



## SOMERLEY CAPITAL LIMITED

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January 11, 2024

*To: the Independent Board Committee and the Independent Shareholders*

Dear Sirs,

### CONTINUING CONNECTED TRANSACTIONS

#### INTRODUCTION

We refer to our appointment to advise the Independent Board Committee and the Independent Shareholders in respect of (i) the 2024 Sales Framework Agreement; and (ii) the 2024 Entrusted Processing Framework Agreement, and each of the transactions contemplated thereunder (including the proposed annual caps), details of which are set out in the letter from the Board ("**Letter from the Board**") of the circular of the Company dated January 11, 2024 (the "**Circular**"), of which this letter forms a part. Terms used in this letter shall have the same meanings as those defined in the Circular unless the context otherwise requires.

The Company (for itself and on behalf of the Group) entered into (i) the sales framework agreement (the "**2023 Annual Sales Framework Agreement**") on March 28, 2023 with Luoyang Company (for itself and on behalf of its subsidiaries); (ii) the sales framework agreement (the "**2023 Sales Framework Agreement**") on November 10, 2023 with CALB USA; and (iii) the entrusted processing framework agreement (the "**2023 Entrusted Processing Framework Agreement**") on November 10, 2022 with Luoyang Company (for itself and on behalf of its Group).

As the 2023 Annual Sales Framework Agreement, 2023 Sales Framework Agreement and the 2023 Entrusted Processing Framework Agreement have expired on December 31, 2023, the Company and Luoyang Company entered into (i) the 2024 Sales Framework Agreement, pursuant to which the Company will sell Lithium Batteries and related products (such as raw materials, semi-finished products, finished products) to Luoyang Company and its associates; and (ii) the 2024 Entrusted Processing Framework Agreement, pursuant to which the Company agrees to entrust Luoyang Company to provide processing services of Lithium Batteries for the Company, for a term of one year commencing from January 1, 2024 (subject to the approval



of the 2024 Sales Framework Agreement and the 2024 Entrusted Processing Framework Agreement by the Independent Shareholders at EGM) to December 31, 2024 (both days inclusive).

As at the Latest Practicable Date, Jintan Holding held approximately 25.54% issued Shares of the Company and is one of the substantial Shareholders of the Company, and thus Jintan Holding and its associates are connected persons of the Company. Luoyang Company is owned as to 49% by Jinhang Holding and 51% by Jincheng Technology, respectively. Jincheng Technology is wholly owned by Jintan Holding, and hence an associate of Jintan Holding and a connected person of the Company. Accordingly, the transactions contemplated under each of the 2024 Sales Framework Agreement and the 2024 Entrusted Processing Framework Agreement constitute continuing connected transactions of the Company under Chapter 14A of the Listing Rules. As one or more of the applicable percentage ratios under the Listing Rules in respect of the highest annual cap for the transactions contemplated under each of the 2024 Sales Framework Agreement and the 2024 Entrusted Processing Framework Agreement exceeds 5%, the transactions contemplated under each of the 2024 Sales Framework Agreement and the 2024 Entrusted Processing Framework Agreement are subject to the reporting, annual review, announcement, circular and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

The Independent Board Committee, comprising all the independent non-executive Directors, namely Mr. Wu Guangquan, Mr. Wang Susheng, and Mr. Chen Zetong, has been established to advise the Independent Shareholders in relation to the 2024 Sales Framework Agreement and the 2024 Entrusted Processing Framework Agreement and each of the transactions contemplated thereunder and the proposed annual cap (the “**Non-exempt CCTs**”). We, Somerley Capital Limited, have been appointed to advise the Independent Board Committee and the Independent Shareholders in the same regard.

We are not associated with the Company, Luoyang Company or their respective core connected persons or associates. In the past two years prior to this appointment, there was no engagement between the Group and us. Apart from normal professional fees paid or payable to us in connection with this appointment, no arrangement exists whereby we will receive any fees or benefits from the Company, Luoyang or their respective core connected persons or associates. Accordingly, we are considered eligible to give independent advice on the Non-exempt CCTs and the proposed annual caps.

In formulating our opinion and advice, we have relied on the information and facts supplied, and the opinions expressed, by the Directors and management of the Company, which we have assumed to be true, accurate and complete in all material aspects. We have reviewed the information of the Company, among other things, (i) the annual report of the Company for the year ended December 31, 2022 (the “**2022 Annual Report**”) and the interim report of the Company for the six months ended June 30, 2023 (the “**2023 Interim Report**”); (ii) the announcement of the Company dated December 18, 2023 in relation to, among others, the Non-exempt CCTs (the “**Announcement**”); and (iii) other information contained in the Circular. We also have sought and received confirmation from the Company that no material



facts have been omitted from the information supplied and opinions expressed to us were not misleading in any material aspects. We consider that the information we have received is sufficient for us to reach our opinion and give our advice and recommendation set out in this letter. We have no reason to believe that any material information has been omitted or withheld, or to doubt the truth or accuracy of the information provided. We have, however, not conducted any independent investigation into the business and affairs of the Company, Luoyang Company or any of their respective associates or any party acting, or presumed to be acting, in concert with any of them, nor have we carried out any independent verification of the information supplied. We have also assumed that all representations contained or referred to in the Circular were true at the time they were made and at the date of the Circular and will continue to be true up to the time of the EGM, and Shareholders will be informed of any material change as soon as possible.

## PRINCIPAL FACTORS AND REASONS CONSIDERED

### 1. Information of the parties

#### 1.1 Information of the Company

The Company and its subsidiaries have been engaging in the design, research and development, production and sales of EV batteries and ESS products. The Group has established a comprehensive energy operation system, providing comprehensive product solutions and life-cycle management for the new energy full-scenario application market represented by power and energy storage industries. The Group was listed on the main board of the Stock Exchange on October 6, 2022.

Set out below is the summary of the financial information of the Group for the years ended December 31, 2021 and 2022 and the six months ended June 30, 2022 and 2023 as extracted from the 2022 Annual Report and the 2023 Interim Report:

	For the six months ended June 30,		For the year ended December 31,	
	2023	2022	2022	2021
	RMB'000	RMB'000	RMB'000	RMB'000
	(Unaudited)	(Unaudited)	(Audited)	(Audited)
Revenue				
– Sales of EV battery	10,377,467	8,646,346	18,323,505	6,065,200
– Sales of ESS products and others	1,917,245	520,854	2,051,437	751,915
	12,294,712	9,167,200	20,374,942	6,817,115
Gross profit	1,179,065	870,479	2,103,520	510,950
Profit for the year/period attributable to owners of the Company	146,517	166,719	691,626	140,029



*For the two years ended December 31, 2021 and 2022*

For the years ended December 31, 2021 and 2022, the Group recorded a revenue of approximately RMB6,817.1 million and RMB20,374.9 million respectively, representing an increase of approximately 198.9%. Nearly 90% of the revenue are generated from sales of EV batteries. As disclosed in the 2022 Annual Report, the strong growth in sales of EV batteries was mainly attributable to the release of the Company's production capacity and the increased customer demands, as well as the rapid growth of the passenger vehicle and commercial vehicle businesses.

The Group's gross profit for the year ended December 31, 2021 and 2022 amounted to approximately RMB511.0 million and RMB2,103.5 million respectively, representing an increase of approximately 311.7%. As disclosed in the 2022 Annual Report, the gross margin in 2022 was approximately 10.3%, up by about 2.8 percentage point from 2021, mainly due to the gradual release of the Group's production capacity during 2022, resulting in more significant economies of scale.

The Group's profit attributable to owners of the Company for the year ended December 31, 2021 and 2022 amounted to approximately RMB140.0 million and RMB691.6 million respectively, representing an increase of approximately 393.9%. Such increase was mainly attributable to (i) the increase in revenue as well as the gross profit; and (ii) the absence of impairment loss on investment in associates in 2022.

*For the six months ended June 30, 2022 and 2023*

For the six months ended June 30, 2022 and 2023, the Group recorded a revenue of approximately RMB9,167.2 million and RMB12,294.7 million respectively, representing an increase of approximately 34.1%. As disclosed in the 2023 Interim Report, the increase was mainly due to the gradual release of the Group's production capacity, continuously enriched product lines, market expansion and the increasing customer demands.

The Group's gross profit for the six months ended June 30, 2022 and 2023 amounted to approximately RMB870.5 million and RMB1,179.1 million respectively, representing an increase of approximately 35.5%. The gross margin in the first half of 2023 was approximately 9.6%, up by about 0.1 percentage point from the same period in 2022, which is relatively stable.

The Group's profit attributable to Shareholders for the six months ended June 30, 2022 and 2023 amounted to approximately RMB166.7 million and RMB146.5 million respectively, representing a decrease of approximately 12.1%. Such decrease was mainly attributable to (i) increase of allowance for inventories; and (ii) the increase in finance costs due to the increase in financing scale, and partially offset by the increase of gross profit.



Set out below is the summary of the financial position of the Group as at December 31, 2021, 2022 and June 30, 2023 as extracted from the 2022 Annual Report and the 2023 Interim Report:

	As at June 30, 2023 RMB'000 (Unaudited)	As at December 31, 2022 RMB'000 (Audited)	2021 RMB'000 (Audited)
Total assets	100,280,715	90,460,618	38,620,485
Total liabilities	55,374,690	48,885,159	13,634,361
Net assets	44,906,025	41,575,459	24,986,124

As at June 30, 2023, the Group's total assets amounted to approximately RMB100.3 billion, mainly comprised of (i) property, plant and equipment of approximately RMB60.5 billion; (ii) inventories of approximately RMB10.0 billion; (iii) bank and cash balances of approximately RMB8.4 billion; and (iv) prepayments, deposits and other receivables of approximately RMB7.4 billion.

As at June 30, 2023, the Group's total liabilities amounted to approximately RMB55.4 billion, mainly comprised of (i) bank borrowings of approximately RMB26.8 billion; (ii) trade and bills payable of approximately RMB18.0 billion; and (iii) accruals and other payables of approximately RMB8.6 billion.

As at June 30, 2023 and December 31, 2022, the Group's net assets remained relatively stable at approximately RMB44.9 billion and RMB41.6 billion respectively. The significant increase of net assets as at December 31, 2022 compared to December 31, 2021 is mainly attributable to (i) the proceeds from the issue of H shares of the Company; (ii) capital contribution from non-controlling interests; and (iii) the profit earned during the year ended 31 December 2022.

In our view, based on the above analysis, the Group has financed its growth and retained a satisfactory financial position.

## **1.2 Information of Luoyang Company**

Luoyang Company is an other limited liability company established in the PRC, principally engaged in research, production, sales and market application development of Lithium Batteries, battery management systems (BMS), energy storage batteries and related integrated products and Lithium Battery-related materials and sales of new energy vehicles and parts. The ultimate beneficial owner of Luoyang Company is the People's Government of Jintan District, Changzhou.



## **2. Reasons for and benefits of the Non-exempt CCTs**

### ***2.1 The 2024 Sales Framework Agreement***

As stated in the Letter from the Board of the Circular, the transactions under the 2024 Sales Framework Agreement will benefit the Company, mainly because the Company's principal business includes the sale of Lithium Batteries and related products. The sale of Lithium Batteries and related products to Luoyang Company and its associates at fair, reasonable and competitive prices is part of the Company's ordinary and usual course of business, which helps to enhance the Group's revenue in the sale of Lithium Batteries and related products and promote the Group's business development. Luoyang Company has a thorough understanding of the Company's product range, product quality and cooperation model, and it is cost effective and mutually beneficial for both parties to continue the cooperation.

### ***2.2 The 2024 Entrusted Processing Framework Agreement***

As stated in the Letter from the Board of the Circular, the transactions under the 2024 Entrusted Processing Framework Agreement are to the benefit of the Company because (i) Luoyang Company has obtained a mature and stable production line, and is able to serve the Company's existing customers nearby. The use of the Luoyang Company's existing production capacity is more economical than the construction of new production lines by the Company, which can ensure the stability of products of relevant models and the continuity of orders so as to meet customer needs; (ii) Luoyang Company as well as the shareholders of Luoyang Company have already entered into a non-compete undertaking in favour of each member of the Group and undertook that Luoyang Company cannot engage in the business of manufacturing, research and development and sales of Lithium Batteries unless the Company's demands for entrusted processing services for the Lithium Batteries have been satisfied and an expressed consent have been obtained from the Company. Such undertaking can effectively avoid potential competition from Luoyang Company; and (iii) it is not easy to find a substitute for provision of processing service of Lithium Batteries in the market with similar quality, price, production capacity and cultivated trust and understanding.

Taking into account the above and the fact that (i) the principal terms of the Non-exempt CCTs are on normal commercial terms (as discussed in the sections below); (ii) the transactions under the 2024 Sales Framework Agreement could generate revenue to the Group and Luoyang Company is a reliable long-term business partner of the Group; (iii) the transactions under the 2024 Entrusted Processing Framework Agreement provide the Group with stable and reliable long-term service provider; (iv) the 2024 Sales Framework Agreement and the 2024 Entrusted Processing Framework Agreement do not restrict the Group from selling/procuring goods/services to/from other customers/suppliers and offered the Group with flexibilities to conduct business with Luoyang Company; and (v) the internal control measures in place to ensure that the Non-exempt CCTs are conducted in accordance with their terms and conditions (as discussed in the section headed "5. Internal control measure" below), we concur with the Directors that the Non-exempt CCTs, which are conducted in the ordinary and usual course of business of the Group, are in the interests of the Company and the Shareholders as a whole.



### 3. The 2024 Sales Framework Agreement

#### 3.1 Principal terms of the 2024 Sales Framework Agreement

The following sets forth the principal terms of the 2024 Sales Framework Agreement. For detailed terms of the 2024 Sales Framework Agreement, please refer to the section headed “2024 Sales Framework Agreement” in the Letter from the Board.

<b>Parties:</b>	(i) the Company (for itself and on behalf of the Group); and (ii) Luoyang Company (for itself and on behalf of its associates).
<b>Term:</b>	One year commencing from January 1, 2024 (subject to the approval of the 2024 Sales Framework Agreement by the Independent Shareholders at the EGM) to December 31, 2024 (both days inclusive)
<b>Nature of transaction:</b>	The Group will sell Lithium Batteries and related products (such as raw materials, semi-finished products, finished products) to the Luoyang Company and its associates
<b>Pricing:</b>	The prices of Lithium Batteries and related products sold by the Group to the Luoyang Company and its associates will be determined after arm’s length negotiations mainly by reference to market prices and the sales prices of similar products supplied by the Group to other Independent Third Party customers, having taken into account the costs plus a reasonable profit margin. Specifically, the prices of Lithium Batteries and related products are determined after arm’s length negotiations based on the manufacturing costs of the Group’s Lithium Batteries and related products and a profit margin of approximately 2% to 10%. The profit margin is determined after arm’s length negotiation between the parties with reference to the profit margin of similar and comparable transactions with Independent Third Parties in the corresponding period.

#### 3.2 Our assessment of the terms of the 2024 Sales Framework Agreement

As set out in the paragraphs headed “2. Reasons for and benefits of the Non-exempt CCTs” above, the entering into of the 2024 Sales Framework Agreement is to extend the terms of 2023 Annual Sales Framework Agreement and 2023 Sales Framework Agreement, which have expired on December 31, 2023, to allow the Group to continue its long-standing business relationship with Luoyang Company. Based on our discussion with the management of the Company and the review of the 2024 Sales Framework Agreement and the 2023 Annual Sales Framework Agreement and the 2023 Sales Framework Agreement, no material changes were made to the principal terms of the 2024 Sales Framework Agreement.



As stated in the Letter from the Board, the prices of Lithium Batteries and related products sold by the Group to the Luoyang Company and its subsidiaries will be determined after arm's length negotiations mainly by reference to market prices and the sales prices of similar products supplied by the Group to other Independent Third Party customers, having taken into account the costs plus a reasonable profit margin.

In assessing the terms of the 2024 Sales Framework Agreement, we have obtained and reviewed five largest sample contracts during the ten months ended October 31, 2023 (the "**Relevant Period**") pursuant to the 2023 Annual Sales Framework Agreement and the 2023 Sales Framework Agreement and comparable transactions entered into between the Group and Independent Third Party customers for the provision of same products. We have obtained and compared the unit price for each of the sample contracts and the respective comparable contracts. From our view, we noted that the unit price for products sold by the Group to the Luoyang Company and its subsidiaries are not less than those offered by the Group to the Independent Third Party customers. As we have obtained the five largest sample contracts covering approximately 10% of the historical transaction amounts during the ten months ended October 31, 2023, we are of the view the selected samples are a fair and reasonable representation. In addition, we have discussed with and understood from the management of the Company that as certain products may tailored for individual order in accordance with the specific requirements of the customers, prices might not be comparable across orders for similar type of products, where no such tailor-made products were sold by the Group to the Luoyang Company and its subsidiaries during the ten months ended October 31, 2023. However, the Group shall, as the case maybe, negotiate the terms for each contract, including those with Luoyang Company and other Independent Third Party customers, on arm's length basis and on normal commercial terms according to the same pricing principal of the Company, which was mainly determined based on a cost-plus basis with a reasonable profit margin level maintained by the Group. Based on the above, we are of the view that the principal terms of the 2024 Sales Framework Agreement are fair and reasonable so far as the Independent Shareholders are concerned.

### ***3.3 Proposed annual caps for the 2024 Sales Framework Agreement***

As stated in the announcement of the Company dated March 28, 2023, as the counterparties of the Company under the 2023 Annual Sales Framework Agreement and the 2023 Sales Framework Agreement were all associates of Jintan Holding and the transactions were of the same nature, 2023 Annual Sales Framework Agreement and the 2023 Sales Framework Agreement shall be aggregated pursuant to Rule 14A.81 of the Listing Rules. The table below sets forth the historical transaction amounts and the respective annual cap for the sales of Lithium Batteries and related products (such as raw materials, semi-finished products, finished products) received by the Group from Luoyang Company and its associates under the 2023 Annual Sales Framework Agreement and the 2023 Sales Framework Agreement for the ten months ended October 31, 2023:





**For the year ended  
December 31, 2023**  
*RMB'000*

Historical transaction amounts	27,790 <i>(Note)</i>
Existing annual cap amounts	260,000

*Note:* The actual transaction amounts for the year ended December 31, 2023 represent the amounts for the ten months ended October 31, 2023.

The following table sets forth the proposed annual caps for the fees to be received by the Company from the transactions with Luoyang Company and its associates under the 2024 Sales Framework Agreement:

**For the year ending  
December 31, 2024**  
*RMB'000*

Proposed annual caps	1,400,000
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As set out in the Letter from the Board, the proposed annual caps under the 2024 Sales Framework Agreement were determined after having taken into account the following factors:

- (a) the historical and expected amount of the sales of Lithium Batteries and related products by the Group to Luoyang Company and its associates for the year of 2023;
- (b) the estimated demands of Lithium Batteries and related products in 2024 provided by Luoyang Company;
- (c) types of the related products procured by Luoyang Company from the Group increased as compared with that in 2023;
- (d) the expected selling prices of the Lithium Batteries and related products under the 2024 Sales Framework Agreement; and
- (e) approximately 3% buffer set for price changes of related products and possible market changes.

As set out in the table above, the historical transaction amounts of the sales of Lithium Batteries and related products during the ten months ended October 31, 2023 amounted to approximately RMB27.79 million, representing a utilisation rate of approximately 12.8% (on pro-rata basis) of the existing annual caps. As advised by the management of the Company, based on the current market conditions and product delivery schedule, the utilization rate of



annual cap is expected to reach over 70%. As at the Latest Practicable Date, the amounts received by the Company from Luoyang Company and its associates in respect of the sales of Lithium Batteries and related products does not exceed the annual cap under the sales framework agreements in 2023.

As advised by the management of the Company, the Lithium Batteries and related products planned to be sold to the Luoyang Company for the year ending December 31, 2024 are mainly (i) raw materials; (ii) electrode coils; and (iii) lithium battery cell products. For raw materials, it is expected the sales of raw materials, mainly battery cathode materials, will be approximately RMB380 million. We have understood from the Company that Luoyang Company have gradually switched their cathode material suppliers from other vendors to the Company. The forecasted amount is based on the specific cell models planned to be sold to Luoyang Company in 2024, which have already begun in November 2023.

For electrode coils, it is expected the sales will be approximately RMB830 million. We understand from the Company that Luoyang Company currently do not have corresponding electrode coils production lines, which they are relying the Company to provide them the electrode coils for further processing. For lithium battery cell products, the estimated demands provided by Luoyang Company will be approximately RMB130 million in 2024.

We further understood from the Company that the demands on Lithium Batteries and related products have increased due to (i) favourable government regulations and policies; and (ii) the increase in general demand of lithium batteries in PRC. As disclosed in the 2023 Interim Report, we have noted that in June 2023, the Ministry of Finance and other two departments jointly issued the Announcement on Continuing and Optimizing the Vehicle Purchase Tax Reduction and Exemption Policy for New Energy Vehicles, extending the tax reduction and exemption policy for another four years to 2027, facilitating to stabilize market expectations for new energy vehicles and optimize the market environment. In terms of China's market, according to the statistics of China Automotive Battery Innovation Alliance, the installed capacity of domestic EV batteries from January to June 2023 was 152.1GWh, representing a cumulative year-on-year increase of 38.1%, of which the cumulative installed capacity of LFP batteries was 103.9GWh, accounting for 68.3% of the total installed capacity, representing a cumulative year-on-year increase of 61.5%; and the cumulative installed capacity of NCM batteries was 48.0GWh, accounting for 31.5% of the total installed capacity, representing a year-on-year increase of 5.2%, as disclosed in the 2023 Interim Report.

Given that (i) there is a long term and reliable business relationship between the Group and Luoyang Company; (ii) the anticipated growing demand for Lithium Batteries and related products, driven by the estimated demands provided by Luoyang Company and its associates; (iii) the favourable government regulations and policies and the increase in market demand of lithium batteries in PRC; and (iv) the fact that the proposed annual caps provide the Group with flexibility to conduct business with Luoyang Company to generate additional revenue, we are of the view that such proposed annual caps are fair and reasonable so far as the Independent Shareholders are concerned.



#### **4. The 2024 Entrusted Processing Framework Agreement**

##### ***4.1 Principal terms of the 2024 Entrusted Processing Framework Agreement***

The following sets forth the principal terms of the 2024 Entrusted Processing Framework Agreement. For detailed terms of the 2024 Entrusted Processing Framework Agreement, please refer to the section headed “*2024 Entrusted Processing Framework Agreement*” in the Letter from the Board.

<b>Parties:</b>	(i) the Company; and (ii) Luoyang Company (for itself and on behalf of the Luoyang Group)
<b>Term:</b>	One year commencing from January 1, 2024 (subject to the approval of the 2024 Entrusted Processing Framework Agreement by the Independent Shareholders at the EGM) to December 31, 2024 (both days inclusive)
<b>Nature of transaction:</b>	The Group entrusts Luoyang Group for the provision of processing service of Lithium Batteries. The Luoyang Group will be responsible for the raw materials, front line workers and technicians whose licenses and qualifications are approved by the Group and completing the production and processing. Front line workers in special positions shall obtain qualifications such as special equipment operating certificates or certificates for operators of special equipment granted by the government and certain technicians in special positions shall obtain the IATF16949 quality system internal auditor qualification issued by the qualified external professional organizations.



**Pricing:**

The prices of processing service of Lithium Batteries entrusted by the Group to Luoyang Group are determined with reference to the cost of processing and producing Lithium Batteries and the prevailing market price of processing services in the same or proximity areas charged by Independent Third Parties, which mainly comprise (i) the costs to be incurred by Luoyang Group for processing and producing Lithium Batteries; and (ii) a reasonable profit margin of around 2% to 3% of the above mentioned costs for the processing services. The profit margin is determined after arm's-length negotiation between the parties with reference to the profit margin of similar and comparable transactions with Independent Third Parties in the corresponding period. The profit margin applied in the processing service provided by Luoyang Group is comparable to that of the processing service provided by the Independent Third Party. The Company would normally review at least two quotations from and/or agreements entered into with the Independent Third Parties for providing similar services as comparison in determining the fees to be paid for processing services under 2024 Entrusted Processing Framework Agreement. Having considered the aforesaid, the Board is of the view that the pricing basis and the percentage of profit margin are fair and reasonable, on the normal commercial terms and in the interest of the Company and its Shareholders as whole.

Upon receiving the pricing terms of the transactions under the 2024 Entrusted Processing Framework Agreement from Luoyang Group, the Company will normally compare it with (i) the Company's expected cost of manufacturing the same categories of products; and (ii) the quotation from and/or agreements entered into with the Independent Third Parties providing similar services, to ensure that the prices and terms offered in 2024 Entrusted Processing Framework Agreement are fair and reasonable to the Company.

**Licensing of  
patent:**

The Company grants Luoyang Company the right to use certain specified patents of the Company ("**Authorized Patents**") which are necessary for its provision of Lithium Batteries processing services. In this connection, Luoyang Company undertakes to only use the Authorized Patents for the purpose of the Lithium Batteries processing services under the 2024 Entrusted Processing Framework Agreement and that it shall not be entitled to use the Authorized Patents for other purposes unless prior written consent is obtained from the Company.



#### ***4.2 Our assessment of the terms of the 2024 Entrusted Processing Framework Agreement***

As set out in the paragraphs headed “2. *Reasons for and benefits of the Non-exempt CCTs*” above, the entering into of the 2024 Entrusted Processing Framework Agreement is to extend the term of 2023 Entrusted Processing Framework Agreement, which has expired on December 31, 2023, to allow the Group to continue entrust Luoyang Company for the provision of services. Based on our discussion with the management of the Company and the review of the 2024 Entrusted Processing Framework Agreement and the 2023 Entrusted Processing Framework Agreement, no material changes were made to the principal terms of the 2024 Entrusted Processing Framework Agreement.

As discussed with the management of the Company, upon receiving the pricing terms of the transactions under the 2024 Entrusted Processing Framework Agreement from Luoyang Company, the Company will normally compare it with (i) the Company’s expected cost of manufacturing the same categories of products; and (ii) the quotation from and/or agreements entered into with the Independent Third Parties for providing similar services, to ensure that the prices and terms offered in 2024 Entrusted Processing Framework Agreement are fair and reasonable to the Company.

In assessing the terms of the 2024 Entrusted Processing Framework Agreement, we have obtained and reviewed the contract entered between the Company and Luoyang Company pursuant to the 2023 Entrusted Processing Framework Agreement and compared with relevant three quotations obtained by the Group from other Independent Third Party suppliers for entrusted processing services. As advised by the Company, these three suppliers represent more than half of all the independent third parties currently providing entrusted processing services to the Group, we are of the view that the selected sample are a fair and reasonable representation. From our review, we noted that the reasonable profit charged by Luoyang Company was not less favourable to the Group than those offered by the Independent Third Parties for the entrusted processing service of Lithium Batteries. In addition, as discussed with the management of the Company, the Company conduct cross check of cost incurred by Luoyang Company for processing and producing Lithium Batteries on a monthly basis. For our due diligence purpose, we requested the Company to provide us supporting for their cross check on cost incurred by Luoyang Company under 2023 Entrusted Processing Framework Agreement. The Company provided us supporting information showing the cross-check procedures conducted between the Company and Luoyang Company during the year of 2023. We have also obtained and reviewed three underlying monthly calculation of the costs incurred by Luoyang Group for processing and producing Lithium Batteries and the profit margin as stated in the contract. As such, we are of the view that the pricing policies of the 2024 Entrusted Processing Framework Agreement are fair and reasonable so far as the Independent Shareholders are concerned.



#### ***4.3 Proposed annual caps for the 2024 Entrusted Processing Framework Agreement***

The table below sets forth the historical transaction amounts for the fees incurred from entrusted processing services provided by Luoyang Company for the ten months ended October 31, 2023:

	<b>For the year ended December 31, 2023</b> <i>RMB' 000</i>
Historical transaction amounts	1,666,270 <i>(Note)</i>
Existing annual cap amounts	4,200,000

*Note:* The actual transaction amounts for the year ended December 31, 2023 represent the amounts for the ten months ended October 31, 2023.

The following table sets forth the proposed annual caps for the fees to be incurred under the 2024 Entrusted Processing Framework Agreement for the year ending December 31, 2024:

	<b>For the year ending December 31, 2024</b> <i>RMB' 000</i>
Proposed annual caps	3,000,000

As set out in the Letter from the Board, the proposed annual caps under the 2024 Entrusted Processing Framework Agreement were determined after having taken into account the following factors:

- (a) the historical amount incurred in 2023;
- (b) the cost of processing and producing the Lithium Batteries;
- (c) the prevailing market price for the provision of processing services in the same or proximity areas;
- (d) the expected approximately 5GWh per year production capacity of Luoyang Company;
- (e) the compound annual growth rate of 126% from 2020 to 2022 of sales volume of EV batteries and ESS products respectively; and
- (f) the expected production capacity and utilization.



As set out in the table above, the historical transaction amounts of the fees incurred from entrusted processing services provided by Luoyang Company for the ten months ended October 31, 2023 amounted to approximately RMB1,666.27 million, representing the utilisation rate of approximately 47.6% (on pro-rata basis) of the existing annual caps. As discussed with the management of the Company, the low utilisation rates were mainly due to (i) the decrease in price of raw materials during 2023 which led to the decrease in transaction value as it is determined based on a cost-plus basis; and (ii) the reduced cost of entrusted processing service from the Group on some of the battery models as the Group is able to provide electrode coils internally for some of the battery models.

As advised by the management of the Company, it is expected Luoyang Company would provide entrusted processing service to the Group for eight battery models in 2024. We have obtained and reviewed the calculation from the Company and noted that the components of the proposed annual cap were (a) the effective production capacity of the Luoyang Company; and (b) the estimated unit cost of entrusted processing service of Lithium Batteries to be provided by Luoyang Company. We further understood from the Company that the demands on Lithium Batteries and related products have increased due to (i) favourable government regulations and policies; and (ii) the increase in general demand of lithium batteries in PRC as mentioned in the section headed “3.3 Proposed annual caps for the 2024 Sales Framework Agreement”.

In addition, as disclosed in the Letter from the Board, before Luoyang Company can start production, they must meet the quality and technical requirements set by the Company. The Company will verify Luoyang Company’s qualifications by checking their quality assurance certificates, reviewing their equipment and production sites, and ensuring that their workers have the necessary certifications. Luoyang Company is required to label each product batch with specific information and provide testing results consistent with the delivered goods. They must also maintain records of key processes and possess equipment for product examinations. Failure to comply may result in product rejection or examination by a designated national examination center at Luoyang Company’s expense.

Based on the above, we are of the view that such proposed annual caps under the 2024 Entrusted Processing Framework Agreement were determined based on reasonable estimation and after due and careful consideration. Taking into account the fact that the proposed annual caps provide the Group with flexibility to conduct business with the Luoyang Company, we are of the view that such proposed annual caps are fair and reasonable so far as the Independent Shareholders are concerned.

## **5. Internal control measures**

The Company has established a comprehensive internal control system and adopted various internal control measures, including a management system on connected transactions and procurement and tender administration measures, to ensure that the Non-exempt CCTs are conducted in accordance with their terms and conditions. Details of the internal control measures of the Group are set out in the sections headed “INTERNAL CONTROL MEASURES” in the Letter from the Board.



Pursuant to Rules 14A.55 to 14A.59 of the Listing Rules, the Non-exempt CCTs are subject to the following annual review requirements:

- (a) the independent non-executive Directors must review the Non-exempt CCTs every year and confirm in the annual report that the transactions have been entered into:
  - (i) in the ordinary and usual course of business of the Group;
  - (ii) on normal commercial terms or better; and
  - (iii) according to the agreements governing them on terms that are fair and reasonable and in the interests of the Shareholders as a whole;
- (b) the Company's auditors must provide a letter to the Board (with a copy to be provided to the Stock Exchange at least ten business days before the bulk printing of the Company's annual report) confirming whether anything has come to their attention that causes them to believe that the Non-exempt CCTs:
  - (i) have not been approved by the Board;
  - (ii) were not, in all material respects, in accordance with the pricing policies of the Group;
  - (iii) were not entered into, in all material respects, in accordance with the relevant agreements governing them; and
  - (iv) have exceeded the relevant annual caps;
- (c) the Company must allow, and ensure that the counterparties to the Non-exempt CCTs allow, the Company's auditors sufficient access to their records for the purpose of the reporting on the Non-exempt CCTs; and
- (d) the Company must promptly notify the Stock Exchange and publish an announcement if the independent non-executive Directors and/or auditors of the Company cannot confirm the matters as required. The Stock Exchange may require the Company to re-comply with the announcement and Shareholders' approval requirements and may impose additional conditions.

In light of the reporting requirements attached to the Non-exempt CCTs, in particular, (i) the restriction of the transaction value by way of annual caps; and (ii) the ongoing review by the independent non-executive Directors and auditors of the Company of the terms of the relevant agreements in relation to the Non-exempt CCTs and the respective proposed annual caps not being exceeded, we are of the view that appropriate measures will be in place to govern the conduct of the Non-exempt CCTs and assist in safeguarding the interests of the Company and the independent Shareholders as a whole.





## OPINION AND RECOMMENDATIONS

Having taken into account the above principal factors and reasons, we consider that the entering into of 2024 Sales Framework Agreement and the 2024 Entrusted Processing Framework Agreement, including their respective proposed annual caps, are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned, in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole. 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 Non-exempt CCTs and their respective annual caps to be proposed 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 19 years of experience in the corporate finance industry.*