



SOMERLEY CAPITAL LIMITED

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December 9, 2024

To: the Independent Board Committee and the Independent Shareholders

Dear Sirs,

RENEWAL OF CONTINUING CONNECTED TRANSACTION

INTRODUCTION

We refer to our appointment to advise the Independent Board Committee and the Independent Shareholders in respect of the 2025 Entrusted Processing Framework Agreement, and the transactions contemplated thereunder (including the proposed annual cap), details of which are set out in the letter from the Board ("**Letter from the Board**") of the circular of the Company dated December 9, 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 the entrusted processing framework agreement (the "**2024 Entrusted Processing Framework Agreement**") on January 4, 2024 with Luoyang Company (for itself and on behalf of its Group), pursuant to which the Company entrusts Luoyang Group for the provision of processing service of Lithium Batteries.

As the 2024 Entrusted Processing Framework Agreement will expire on December 31, 2024, the Company and Luoyang Company entered into the 2025 Entrusted Processing Framework Agreement on November 20, 2024, pursuant to which the Company will entrust Luoyang Company to provide processing services of Lithium Batteries to the Group, for a term of one year commencing from January 1, 2025 (subject to the approval of the 2025 Entrusted Processing Framework Agreement by the Independent Shareholders at EGM) to December 31, 2025 (both days inclusive).

As at the Latest Practicable Date, Jintan Holding held approximately 26.02% 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. Therefore, the transactions contemplated under the 2025 Entrusted Processing Framework Agreement will constitute continuing connected transactions of the Company under the Chapter 14A of the Listing Rules. As the highest applicable percentage ratios of the annual cap under the 2025 Entrusted Processing Framework Agreement is more than 5%, the transactions contemplated thereunder are therefore subject to the reporting, announcement, annual review and the 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 2025 Entrusted Processing Framework Agreement and 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, saved for our engagement as the independent financial adviser to the independent board committee and the independent shareholders of the Company in relation to the renewal of continuing connected transactions as disclosed in the circular of the Company dated January 11, 2024, 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 cap.

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 reports of the Company for the year ended December 31, 2023 (the “**2023 Annual Report**”) and the interim report of the Company for the six months ended June 30, 2024 (the “**2024 Interim Report**”); (ii) the announcement of the Company dated November 15, 2024 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 Group is an international leading new energy technology company mainly engaged in the design, R&D, production and sales of EV batteries and ESS products. The Company 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, 2022 and 2023 and the six months ended June 30, 2023 and 2024 as extracted from the 2023 Annual Report and the 2024 Interim Report respectively:

	For the six months ended June 30,		For the year ended December 31,	
	2024	2023	2023	2022
	RMB'000	RMB'000	RMB'000	RMB'000
	(Unaudited)	(Unaudited)	(Audited)	(Audited)
Revenue				
– Sales of EV batteries	9,723,980	10,377,467	22,249,046	18,323,505
– Sales of ESS products and others	<u>2,745,257</u>	<u>1,917,245</u>	<u>4,756,839</u>	<u>2,051,437</u>
	12,469,237	12,294,712	27,005,885	20,374,942
Gross profit	1,948,130	1,179,065	3,511,518	2,103,520
Profit for the year/period attributable to owners of the Company	248,987	146,517	294,377	691,626



For the two years ended December 31, 2022 and 2023

For the years ended December 31, 2022 and 2023, the Group recorded a revenue of approximately RMB20,374.9 million and RMB27,005.9 million respectively, representing an increase of approximately 32.5%. Over 80% of the revenue are generated from sales of EV batteries. As disclosed in the 2023 Annual 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. Revenue generated from sales of EV batteries increased by approximately 21.4% mainly attributable to the release of the Group's production capacity, continuously enriched product lines, the increase in market and customers demand, increased stickiness of cooperation with core customers, the further diversification of supporting customers, as well as the sustained growth of the passenger vehicle and commercial vehicle businesses. Revenue generated from the ESS products and others increased by approximately 131.9% for the year ended 31 December 2023, mainly due to the fact that the Group continued to explore the markets including ESS segments at home and abroad and formed the strategic cooperation with leading customers in various ESS segments, which led to a rapid growth in sales.

The Group's gross profit for the years ended December 31, 2022 and 2023 amounted to approximately RMB2,103.5 million and RMB3,511.5 million respectively, representing an increase of approximately 66.9%. As disclosed in the 2023 Annual Report, the gross profit margin of the Group increased by 2.7 percentage points from approximately 10.3% for the year ended December 31, 2022 to approximately 13.0% for the year ended December 31, 2023.

The Group's profit attributable to owners of the Company for the years ended December 31, 2022 and 2023 amounted to approximately RMB691.6 million and RMB294.4 million respectively, representing a decrease of approximately 57.4%. Such decrease was mainly attributable to (i) the increase of allowance for inventories; (ii) the increase in research and development expenses; and (iii) the increase in finance costs due to the increase in financing scale, partially offset by the increase of revenue and gross profit as mentioned above.

For the six months ended June 30, 2023 and 2024

For the six months ended June 30, 2023 and 2024, the Group recorded a revenue of approximately RMB12,294.7 million and RMB12,469.2 million respectively, representing an increase of approximately 1.4%. As disclosed in the 2024 Interim Report, the increase was mainly due to the gradual release of the Group's production capacity, the increase in customer demands and sustained significant growth of the ESS products business.

The Group's gross profit for the six months ended June 30, 2023 and 2024 amounted to approximately RMB1,179.1 million and RMB1,948.1 million respectively, representing an increase of approximately 65.2%. As disclosed in the 2024 Interim Report, the gross profit margin of the Group increased by 6.0 percentage points from approximately 9.6% for the six months ended June 30, 2023 to approximately 15.6% for the six months ended June 30, 2024.



The Group's profit attributable to Shareholders for the six months ended June 30, 2023 and 2024 amounted to approximately RMB146.5 million and RMB249.0 million respectively, representing an increase of approximately 69.9%. Such increase was mainly attributable to increase of gross profit; partially offset by (i) the increase of research and development expenses; (ii) the increase of administrative expenses; and (iii) the increase of finance cost.

Set out below is the summary of the financial position of the Group as at December 31, 2022, 2023 and June 30, 2024 as extracted from the 2023 Annual Report and the 2024 Interim Report:

	As at June 30, 2024 RMB'000 (Unaudited)	As at December 31, 2023 RMB'000 (Audited)	2022 RMB'000 (Audited)
Total assets	111,262,513	105,429,025	90,460,618
Total liabilities	63,893,929	59,043,235	48,885,159
Net assets	47,368,584	46,385,790	41,575,459

As at June 30, 2024, the Group's total assets amounted to approximately RMB111.3 billion, mainly comprised of (i) property, plant and equipment of approximately RMB73.3 billion; (ii) bank and cash balances of approximately RMB9.0 billion; (iii) trade and bills receivables of approximately RMB8.4 billion; and (iv) prepayments, deposits and other receivables of approximately RMB7.1 billion.

As at June 30, 2024, the Group's total liabilities amounted to approximately RMB63.9 billion, mainly comprised of (i) bank borrowings of approximately RMB37.5 billion; (ii) trade and bills payable of approximately RMB17.8 billion; and (iii) accruals and other payables of approximately RMB6.4 billion.

As at June 30, 2024 and December 31, 2023, the Group's net assets amounted remained relatively stable at approximately RMB47.4 billion and RMB46.4 billion respectively. The gearing ratio (i.e. net debt divided by equity) of the Group has increased from approximately 47.1% as at December 31, 2023 to approximately 61.2% as at June 30, 2024, mainly due to the increased borrowings for project construction.

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 entering into the 2025 Entrusted Processing Framework Agreement

As stated in the Letter from the Board of the Circular, the transactions under the 2025 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 the 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 2025 Entrusted Processing Framework Agreement are on normal commercial terms (as discussed in the sections below); (ii) the transactions under the 2025 Entrusted Processing Framework Agreement provide the Group with stable and reliable long-term service provider; (iii) the 2025 Entrusted Processing Framework Agreement do not restrict the Group from procuring services from other suppliers and offered the Group with flexibilities to conduct business with Luoyang Company; and (iv) 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 "4. 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 2025 Entrusted Processing Framework Agreement

3.1. Principal terms of the 2025 Entrusted Processing Framework Agreement

The following sets forth the principal terms of the 2025 Entrusted Processing Framework Agreement. For detailed terms of the 2025 Entrusted Processing Framework Agreement, please refer to the section headed “III. 2025 Entrusted Processing Framework Agreement” in the Letter from the Board.

Date:	November 20, 2024
Parties:	(i) the Company (for itself and on behalf of the Group); and (ii) Luoyang Company (for itself and on behalf of the Luoyang Group)
Term:	One year commencing from January 1, 2025 (subject to the approval of the 2025 Entrusted Processing Framework Agreement by the Independent Shareholders at the EGM) to December 31, 2025 (both days inclusive)
Nature of transaction:	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 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 technicians in special positions shall obtain the IATF16949 quality system internal auditor qualification certified by a certification body with certification qualification.



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 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 2025 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 2025 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 2025 Entrusted Processing Framework Agreement is 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 2025 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.



3.2. Our assessment of the terms of the 2025 Entrusted Processing Framework Agreement

As set out in the paragraphs headed “2. Reasons for and benefits of entering into the 2025 Entrusted Processing Framework Agreement” above, the entering into of the 2025 Entrusted Processing Framework Agreement is to extend the term 2024 Entrusted Processing Framework Agreement, which will expire on December 31, 2024, 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 2025 Entrusted Processing Framework Agreement and the 2024 Entrusted Processing Framework Agreement, no material changes were made to the principal terms of the 2025 Entrusted Processing Framework Agreement.

As discussed with the management of the Company, upon receiving the pricing terms of the transactions under the 2025 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 2025 Entrusted Processing Framework Agreement is fair and reasonable to the Company.

In assessing the terms of the 2025 Entrusted Processing Framework Agreement, we have obtained and reviewed the contract entered between the Company and Luoyang Company pursuant to the 2024 Entrusted Processing Framework Agreement and compared with relevant three quotations obtained by the Group, on random basis, from other Independent Third Party suppliers for entrusted processing services. As advised by the Company, these three suppliers represent approximately half of the number of all the Independent Third Parties currently providing entrusted processing services to the Group and 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 2024 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 2024. 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 2025 Entrusted Processing Framework Agreement are fair and reasonable so far as the Independent Shareholders are concerned.



3.3. Proposed annual cap for the 2025 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, 2024:

	For the year ending December 31, 2024 RMB'000
Historical transaction amounts	1,654,400 ^(Note)
Existing annual cap amounts	3,000,000

Note: The actual transaction amounts for the year ending December 31, 2024 represent the amounts for the ten months ended October 31, 2024.

The following table sets forth the proposed annual cap for the fees to be incurred under the 2025 Entrusted Processing Framework Agreement for the year ending December 31, 2025:

	For the year ending December 31, 2025 RMB'000
Proposed annual cap	3,000,000

As set out in the Letter from the Board, the proposed annual cap under the 2025 Entrusted Processing Framework Agreement was determined after having taken into account the following factors:

- (a) the historical amount incurred for the ten months ended October 31, 2024;
- (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 production capacity of approximately 6GWh per year of Luoyang Company;
- (e) the compound annual growth rate of 97% from 2021 to 2023 of sales volume of Lithium Batteries; 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, 2024 amounted to approximately RMB1,654.40 million, representing the utilisation rate of approximately 66.2% (on pro-rata basis) of the existing annual cap. As discussed with the management of the Company, based on the demand from certain clients in November and December, they expect the annual cap utilization rate is projected to exceed 90%.

As advised by the management of the Company, it is expected Luoyang Company would provide entrusted processing service to the Group for ten battery models in 2025. 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.

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 cap under the 2025 Entrusted Processing Framework Agreement was determined based on reasonable estimation and after due and careful consideration. Taking into account the fact that the proposed annual cap provides the Group with flexibility to conduct business with the Luoyang Company, we are of the view that such proposed annual cap is fair and reasonable so far as the Independent Shareholders are concerned.

4. 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 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 cap;
- (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 cap; 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 proposed annual cap 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 the 2025 Entrusted Processing Framework Agreement, including the proposed annual cap, 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 2025 Entrusted Processing Framework Agreement and the annual cap 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 20 years of experience in the corporate finance industry.