assess the pricing policy, we selected year 2021 for timeframe of samples as it is the last year before the suspension of production by the Brilliance China Group since 2022 due to the Reorganisation. Based on this timeframe, we selected one historical sales transactions to the Brilliance China Group in 2021 on random basis, for each of the selected two engine series (R-series and Y-series). We originally intended to select historical sales transaction to the Brilliance China Group for the two engine series, being R-series and D-series, as they are the two engine series expected to be sold under the Brilliance China Sale Agreement 2025-2027. Since D-series was not sold to the Brilliance China Group in 2021, we selected Y-series as supplemental engine series for sampling. For each selected sales transaction, we compare the selling price agreed in the relevant pricing agreement against the selling price in three comparable sales and corresponding sales invoices to independent third parties for engines of same engine series in the same month. We noted that the selling prices for historical sales transactions to the Brilliance China Group, for both R-series and Y-series, were either higher than or comparable to those of the comparable sales to independent third parties. We consider the overall sample size, of two historical sales transactions to the Brilliance China Group in 2021, is sufficient as it covered one engine series (i.e. the R-series engine) that is expected to be sold to the Brilliance China Group with a supplemental sample on another engine series (i.e. the Y-series engine) as an additional assurance for the engine series (i.e. the D-series engine) without available historical transactions, while the three corresponding sales invoices to independent third parties for each of the engine series (i.e. total six sales invoices to independent third parties), also provided multiple external references from transactions with independent third parties for each engine series. From the assessment, we noted that the pricing policy of the Group was effective and ensured the transactions before the Reorganisation were conducted on normal commercial terms and terms no less favourable than those to the independent third party customers. Given that the pricing policy for the transactions under Brilliance China Sale Agreement 2025-2027 remains consistent with that implemented before the Reorganisation, we are of the view that the pricing policy of the Group is effective and such pricing policy can ensure the transactions under the Brilliance China Sale Agreement 2025-2027 will be on normal commercial terms and terms no less favourable than those to the independent third party customers.

- *The pricing policy for the Xinhua Combustion Engine Purchase Agreement 2025-2027*

Pursuant to the Xinhua Combustion Engine Purchase Agreement 2025-2027, Mianyang Xincheng agreed to purchase various gasoline and diesel engine components such as crankshafts, exhaust manifolds, cylinder chambers and cylinder heads from Xinhua Combustion Engine on terms which are no less favourable than the terms which can be obtained by Mianyang Xincheng from independent third party suppliers for purchasing products of comparable quality, quantity and specifications for a term of three years commencing on 1 January 2025 and ending on 31 December 2027, and it shall be renewable for an additional term of three years subject to fulfillment of all necessary statutory and regulatory requirements including but not limited to any applicable requirement under the Listing Rules. The price for engine components to be purchased from Xinhua Combustion Engine is determined by reference to the prevailing market price of the products of comparable quality, quantity and specifications that can be obtained from independent third party suppliers on normal commercial terms or better in the ordinary course of business. In determining the prevailing market prices of the relevant engine components, we noted that the Group will make reference to the price quotations obtained from other independent third party suppliers for products of comparable quality, quantity and specifications.

To assess the pricing policy, we have obtained three price quotations on random basis from independent third party suppliers of the Group for comparable engine components during the ten months ended 31 October 2024. Notably, the engine components to be purchased under the Xinhua Combustion Engine Purchase Agreement 2025-2027 are intended for the production of engine series of Y-series, R-series and D-series. As such, the selection criteria were based on quotations from 2024, with one representative quotation randomly selected for each engine product series (Y-series, R-series and D-series), where the engine component is required for production of that specific engine series. We have also obtained an agreement entered into between Mianyang Xincheng and Xinhua Combustion Engine (the “**2024 Purchase Agreement**”), effective since 1 January 2024, which has listed all individual unit price of the engine components that Mianyang Xincheng could purchase from Xinhua Combustion Engine for the year ending 31 December 2024. Upon comparison, we noted that the quoted prices of the independent third party suppliers were higher than purchase prices for engine components purchased from Xinhua Combustion Engine as agreed in the 2024 Purchased Agreement. We consider the overall sample size of three engine components, with their individual unit prices compared against three quotations from independent third parties, is sufficient as it covered the engine components for all three engine product series (Y-series, R-series and D-series), and it represented the latest effectiveness of the pricing policy. Taking into account the above, we are of the view that the pricing policy of the Group is effective and such pricing policy can ensure the transactions under the Xinhua Combustion Engine Purchase Agreement 2025-2027 will be on normal commercial terms and terms no less favourable than those to the independent third party suppliers.



## 5. The Proposed Caps

The following table sets out the Proposed Caps for the three years ending 31 December 2027:

Continuing Connected Transactions 2025-2027	Major type of products	For the financial year ending 31 December		
		2025 Proposed Cap (RMB'000)	2026 Proposed Cap (RMB'000)	2027 Proposed Cap (RMB'000)
1. Sales of engines to the Brilliance China Group	Engines	106,100	168,720	217,950
2. Purchases of engine components from Xinhua Combustion Engine	Engine components	97,820	126,360	191,700

As stated in the Letter from the Board, the Proposed Caps are determined primarily based on the following:

- (i) the historical transaction amounts of the relevant Continuing Connected Transactions 2022-2024;
- (ii) in respect of the Brilliance China Sale Agreement 2025-2027, (a) the expected unit price of engines to be sold; (b) the number of engines required by the Brilliance China Group based on their internal sales targets of the relevant light commercial vehicles which require the engines from the Group; (c) the anticipated increase in sales of vehicle produced by the Brilliance China Group with the introduction of new models developed with reference to market trend; (d) the gradual recovery in operation of the Brilliance China Group during the first half of 2024 following the completion of the reorganisation of Huachen Automotive Group Holdings Company Limited and its subsidiaries; and (e) the expected growth in the automobile market boosted by the favourable government policy encouraging the public to replace old vehicles with new models; and
- (iii) in respect of the Xinhua Combustion Engine Purchase Agreement 2025-2027, (a) the expected purchase prices of the engine components to be purchased; and (b) the estimated number of engines to be produced and sold by the Group to customers under its existing product lines as well as new models of engines to be launched based on the expected demand from its customers after discussions between the Group's sales teams and its customers on their business plans.

In order to assess the fairness and reasonableness of the estimated quantity and estimated price adopted for the determination of the Proposed Caps, we have performed the following analysis:

• *The Proposed Caps for the Brilliance China Sale Agreement 2025-2027*

To understand the calculation of the Proposed Caps for the Brilliance China Sale Agreement 2025-2027, we have obtained and reviewed the Sales Plan of the relevant engines to be sold to the Brilliance China Group which was planned according to the vehicle sales plan provided by the Brilliance China Group, and noted that the Proposed Caps for the Brilliance China Sale Agreement 2025-2027 were arrived at based on the expected selling prices and the demand for the Group's engines for use in the Brilliance China Group's manufacturing of light commercial vehicles. As advised by the management of the Company, the engines to be supplied to the Brilliance China Group mainly involve the D-series engines and the R-series engines, which are customised according to the specifications required by the Brilliance China Group.

We also noted that the Group has set the expected unit prices in determining the Proposed Caps for the Brilliance China Sale Agreement 2025-2027. For R-series engines, the expected unit prices were based on the historical selling price of the same type of engines sold to the Brilliance China Group in April 2021 which is the last month with normal level of sales activity with the Brilliance China Group before the Reorganisation. For D-series engines, since there was no sales of such engine series to the Brilliance China Group, the expected unit prices were based on the Group's understanding upon pricing negotiation with the Brilliance China Group. In order to assess the fairness and reasonableness of the selling price of the relevant engines in determining the Proposed Caps for the Brilliance China Sale Agreement 2025-2027, we have obtained two historical transactions and corresponding invoices of engines of similar specification and components provided to or sold to independent third parties in 2024 and compared it with the selling prices of the relevant engines to be sold to the Brilliance China Group used in determining the Proposed Caps. We noted that the engines to be sold to the Brilliance China Group are priced comparably to those sold to independent third parties while having similar performance specifications and sharing common core components. Based on the above findings, we consider the expected unit prices set by the Group in determining the Proposed Caps for the Brilliance China Sale Agreement 2025-2027 reflect selling prices under the prevailing market conditions.

We noted that the expected selling prices under the Proposed Caps are stable across the three years ended 31 December 2027. As advised by the Company, the management of the Company projected that the selling prices for products sold to the Brilliance China Group will maintain at a stable level as they do not expect sales quantity to the Brilliance China Group in the three years ended 31 December 2027 to deviate largely from the current Sales Plan. Such deviations, if within normal range, would typically trigger a 3% price adjustment upon annual price negotiation with the Brilliance China Group. Therefore, the management considered the stable selling price to be prudence estimation for the Proposed Caps across the three years ended 31



December 2027. To evaluate the assessment by the management of the Company, we have reviewed the price adjustment for sales to the Brilliance China Group during the year ended 31 December 2021 and noted that for products with change in annual sales quantity by not more than 50%, there was less than 3% price adjustment for such product, which we consider the finding is consistent to the expectation of the management of the Company. We have further researched the annual change of average consumer prices of the PRC to observe its trend of inflation rate. According to the International Monetary Fund\*, the average consumer prices for the PRC in year 2021 to 2023 are 0.9%, 2.0% and 0.2% respectively, which suggests the price pressure is minimal to be added to the Proposed Caps. Taking into account the above, we are of the view that the adopted selling prices of the engines to be sold to the Brilliance China Group in determining the Proposed Caps for the Brilliance China Sale Agreement 2025-2027 are fair and reasonable.

In respect of the quantity of the engines to be sold to the Brilliance China Group under the Proposed Caps, it was estimated based on (i) the number of engines required by the Brilliance China Group based on their internal sales targets of the relevant light commercial vehicles which require the engines from the Group; (ii) the anticipated increase in sales of vehicle produced by the Brilliance China Group with the introduction of new models developed with reference to market trend; (iii) the gradual recovery in operation of the Brilliance China Group following the completion of the Reorganisation during the first half of 2024; and (iv) the expected growth in the automobile market boosted by the favourable government policy encouraging the public to replace old vehicles with new models as discussed in the section headed “2. Industry overview” which would drive the demand for the vehicles to be produced by the Brilliance China Group.

To further assess the estimated quantity, we have reviewed the actual sales amount of the relevant engines to the Brilliance China Group in 2020, being the latest year with normal full-year activity level of sales transactions to the Brilliance China Group before the Reorganisation since the last month with normal sales activity level of sales transactions to the Brilliance China Group was April 2021. We noted that the Group’s historical sales of engines to the Brilliance China Group in 2020 amounted to approximately RMB289.8 million (primarily attributable to sales of the R-series engines at 22,297 units and the Y-series engines at 838 units). Following the completion of the Reorganisation in the first half of 2024, the Proposed Caps for the three year ended 31 December 2027 reflect a transition in product mix and gradual recovery trajectory. For 2025, sales are estimated to recover to 8,100 units of R-series engines, with Y-series engines being phased out. For 2026, sales are estimated to further recover to 11,800 units of R-series engines, complemented by the introduction of 600 units of D-series engines. For 2027, sales are expected to reach 15,000 units of

\* Please refer to the link below for the data:  
<https://www.imf.org/external/datamapper/PCPIPCH@WEO/CHN>

R-series engines and 900 units of D-series engines. Comparing to the Group's historical sales quantity of engines to the Brilliance China Group in 2020, the total estimated sales quantity of engines under the Proposed Caps indicated overall recovery level of 35.0%, 53.6% and 68.7%. Observing the recovery pace over three years, we consider the projected recovery path aligns with our understanding for the Brilliance China Group's operational recovery following the completion of the Reorganisation during the first half of 2024. We have further obtained the vehicle sales plan provided by the Brilliance China Group to the Group's sales teams and compare it against the Sales Plan and noted that the types and units of engines planned to be sold to the Brilliance China Group agreed with the vehicle sales plan provided by the Brilliance China Group. Taking into account the above, we are of the view that the estimated quantities of the engines to be sold to the Brilliance China Group in determining the Proposed Caps for the Brilliance China Sale Agreement 2025-2027 are justifiable.

On the above basis, we are of the view that the bases on which the Proposed Caps for the Brilliance China Sale Agreement 2025-2027 were determined are fair and reasonable and in the interests of the Shareholders and the Company as a whole.

• ***The Proposed Caps for the Xinhua Combustion Engine Purchase Agreement 2025-2027***

We have obtained and reviewed the Purchase Plan of the relevant engine components to be purchased from Xinhua Combustion Engine and noted that the Proposed Caps for the Xinhua Combustion Engine Purchase Agreement 2025-2027 were arrived at based on the expected purchase prices and the estimated volumes of engines components required by the Group based on the estimated demand for the Group's engines from its customers after communicating with its customers' on their demand level for engines in the coming years.

We noted that the expected unit prices in determining the Proposed Caps for the Xinhua Combustion Engine Purchase Agreement 2025-2027 were based on the historical purchase price of relevant engine components as agreed in the 2024 Purchase Agreement. To assess the fairness and reasonableness of the expected unit prices, we reviewed and cross checked the purchase price of each engine component in the 2024 Purchase Agreement against those listed in the Purchase Plan, and noted that the estimated unit price of each engine component used in determining the Proposed Caps is expected to remain at the same level as those listed in the 2024 Purchase Agreement. As discussed in the section headed "4. Pricing policy", we have assessed the agreed prices in the 2024 Purchase Agreement. As the expected unit prices under the Proposed Caps are based on such agreed price, we considered the expected unit prices align with the Group's pricing policy and reflect the prevailing market price. As advised by the management of the Company, the Group negotiate the purchase prices with Xinhua Combustion Engine annually based on various factors, in particular, the



staff costs and production costs required by Xinhua Combustion Engine to produce the engine components. Based on the understanding of the management of the Company on the industry condition, the staff costs and production costs of the Xinhua Combustion Engine will not have significant fluctuation in the coming years. As such, the management of the Company considered having the expected unit prices at the same level over the three years ended 31 December 2027 will be a prudence estimation for the Proposed Caps. We concur with the view of the management of the Company as we noted the stable staff costs and production costs as discussed above are in line with the low PRC inflation rates, which ranging between 0.2% and 2.0% from 2021 to 2023. This low inflationary environment demonstrated minimal price pressure on the purchase prices for the engine components.

On the above basis, we are of the view that estimated purchase prices for the engine components adopted in the Purchase Plan are reasonable.

In respect of the quantity of the engine components under the Purchase Plan, it was arrived at based on the estimated number of underlying engines to be produced and sold by the Group to customers under its existing product lines as well as new engine models to be launched based on the expected demand from its customers after discussions between the Group's sales teams and its customers on their business plans.

We have reviewed the Purchase Plan and noted that the quantity of engine components was arrived at after taking into account (i) the fulfillment of the sales order from the aforementioned revamp of production for the light commercial vehicles by the Brilliance China Group after the Reorganisation and the gradual increment in the purchase amount for the relevant engine components for the engines to be sold to the Brilliance China Group under the Sales Plan, contributing to approximately 14.5%, 16.4% and 13.2% of the estimated quantity of engine components under the Purchase Plan in 2025, 2026 and 2027, respectively; (ii) the expected increment in demand for the Group's engines from its local customers other than the Brilliance China Group, including several major Chinese automakers that produce a diverse range of passenger vehicles and light commercial vehicles; and (iii) the expected expansion of the sales of the Group's engines to the overseas market of developing countries in various regions which is experiencing growing regional demand for engine and engine components made in the PRC as local manufacturers of these countries are starting to collaborate with Chinese automakers to develop domestic production facilities. The relevant engines components required for this expected growth in sales in the overseas market contributes approximately 43.3%, 49.6% and 48.2% of the estimated quantity of engine components under the Purchase Plan in 2025, 2026 and 2027, respectively, which is in line with the Group's strategy on overseas market expansion to capitalise the opportunities in the overseas market.

As presented above, the estimated quantity of engine components under the Purchase Plan comprised of three parts of estimates: (i) the quantity of engine components for underlying engines to fulfill orders from the Brilliance China Group; (ii) the quantity of engine components for underlying engines to fulfill orders from local customers other than Brilliance China Group; and (iii) the quantity of engine components for underlying engines to fulfill expected demand for overseas markets. The following analysis examines the trends in estimated number of underlying engines for each part of the estimates for the engine components required under the Purchase Plan.

For the estimated number of underlying engines for fulfilling orders from Brilliance China Group, we have cross checked the estimated quantity of engine components and the number of underlying engines to be sold to the Brilliance China Group in the Purchase Plan, against the Sales Plan. We noted that the estimated quantity of engine components and the number of underlying engines to be sold to the Brilliance China Group are matched in the two plans. We also noted that the number of underlying engines expected to be sold to the Brilliance China Group in the Purchase Plan showed same pace of recovery of engine sales as in the Sales Plan.

For the estimated number of underlying engines for fulfilling orders from other local customers other than the Brilliance China Group, we noted that the estimated underlying engines over the three years from 2025 to 2027 represent annual growth rate of approximately 5% and 67% in 2026 and 2027, respectively. The 5% growth rate for engines required by customers other than the Brilliance China Group in 2026 is considered a reasonable estimate comparing to statistics as discussed in the section headed “2. Industry overview” where in the first six months in 2024, vehicle sales volumes and production marked 6.1% and 4.9% increase year-over-year, respectively. The 67% growth for engines required by customers other than the Brilliance China Group in 2027 was attributable to the launch of new engine model which is expected to be marketed in 2027, in additional to the existing product mix. The management of the Company has confidence that the new engine model will become another income driver for the Company, as the new engine model is expected to have advantageous key specification indicators, including fuel consumption, dry weight and torque, addressing market opportunities where current available solutions in the market only partially meet customer demands. According to China Association of Automobile Manufacturers, the PRC’s light commercial vehicle production reached approximately 2.3 million units in 2023, comprising 1.9 million light trucks and 0.4 million light passenger vehicles. The number of units as sales target for the launch of new engine model in 2027 represents less than 1% of the projected 2024 market size in term of light commercial vehicle production volume, assuming a 4.9% annual growth rate based on industry performance in the first half of 2024. Moreover, according to the China Association of Automobile Manufacturers, the production of vehicles in first half of 2024 in the PRC is approximately 13.9 million units while the sales volume of



engines of the Group for the same period, as disclosed in the latest interim report of the Company, was approximately 210,000 units, representing a market share of approximately 1.5% for sales volume of all type of vehicles. Given the market's unsaturated state, the growth potential for the new engine model and the existing market position of the Group, we consider this target to be a reasonable estimate.

For the estimated number of underlying engines for overseas market, we noted that the estimated underlying engines over the three years from 2025 to 2027 represent annual growth rate of 50% and 54% during 2026 and 2027. According to data from the China Association of Automobile Manufacturers, Chinese vehicle exports experienced fast growth, reaching a record of approximately 4.91 million vehicles for 2023, with annual growth rates at around 57.9% and around 54.0% in 2023 and 2022, respectively. Upon comparison, the estimated number of engines for exporting to overseas market in 2025 represents less than 1% of the total vehicle export in 2023 which is small amount compared to the fast-growing market size and not excessive compared to the existing market position of the Group. The annual growth rates of the estimated number of engines for overseas market of 50% and 54% for 2026 and 2027 are also in line with the historical growth rate of Chinese vehicle exports of around 57.9% and around 54.0% in 2023 and 2022, respectively. The Group is actively enhancing its business networks and collaborating with potential business partners to export its products for overseas markets in 2025. Currently, the engine model targeting international markets is already undergoing engine testing processes with potential business partner of the Group. There are generally three stages for the collaboration process with potential business partner before official launch of sales of engine in large scale, including initial stage for technology discussion and feasibility analysis, middle stage for engine testing processes, and final stage for small-batch market launch and tracking. The on-going engine testing processes are considered the middle stage of the collaboration process and essential for optimising vehicle performance and ensuring the quality of vehicles assembled with engines supplied by the engine manufacturer such as the Group.

We have further checked that the estimated quantity of engine components under the Purchase Plan aligns with the estimated numbers of underlying engine required to fulfill sales order from customers. Taking into account of the above, we are of the view that the estimated quantities of the engine components to be purchased from Xinhua Combustion Engine in determining the Proposed Caps for the Xinhua Combustion Engine Purchase Agreement 2025-2027 are justifiable.

On the above basis, we consider that the bases on which the Proposed Caps for the Xinhua Combustion Engine Purchase Agreement 2025-2027 were determined are fair and reasonable and in the interests of the Shareholders and the Company as a whole.

## 6. Internal control

As advised by the Company, to ensure the Company's conformity with the terms and the pricing mechanism of continuing connected transactions, the Company has established a series of internal control procedures which are stipulated in Company's internal control policy.

In determining the Proposed Caps, the sales department of the Group would estimate the production volume of the engines in the relevant periods while the procurement department would estimate the volume of the engine components required. Also, when entering into new sales or purchase contracts, the sales department and the procurement department of the Group will assess the pricing basis by (i) conducting research and analysis of the recent market conditions of the industry; and (ii) comparing the terms of similar products supplied to or procured from other independent third parties, to ensure that those contemplated transactions are no less favourable than those supplied to or procured from independent third parties. Finance department of the Group will maintain on-going monitoring on transactions under the contracts to ensure terms including pricing and quantity are in line with the contracts assessed by the sales department and the procurement department of the Group. In addition, the pricing are subject to annual review and review upon renewal of contracts and may be adjusted by the Company if necessary, with reference to the then market rates to ensure fairness and reasonableness of such prices, and the transactions under the relevant continuing connected transactions are on normal commercial terms and on terms no less favourable to the independent third parties. As there are cross-departmental efforts and multi-layer safeguards from on-going monitoring to annual review, we consider the Company's design of internal control policy is sufficient to ensure the transactions under the Continuing Connected Transactions 2025-2027 are on normal commercial terms and on terms no less favourable to the independent third party.

The sales and purchase transactions under the Proposed Caps are reviewed by the finance department of the Group. Moreover, the finance department of the Group will quarterly monitor the aggregated transaction amount and perform annual review for the total amount of the relevant continuing connected transactions to ensure the total amount is within the Proposed Caps. With the monitoring of relevant continuing connected transactions and the momentum of the sales and purchase transactions, the Group will evaluate, and revise if necessary, the respective annual caps. As (i) the Group had less than 60% annual and annualised utilisation rates on the Existing Caps over the two years ended 31 December 2023 and the ten months ended 31 October 2024; and (ii) the production capacity is planned ahead according to future demand information collected from its customers, we consider the control measures by the Group in monitoring the transaction amounts are sufficient to ensure the transactions under the Continuing Connected Transactions 2025-2027 will not exceed the Proposed Caps.



In assessing whether the Company has put in place effective internal control procedures for the Continuing Connected Transactions 2025-2027, we have obtained and reviewed the following documents: (i) the internal control policies provided by the Company in order to understand the design of the Company's internal control system; (ii) the documentation of the approval process prior to the relevant member of the Group entering into sale agreement or purchase agreement with the relevant connected person of the Company under the Continuing Connected Transactions 2022-2024 where we observed the two approval forms in 2024 and noted that sales and purchase contracts are approved through relevant departments through the approval process and we consider the sample size sufficient as it covered approval processes for both sales and purchase contracts in the most recent year; (iii) the board resolutions concerning the Continuing Connected Transactions 2025-2027; (iv) the independent non-executive Directors' confirmation for the years 2022 and 2023 concerning historical connected transactions; and (v) the auditors' report for years 2022 and 2023 concerning the historical connected transactions. We note that the above documents were prepared in accordance with the internal control policies of the Company and they are in compliance with the relevant requirements under the Listing Rules. Furthermore, as discussed in the section headed "4. Pricing policy", we have also compared historical transactions with the Brilliance China Group and Xinhua Combustion Engine against prices quoted in invoices and quotations of independent third parties and noted that the internal control procedures are effective. Therefore, we consider that the Company has taken appropriate and adequate measures to govern the Group in carrying out the Continuing Connected Transactions 2025-2027, thereby safeguarding the interests of the Shareholders thereunder.

#### RECOMMENDATION

Having considered the above principal factors, we are of the opinion that the Continuing Connected Transactions 2025-2027 and the Proposed Caps are on normal commercial terms, in the ordinary and usual course of business of the Company, fair and reasonable and in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Board Committee to advise the Independent Shareholders, and we advise the Independent Shareholders, to vote in favour of the ordinary resolutions to be proposed at the Extraordinary General Meeting for approving the Continuing Connected Transactions 2025-2027 and the Proposed Caps.

Yours faithfully,  
For and on behalf of  
Octal Capital Limited



Alan Fung  
Managing Director



Louis Chan  
Director

*Note: Mr. Alan Fung has been a responsible officer of Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities since 2003. Mr. Fung has more than 30 years of experience in corporate finance and investment banking and has participated in and completed various advisory transactions in respect of mergers and acquisitions, connected transactions and transactions subject to the compliance to the Takeovers Code of listed companies in Hong Kong.*

*Mr. Louis Chan has been a responsible officer of Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities since 2008. Mr. Chan has more than 20 years of experience in corporate finance and investment banking and has participated in and completed various advisory transactions in respect of mergers and acquisitions, connected transactions and transactions subject to the compliance to the Takeovers Code of listed companies in Hong Kong.*