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LETTER FROM THE BOARD

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中國航空科技工業股份有限公司  
**AviChina Industry & Technology Company Limited\***  
(A joint stock limited company incorporated in the People's Republic of China with limited liability)  
(Stock Code: 2357)

*Executive Directors:*

Mr. Zhang Minsheng  
Mr. Yan Lingxi

*Non-executive Directors:*

Mr. Lian Dawei  
Mr. Li Xichuan  
Mr. Xu Gang  
Mr. Wang Jun

*Independent non-executive Directors:*

Mr. Liu Weiwu  
Mr. Mao Fugen  
Mr. Lin Guiping

*Registered Office:*

2nd floor, Building 27  
No. 26 Xihuan South Street  
Beijing Economic Technological  
Development Area  
Beijing, PRC

*Place of business in Hong Kong*

Unit 2202A, 22nd Floor  
Fairmont House  
8 Cotton Tree Drive  
Central  
Hong Kong

29 September 2022

*To the Shareholders:*

Dear Sir or Madam,

- (1) PROPOSED ACQUISITION OF THE ENTIRE EQUITY INTEREST IN AVIC ELECTROMECHANICAL;**
- (2) PROPOSED DEEMED DISPOSAL OF THE EQUITY INTEREST IN AVIC AVIONICS;**
- (3) PROPOSED SUBSCRIPTION OF AVIC AVIONICS A SHARES BY THE COMPANY; AND**
- (4) PROPOSED CHANGE OF DIRECTOR**

\* For identification purpose only

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### A. INTRODUCTION

References are made to the announcements of the Company: (i) dated 26 May 2022 and 10 June 2022 in relation to the Share Swap and Absorption and Subscription, among other things, the proposed acquisition and connected transaction of 100% equity interests of AVIC Electromechanical, the proposed deemed disposal and connected transaction of equity interests in AVIC Avionics and the proposed subscription of AVIC Avionics A Shares by the Company; and (ii) dated 30 August 2022 in relation to the proposed change of Director.

After trading hours on 10 June 2022, (i) AVIC Avionics and AVIC Electromechanical have entered into the Share Swap and Absorption Agreement; and (ii) AVIC Avionics and the Company, AVIC Aviation Industry Investment, AVIC Shenfei and Chengdu Aircraft Industry have entered into the Subscription Agreements respectively.

The purpose of this circular is to provide you with, among other things, (i) details relating to the Share Swap and Absorption and Subscription and the transactions contemplated thereunder; (ii) proposed change of Director (iii) a letter of recommendation from the Independent Board Committee on the Subscription and the transactions contemplated thereunder to the Independent Shareholders; (iv) a letter of advice from the Independent Financial Adviser on the connected transactions contemplated under the Subscription to the Independent Shareholders and the Independent Board Committee; (v) the financial information of the Company; (vi) the financial information of AVIC Avionics; (vii) the financial information of AVIC Electromechanical and its subsidiaries; (viii) the accountants' report of AVIC Electromechanical and its subsidiaries; (ix) the unaudited pro forma financial information of the Enlarged Group; (x) other information under the Listing Rules; and (xi) the notice of the EGM.

### B. SHARE SWAP AND ABSORPTION

#### Share Swap and Absorption Agreement

The major terms of the Share Swap and Absorption Agreement are summarised as follows:

#### Date

10 June 2022

#### Parties to the Share Swap and Absorption Agreement

1. AVIC Avionics; and
2. AVIC Electromechanical

#### Subject Matter

AVIC Avionics has agreed to issue AVIC Avionics A Shares to the Share Swap participating shareholders of AVIC Electromechanical in exchange for the entire AVIC Electromechanical A Shares held by them as at the Share Swap Date. Upon Completion, AVIC Avionics will take over all

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the assets, liabilities, business operation, employees, contracts and other rights and obligation of AVIC Electromechanical and its subsidiaries, and AVIC Electromechanical will apply to delist from the Shenzhen Stock Exchange and registration. Application will be made by AVIC Avionics to the Shanghai Stock Exchange for approval for the listing of, and permission to deal in, the Exchange Shares.

### **The Exchange Price and the Exchange Ratio**

The Exchange Ratio is determined with reference to the exchange price of AVIC Avionics A Shares (the “AVIC Avionics Exchange Price”) and the exchange price of AVIC Electromechanical A Shares (the “AVIC Electromechanical Exchange Price”). Each of the AVIC Electromechanical Exchange Price and the AVIC Avionics Exchange Price is determined with reference to the average trading price of AVIC Electromechanical A Shares and AVIC Avionics A Shares, respectively, for the 120 trading days prior to the Price Determination Date. Based on the above formula, AVIC Electromechanical Exchange Price is RMB12.59 per share (as adjusted by its 2021 profit distribution plan) and AVIC Avionics Exchange Price is RMB18.94 per share (as adjusted by its 2021 profit distribution plan). Therefore, the Exchange Ratio equals to 1: 0.6647, which means that one AVIC Electromechanical A Share can exchange for 0.6647 AVIC Avionics A Share.

The Exchange Ratio was arrived at with reference to, among other things, (i) the rules and regulations under the Material Asset Restructuring Measures 《上市公司重大資產重組管理辦法》 and the Companies Law of the PRC; (ii) the valuation value of AVIC Electromechanical and AVIC Avionics in the past; and (iii) the usual practice and operation of share swap and absorption in other comparable cases in the market. Furthermore, the Company considers that the 120 day average trading price of AVIC Avionics A Shares and AVIC Electromechanical A Shares can better reflect the fair value of AVIC Avionics and AVIC Electromechanical given the recent huge short-term fluctuation of the A-shares stock market.

### **Number of Exchange Shares to be issued**

As at the Latest Practicable Date, the total issued share capital of AVIC Electromechanical is 3,884,824,789 AVIC Electromechanical A Shares, which will all participate in the Share Swap and Absorption. Based on the Exchange Ratio, it is estimated that a total of 2,582,243,037 AVIC Avionics A Shares (representing approximately 133.92% of the AVIC Avionics A Shares in issue as at the Latest Practicable Date) will be issued as Exchange Shares to the shareholders of AVIC Electromechanical. Upon Completion, the total number of issued shares of AVIC Avionics will be 4,510.46 million.

If any ex-rights and ex-dividend events, such as distribution of cash dividends, stock dividends, conversion of capital reserves to share capital, allotment of shares and cancellation of treasury shares occurs on AVIC Avionics or AVIC Electromechanical between the Price Determination Date to the implementation date of Share Swap and Absorption, the number of Exchange Shares will be adjusted accordingly.

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The number of AVIC Avionics A Shares to be acquired by the AVIC Electromechanical shareholders shall be an integer. If the number of AVIC Electromechanical A Shares held by them is not an integer after multiplying the Exchange Ratio, the AVIC Electromechanical shareholders shall be sorted according to the size of the mantissa after the decimal point and one AVIC Avionics A Share will be issued to these shareholders in turn until the actual number of swapped AVIC Avionics A Shares equals to the number of AVIC Avionics A Shares intended to be issued for the Share Swap and Absorption.

Upon Completion, the shareholding of the Company in AVIC Avionics will reduce from 39.43% to 16.86%. Therefore, the Share Swap and Absorption will also constitute a Deemed Disposal of AVIC Avionics under the Listing Rules. AVIC Avionics will continue to be a subsidiary of the Company upon the Completion.

### **Listing of the Exchange Shares**

The Exchange Shares will be listed and circulated on the main board of the Shanghai Stock Exchange.

### **Appraisal Right of the Opposing AVIC Avionics Shareholders and Opposing AVIC Electromechanical Shareholders**

#### *AVIC Avionics Appraisal Right*

Pursuant to the Share Swap and Absorption Agreement, the Company has agreed to grant the AVIC Avionics Appraisal Right to the shareholders of AVIC Avionics (the “**Opposing AVIC Avionics Shareholders**”) that:

- (i) vote against the resolutions in relation to the Share Swap and Absorption and the Subscription and the signing of the Share Swap and Absorption Agreement at the shareholders’ meetings of AVIC Avionics;
- (ii) retain their AVIC Avionics A Shares in connection with the AVIC Avionics Appraisal Right from the record date of the shareholders’ meeting of AVIC Avionics approving the Share Swap and Absorption until the Appraisal Right Execution Date; and
- (iii) complete the relevant procedures within the period as stipulated in the Share Swap and Absorption Agreement.

The AVIC Avionics Appraisal Right is exercisable on the Appraisal Right Execution Date, pursuant to which the Opposing AVIC Avionics Shareholders can request the Company to purchase the AVIC Avionics A Shares at the AVIC Avionics Appraisal Right Exercise Price.

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### *AVIC Avionics Appraisal Right Exercise Price*

The AVIC Avionics Appraisal Right Exercise Price equals to RMB18.32 per share (as adjusted by its 2021 profit distribution plan), which is determined with reference to the its average trading price for the 20 trading days of AVIC Avionics prior to the Price Determination Date. The AVIC Avionic Appraisal Right Exercise Price was arrived at with reference to the usual practice and operation of share swap and absorption in 20 other comparable cases (the “Comparable Cases”) in the market (including but not limited to the share swap and absorption of: (i) Beijing Capital Retailing Group Co., Ltd.\* (北京首商集團股份有限公司) by Wangfujing Group Co., Ltd.\* (王府井集團股份有限公司); (ii) Yingkou Port Liability Co., Ltd.\* (營口港務股份有限公司) by Liaoning Port Co., Ltd. (遼寧港口股份有限公司); (iii) China CNR Corporation Limited\* (中國北車股份有限公司) by CSR Corporation Limited\* (中國南車股份有限公司); (iv) Chongqing Titanium Industry Co., Ltd of Pangang Group\* (攀鋼集團重慶鈦業有限公司) by Panzihua New Steel & Vanadium Co., Ltd.\* (攀枝花新鋼鈦股份有限公司); and (v) Shanghai Airlines Co., Ltd.\* (上海航空股份有限公司) by China Eastern Airlines Corporation Limited\* (中國東方航空股份有限公司), which the appraisal right exercise price is set as the average trading price for the 20 trading days of the listed company prior to the announcement date of the board approval of the share swap and absorption. Considering: (i) the AVIC Avionics Appraisal Right Exercise Price has no premium over the average trading price for the 20 trading days of AVIC Avionics prior to the Price Determination Date, which is in line with the market practice and is the same as the 1<sup>st</sup> quartile, median and 3<sup>rd</sup> quartile of the premium rate of the appraisal right exercise price of the dissenting shareholders in the Comparable Cases; and (ii) AVIC Avionics A Shares is freely transferable in the secondary market and the use of the average trading price of AVIC Avionics can better reflect the value of AVIC Avionics A Shares, the Directors are of the view that the AVIC Avionics Appraisal Right Exercise Price is fair and reasonable.

### *AVIC Avionics Appraisal Right Exercise Price Adjustment Mechanisms*

Pursuant to the Share Swap and Absorption Agreement, the AVIC Avionics Appraisal Right will be adjusted upon fulfillment of the following conditions:

- (i) **ex-rights and ex-dividend events adjustment:** if any ex-rights and ex-dividend events, such as distribution of cash dividends, stock dividends, conversion of capital reserves to share capital and allotment of shares occurs between the date of the shareholders’ meeting announcement approving the Share Swap and Absorption and the date of exercise of the AVIC Avionics Appraisal Right (including both days) (the “**First AVIC Avionics Appraisal Right Exercise Price Adjustment Period**”), the AVIC Avionics Appraisal Right Exercise Price will be adjusted accordingly. There is no limit on the number of price adjustments under the ex-rights and ex-dividend events adjustment mechanism, and the AVIC Avionics Appraisal Right Exercise Price will be adjusted upon occurrence of any of the ex-rights and ex-dividends events; or
- (ii) **one-off stipulated events adjustment:** if the stipulated events in the Share Swap and Absorption Agreement occur between the date of the shareholders’ meeting announcement approving the Share Swap and Absorption and the date of approval of the Share Swap and Absorption by CSRC (the “**Second AVIC Avionics Appraisal**”), the AVIC Avionics Appraisal Right Exercise Price will be adjusted accordingly.

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**Right Exercise Price Adjustment Period**”), AVIC Avionics shall convene a board meeting within 10 trading days after the occurrence of the stipulated events to determine whether adjustment of AVIC Avionics Appraisal Right Exercise Price under the one-off stipulated events adjustment mechanism is required. The decision of the board of AVIC Avionics will be final and no future adjustment to the AVIC Avionics Appraisal Right Exercise Price will be triggered under the one-off stipulated events adjustment mechanism.

During the overlapping period of the First AVIC Avionics Appraisal Right Exercise Price Adjustment Period and the Second AVIC Avionics Appraisal Right Exercise Period, the AVIC Avionics Appraisal Right Exercise Price will be subject to both the ex-rights and ex-dividend events adjustment and one-off stipulated events adjustment mechanisms.

### *Estimated capital requirement for AVIC Avionics Appraisal Right*

As at the Latest Practicable Date, there are 652 million AVIC Avionics A Shares held by independent shareholders. Assuming the Share Swap and Absorption will be approved at the shareholders meeting of AVIC Avionics by way of special resolutions (resolutions to be approved by two-third of independent shareholders with at most one-third of independent shareholders holding approximately 217 million AVIC Avionics A Shares opposing the Share Swap and Absorption) pursuant to the Measures for the Administration of the Material Asset Restructurings of Listed Companies (2020 Amendment)\* (上市公司重大資產重組管理辦法(2020修正)) and all the Opposing AVIC Avionics Shareholders have chosen to exercise the AVIC Avionics Appraisal Right, the Company estimates that the maximum amount of capital required is approximately RMB3,982 million. However, considering: (i) not all Opposing AVIC Avionics Shareholders will attend the shareholders’ meeting; (ii) not all Opposing AVIC Avionics Shareholders will choose to exercise the AVIC Avionics Appraisal Right and it is expected that the amount of capital required for the AVIC Avionics Appraisal Right will be lower than the maximum amount stated above; and (iii) based on the maximum percentage of opposing shareholders of the purchaser company in the Comparable Cases, the Company estimates that approximately 5.17% independent shareholders of AVIC Avionics will oppose the Share Swap and Absorption and exercise the AVIC Avionics Appraisal Right, and the amount of capital required to purchase the AVIC Avionics A Shares from the Opposing AVIC Avionics Shareholders will not exceed RMB617.87 million.

### *AVIC Electromechanical Appraisal Right*

Pursuant to the Share Swap and Absorption Agreement, the Company has agreed to grant the AVIC Electromechanical Appraisal Right to the shareholders of AVIC Electromechanical (the “**Opposing AVIC Electromechanical Shareholders**”) that:

- (i) vote against the resolutions in relation to the Share Swap and Absorption and the signing of the Share Swap and Absorption Agreement at the shareholders’ meetings of AVIC Electromechanical;

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- (ii) retain their AVIC Electromechanical A Shares in connection with the AVIC Electromechanical Appraisal Right from the record date of the shareholders' meeting of AVIC Electromechanical approving the Share Swap and Absorption until the Appraisal Right Execution Date; and
- (iii) complete the relevant procedures within the period as stipulated in the Share Swap and Absorption Agreement.

The AVIC Electromechanical Appraisal Right is exercisable on the Appraisal Right Execution Date, pursuant to which the Opposing AVIC Electromechanical Shareholders can request the Company to purchase the AVIC Electromechanical A Shares at the AVIC Electromechanical Appraisal Right Exercise Price.

### *AVIC Electromechanical Appraisal Right Exercise Price*

The AVIC Electromechanical Appraisal Right Exercise Price equals to RMB10.33 per share (as adjusted by its 2021 profit distribution plan), which is determined with reference to the average trading price of AVIC Electromechanical for the 20 trading days prior to the Price Determination Date. The AVIC Electromechanical Appraisal Right Exercise Price was arrived at with reference to the usual practice and operation of share swap and absorption in other comparable cases in the market, which the appraisal right exercise price is set as the average trading price for the 20 trading days of the listed company prior to the announcement date of the board approval of the share swap and absorption.

### *AVIC Electromechanical Appraisal Right Exercise Price Adjustment Mechanisms*

Pursuant to the Share Swap and Absorption Agreement, the AVIC Electromechanical Appraisal Right will be adjusted upon fulfillment of the following conditions:

- (i) **ex-rights and ex-dividend events adjustment:** if any ex-rights and ex-dividend events, such as distribution of cash dividends, stock dividends, conversion of capital reserves to share capital and allotment of shares occurs between the date of the shareholders' meeting announcement approving the Share Swap and Absorption and the date of exercise of the AVIC Electromechanical Appraisal Right (including both days) (the "**First AVIC Electromechanical Appraisal Right Exercise Price Adjustment Period**"), the AVIC Electromechanical Appraisal Right Exercise Price will be adjusted accordingly. There is no limit on the number of price adjustments under the ex-rights and ex-dividend events adjustment mechanism, and the AVIC Electromechanical Appraisal Right Exercise Price will be adjusted upon occurrence of any of the ex-rights and ex-dividends events; or
- (ii) **one-off stipulated events adjustment:** if the stipulated events in the Share Swap and Absorption Agreement occur between the date of the shareholders' meeting announcement approving the Share Swap and Absorption and the date of approval of the Share Swap and Absorption by CSRC (the "**Second AVIC Electromechanical Appraisal Right Exercise Price Adjustment Period**"), AVIC Electromechanical shall

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convene a board meeting within 10 trading days after the occurrence of the stipulated events to determine whether adjustment of AVIC Electromechanical Appraisal Right Exercise Price under the one-off stipulated events adjustment mechanism is required. The decision of the board of AVIC Electromechanical will be final and no future adjustment to the AVIC Electromechanical Appraisal Right Exercise Price will be triggered under the one-off stipulated events adjustment mechanism.

During the overlapping period of the First AVIC Electromechanical Appraisal Right Exercise Price Adjustment Period and the Second AVIC Electromechanical Appraisal Right Exercise Period, the AVIC Electromechanical Appraisal Right Exercise Price will be subject to both the ex-rights and ex-dividend events adjustment and the one-off stipulated events adjustment mechanisms.

### *Estimated capital requirement for AVIC Electromechanical Appraisal Right*

As at the Latest Practicable Date, there are 1,866 million AVIC Electromechanical A Shares held by independent shareholders. Assuming the Share Swap and Absorption will be approved at the shareholders meeting of AVIC Electromechanical by way of special resolutions (resolutions to be approved by two-third of independent shareholders with at most one-third of independent shareholders holding approximately 622 million AVIC Electromechanical A Shares opposing the Share Swap and Absorption) pursuant to the Measures for the Administration of the Material Asset Restructurings of Listed Companies (2020 Amendment)\* (上市公司重大資產重組管理辦法(2020修正)) and all the Opposing AVIC Electromechanical Shareholders have chosen to exercise the AVIC Electromechanical Appraisal Right, the Company estimates that the maximum amount of capital required is approximately RMB6,425 million. However, considering: (i) not all Opposing AVIC Electromechanical Shareholders will attend the shareholders' meeting; (ii) not all Opposing AVIC Electromechanical Shareholders will choose to exercise the AVIC Electromechanical Appraisal Right and it is expected that the amount of capital required for the AVIC Electromechanical Appraisal Right will be lower than the maximum amount stated above; and (iii) based on the maximum percentage of opposing shareholders of the vendor company in the Comparable Cases, the Company estimates that approximately 4.22% independent shareholders of AVIC Electromechanical will oppose the Share Swap and Absorption and exercise the AVIC Electromechanical Appraisal Right, and the amount of capital required to purchase the AVIC Electromechanical A Shares from the Opposing AVIC Electromechanical Shareholders will not exceed RMB813.44 million.

### **Arrangement for the Rollover of the Undistributed Profits of AVIC Avionics and AVIC Electromechanical**

In addition to the profit distribution plan approved by the respective shareholders' meetings of AVIC Avionics and AVIC Electromechanical, the accumulated undistributed profits of AVIC Avionics and AVIC Electromechanical as at the Share Swap Date shall be shared by the old and new shareholders of AVIC Avionics in proportion to their shareholdings.



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### Conditions precedent

The Share Swap and Absorption Agreement shall take effect upon the satisfaction of the following conditions:

- (i) the Share Swap and Absorption Agreement having been duly signed by AVIC Avionics and AVIC Electromechanical;
- (ii) AVIC Avionics, AVIC Electromechanical and the Company having obtained all effective approvals in respect of the Share Swap and Absorption from its board of directors and shareholders pursuant to their respective articles and associations;
- (iii) the Share Swap and Absorption having completed all the regulatory procedures of the Stock Exchange; and
- (iv) the Share Swap and Absorption having obtained approvals from SASTIND, SASAC and CSRC.

### Completion

The date of Completion shall be the date of completion of the transfer of all business operation, assets and liabilities of AVIC Electromechanical to AVIC Avionics. Upon Completion, AVIC Avionics will take over all the assets, liabilities, business operation, employees, contracts and other rights and obligation of AVIC Electromechanical, and AVIC Electromechanical will apply to delist from the Shenzhen Stock Exchange and deregistration.

## C. SUBSCRIPTION

### Introduction

Conditional upon the Share Swap and Absorption Agreement becoming effective, AVIC Avionics also intended to place AVIC Avionics A Shares to not more than 35 designated investors to raise fund at a total amount not exceeding RMB5, 000 million. On 10 June 2022 (after trading hours), AVIC Avionics has entered into the Subscription Agreement with the Company, AVIC Aviation Industry Investment, AVIC Shenfei and Chengdu Aircraft Industry respectively. Pursuant to the Subscription Agreements, subject to the Completion, (i) the Company has agreed to subscribe for AVIC Avionics A Shares at a total consideration of RMB500 million in cash; (ii) AVIC Aviation Industry Investment agreed to subscribe for AVIC Avionics A Shares at a total consideration of RMB300 million in cash; (iii) AVIC Shenfei has agreed to subscribe for AVIC Avionics A Shares at a total consideration of RMB180 million in cash; and (iv) Chengdu Aircraft Industry has agreed to subscribe for AVIC Avionics A Shares at a total consideration of RMB180 million in cash.

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### Subscription Agreements

#### *Parties to the Subscription Agreements*

1. AVIC Avionics;
2. the Company;
3. AVIC Aviation Industry Investment;
4. AVIC Shenfei; and
5. Chengdu Aircraft Industry

(the Company, AVIC Aviation Industry Investment, AVIC Shenfei and Chengdu Aircraft Industry, collectively the “AVIC Subscribers”)

#### Subject Matter

Conditional upon the approval of the Share Swap and Absorption, (i) the Company has agreed to subscribe for AVIC Avionics A Shares at a total consideration of RMB500 million in cash; (ii) AVIC Aviation Industry Investment agreed to subscribe for AVIC Avionics A Shares at a total consideration of RMB300 million in cash; (iii) AVIC Shenfei has agreed to subscribe for AVIC Avionics A Shares at a total consideration of RMB180 million in cash; and (iv) Chengdu Aircraft Industry has agreed to subscribe for AVIC Avionics A Shares at a total consideration of RMB180 million in cash. If the number of issued shares of AVIC Avionics is less than one share, the AVIC Subscribers agree to round off the non-integer part. If the balance of the subscription amount is insufficient to convert into one share, such balance shall be converted into the capital reserve of AVIC Avionics.

The final subscription amount and the number of subscribed AVIC Avionics A Shares shall be in accordance with the payment notice as issued to the AVIC Subscribers by the underwriter of AVIC Avionics.

The aviation and airborne equipment manufacturing industry is a typically high-tech, high-value-added and high-risk strategic industry which is knowledge, technology and capital-intensive. The aviation industry in China is experiencing a rapid growth, and puts high requirements on research and development and modification of airborne equipment, which requires a large amount of funds investment.

In order to cope with the national industrial policies and industry development trends, the Group will require capital to improve its production capacity and facilities so as to enhance its production efficiency, product competitiveness and expand its market shares, so that the production tasks can be successfully completed. Although AVIC Avionics and AVIC Electromechanical have

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issued convertible corporate bonds to raise approximately RMB2,400 million and RMB2,100 million in 2017 and 2018 respectively, AVIC Avionics has utilised most of and AVIC Electromechanical has fully utilised the proceeds raised from the issue of the convertible corporate bonds.

Furthermore, with the increase in market demand, there was continuous increase in revenue for AVIC Avionics and AVIC Electromechanical from 2019 to 2021, with a compound annual growth rate of 8.78% and 8.81%, respectively. As a result, in order to meet the increasing orders from customers, AVIC Avionics and AVIC Electromechanical had to purchase more raw materials for production and expand storage and budgets, resulting in the continuous growth of inventories. For the three years ended 31 December 2021, the inventories of AVIC Avionics amounted to RMB3,962 million, RMB4,747 million and RMB6,112 million, and the inventories of AVIC Electromechanical amounted to RMB4,489 million, RMB5,277 million and RMB6,228 million, respectively. With the increase in inventories and accounts receivable alongside with the increase in revenue of AVIC Avionics and AVIC Electromechanical, there will be an increase in demand for the working capital of the Enlarged Group so as to maintain its cashflow position.

Therefore, in order to support the long-term development of AVIC Avionics and the Enlarged Group, the Board is of the view that there is an imminent need to perform the fund raising after the Completion, so as to provide capital for the enhancement of the production capacity and supplement working capital of the Enlarged Group to ensure the stable development of the Enlarged Group and cope with the national industrial policies and industry development trends.

Considering:

- (i) the restriction on the size of the offering under Offering Regulation Q&A – Regulatory Requirements for Guiding and Regulating the Financing Conduct of Listed Companies (Revision) (2020)\* (發行監管問答–關於引導規範上市公司融資行為的監管要求(修訂版)), which states that if a listed company applies for a non-public offering of shares, for the purposes of equity fundraising (including subscription of shares) the number of shares to be issued shall not exceed 30% of the total shares before the offering. As at 31 May 2022, the total number of AVIC Avionics A Shares in issue was 1,928 million. Therefore, the maximum number of shares to be issued in connection with the Subscription will be 578 million and assuming the Subscription Price is RMB18.32 (for details of the basis of determination, please refer to the paragraph headed "Subscription Price" below), the maximum size of the Subscription amount will be approximately RMB10,589 million. The aforementioned regulatory requirement is not applicable to the Share Swap and Absorption as the relevant issuance of shares was not for the purpose of equity fundraising.
- (ii) as disclosed in the section headed "Use of Proceeds" in this circular, it is estimated that the Company would require approximately RMB2,106 million for expansion of production facilities of the Group;

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- (iii) the expected working capital amount of RMB3,147 million required for AVIC Avionics from 2022 to 2024 after absorbing AVIC Electromechanical calculated based on the percentage of current assets and current liabilities to operating income of AVIC Avionics and AVIC Electromechanical for the year ended 31 December 2021; and
- (iv) the prevailing A shares market situation in the PRC and the long term development of the Enlarged Group,

the Board is of the view that the Subscription amount of RMB5,000 million will be a feasible fundraising amount that complies with the relevant laws and regulations in the PRC and fulfills the needs of the Company at the same time. Therefore, the Board is of the view that the total amount of fund raising is fair and reasonable.

### Subscription Price

The Subscription Price will be determined by the underwriters for the Subscription and the board of directors of AVIC Avionics after:

1. CSRC has approved the Subscription;
2. the board of directors of AVIC Avionics have obtained the authorisation from the shareholders' meeting of AVIC Avionics in accordance to the relevant laws and regulations; and
3. considering the price quotation provided by the Subscribers during the price consultation process.

In any event, the Subscription Price shall not be lower than 80% of the average trading price (the "Average Trading Price") of AVIC Avionics A Shares for the 20 trading days prior to the price determination date of the Subscription (being the first day of the Subscription), with ex-rights and ex-dividend events adjustment. The Average Trading Price was determined based on the regulations under the Administrative Measures, pursuant to which the issue price of any non-public issued shares shall not be lower than 80% of the average trading price of the shares for the 20 trading days prior to the price determination date.

Considering:

- (i) the Subscription Price determination mechanism as mentioned above, in particular the Subscription Price will be determined based on the price quotation provided by the Subscribers during the price consultation process;
- (ii) the Subscription Price determination mechanism complies with the relevant laws and regulations in the PRC, such as the Administrative Measures, the Detailed Implementation Rules for the Non-Public Offering of Stocks of Listed Companies (2020 Revision)\* (上市公司非公开发行股票实施细则) and the Material Asset Restructuring Measures; and

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- (iii) assuming 10 June 2022 (being the date of the Share Swap and Absorption and Subscription announcement of the Company) is the first day of the Subscription, the low-end of the Subscription Price, being 80% of the Average Trading Price (as adjusted by AVIC Avionics' 2021 profit distribution plan), is RMB14.65 per share and it is higher than the net asset value per AVIC Avionics A Shares of RMB5.83 per share as at 31 December 2021,

the Board considers that the Subscription Price is fair and reasonable.

The Company, AVIC Aviation Industry Investment, AVIC Shenfei and Chengdu Aircraft Industry will not participate in the price consultation process of the Subscription. However, they will accept the results of the price consultation process and subscribe for AVIC Avionics A Shares with the Subscription Price. If the Subscription Price is not determined by the price consultation process, the Company, AVIC Aviation Industry Investment, AVIC Shenfei and Chengdu Aircraft Industry will subscribe AVIC Avionics A Shares at 80% of the Average Trading Price.

If any ex-rights and ex-dividend events, such as distribution of cash dividends, stock dividends, conversion of capital reserves to share capital and allotment of shares, occurs on any of the 20 trading days (including both the starting and the end date) prior to the first day of the Subscription, the trading price on the date prior to the occurrence of such ex-rights and ex-dividend event shall be adjusted as the trading price after the ex-rights and ex-dividend event. If any of the abovementioned ex-rights and ex-dividend events occur between the first date of the Subscription and the last date of the Subscription (including both days), the Subscription Price will be adjusted according to the relevant regulations of CSRC and the Shanghai Stock Exchange.

The AVIC Subscribers will use their own capital to finance the Subscription. They shall pay the total Subscription amount to the designated bank account for Subscription opened by the underwriter after the effective date of the Subscription Agreement and receipt of the payment notice issued by the underwriter.

### **Lock-up Period**

The AVIC Subscribers undertake not to transfer any of their subscribed AVIC Avionics A Shares within 18 months after the Subscription. For Subscribers other than the AVIC Subscribers, they will undertake not to transfer any of their subscriber AVIC Avionics A Shares within 6 months after the Subscription.

The lock-up period is determined with reference to the regulations under the Administrative Measures, pursuant to which the lock-up period for any non-public issued shares of a listed company subscribed by: (i) independent subscribers shall be 6 months, and (ii) controlling shareholder, actual controller or a corporation controlled by the controlling shareholder or actual controller of a listed company shall be 18 months. As AVIC is the actual controller of AVIC Avionics and AVIC Subscribers are companies controlled by AVIC, the lock-up period for AVIC Subscribers is therefore 18 months.

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## LETTER FROM THE BOARD

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### Conditions precedent

The Subscription Agreements shall take effect upon the satisfaction of the following conditions:

- 1) the Subscription Agreements having been duly signed by AVIC Avionics, the Company, AVIC Aviation Industry Investment, AVIC Shenfei and Chengdu Aircraft Industry;
- 2) the Subscription having obtained all effective approvals from the board of directors and shareholders pursuant to the articles and associations of AVIC Avionics and AVIC Electromechanical;
- 3) the Share Swap and Absorption Agreement having become effective;
- 4) the Subscription having obtained all effective approvals from (i) the Board and Shareholders pursuant to the articles and associations of the Company; (ii) the internal investment decision making body of AVIC Aviation Industry Investment; (iii) the board of directors and shareholders pursuant to the articles and associations of AVIC Shenfei; and (iv) the internal investment decision making body of Chengdu Aircraft Industry;
- 5) the Subscription having completed all the regulatory procedures of the Stock Exchange; and
- 6) the Subscription having obtained approvals from SASTIND, SASAC and CSRC.

### Other fundraising alternatives

Based on the Exchange Ratio of 1: 0.6647, the total AVIC Avionics A Shares is estimated to be 4,510 million after the Completion. Assuming that the total amount of proceeds from the Subscription is RMB5,000 million and the Subscription Price is RMB18.32 per share, the number of shares the original shareholders of AVIC Avionics to be issued in connection with the Subscription will be 273 million. Accordingly, should the original shareholders of AVIC Avionics decide not to participate in the Subscription, the shareholding of AVIC Avionics A Shares held by the original shareholders of AVIC Avionics will be diluted by 5.71% after the completion of the Subscription.

The Company has considered other alternative fundraising methods, such as debt financing. However, despite the dilution effect mention above, the Company considers that compare to debt financing, the Subscription is currently the most feasible fundraising method to the Company during to the following reason:

- debt financing may incur interest burden on the Group and will increase the ongoing interest expenses of the Group which may in turn affect the gearing ratio and profitability of the Company. As at 31 May 2022, the asset-liability ratios of AVIC Avionics and AVIC Electromechanical were 55.38% and 50.51% respectively, which were higher than other comparable A share listed companies in the Shenwan Aviation Equipment II Index (801742.SI) which had an average gearing ratio of 37.94% as at 31

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## LETTER FROM THE BOARD

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December 2021. As debt financing may incur interest and burden on the Group, it will increase the ongoing interest expenses of the Group affect the asset-liability ratio and profitability of the Company. On the other hand, the fund raised from Subscription may decrease the asset-liability ratio of the AVIC Avionics and enhance its financial stability. Assuming the funds raised from the Subscription is RMB5,000 million, it is expected that the pro forma asset-liability ratio of the AVIC Avionics as at 31 May 2022 will reduce from 52.46% to 48.49%, which makes the asset-liability ratio of the AVIC Avionics more comparable to that of its peer companies;

- In the situation of the Subscription, assuming that (i) the Subscription Price is RMB18.32 per share (being the average trading price of AVIC Avionics A Shares for the 20 trading days prior to the price determination date of the Subscription adjusted with ex-rights and ex-dividend events); and (ii) the proceeds from the Subscription is RMB5,000 million, the number of AVIC Avionics A Shares will increase from 4,510 million to 4,783 million. In the situation of a debt financing, the number of AVIC Avionics A Shares remains at 4,510 million, but additional financial costs for issuing bonds will be involved. According to WIND statistics, the average interest rate of corporate bonds issued from 1 January 2022 to 17 August 2022 is 3.43%. Assuming that the interest rate of the debts issued by AVIC Avionics is also 3.43% and the income tax rate is 15%, the annual after-tax finance costs will increase by approximately RMB146 million based on the amount of RMB5,000 million of bonds issued. Considering the above, the earning per share of AVIC Avionics after Share Swap and Absorption and debt financing is expected to be RMB0.4329 and RMB0.4267, respectively. Therefore, the earning per share of AVIC Avionics after completion of the Subscription is higher than that of after completion of debt financing; and
- debt financing may also be subject to lengthy due diligence and negotiations with the banks, which may be relatively uncertain and time-consuming. On the other hand, the time required for Subscription is relatively shorter compared to that of debt financing.

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## LETTER FROM THE BOARD

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### Use of Proceeds

The total amount of proceeds from the Subscription will not exceed RMB5,000 million (inclusive). Net proceeds after deducting the relevant tax expenses and fees for agencies shall be applied in the following items:

No.	Project	Investment amount	Proposed use of proceeds	<i>Unit: RMB million</i> Expected timeline for the use of the proceeds
1	Expanding production capacity of air bleed subsystem	739.80	721.10	36 months
2	Expanding production capacity of hydraulic actuating system	200.00	200.00	36 months
3	Expanding production capacity of aviation power system	190.49	190.49	36 months
4	Expanding production capacity of fuel measuring and controlling system	175.00	175.00	36 months
5	Expanding production capacity of suspension and launching system	154.00	154.00	36 months
6	Expanding production capacity of actuating cylinder and locking device	152.00	152.00	36 months
7	Improving core capability of solenoid valve	150.00	150.00	36 months
8	Expanding production capacity of air refueling receptacle	145.00	145.00	36 months
9	Improving R&D and production capability of thunderbolt igniter	136.00	136.00	36 months
10	Special development for aviation pipeline	97.50	82.50	24 months
11	Supplemental working capital	<u>2,893.91</u>	<u>2,893.91</u>	<i>Note 1</i>
Total		<u><u>5,033.70</u></u>	<u><u>5,000.00</u></u>	

*Note 1*

The Group intends to use this portion of proceeds to supplement working capital for the daily operation of AVIC Avionics. Detailed plans for the use of proceeds will be determined based on the capital needs of AVIC Avionics for daily operation and production in the next three years.



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## LETTER FROM THE BOARD

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In the event the proceeds raised from the Subscription is less than RMB5,000 million, the Group will decide the sequence of the use of the proceeds and the amount of proceeds to be used in the above projects based on, including but not limited to, the investment amounts and urgency of needs of capital of the projects. The Group will prioritise projects that are more urgent and require less funds.

### D. ENTRUSTED VOTING ARRANGEMENT AGREEMENT

On 10 June 2022, the Company has entered into the Entrusted Voting Arrangement Agreement with AVIC Airborne Systems, which as at the date of this circular, owns approximately 16.42% equity interest in AVIC Avionics A Shares. Pursuant to the Entrusted Voting Arrangement Agreement, AVIC Airborne Systems will entrust the Company to exercise the voting rights of the Entrusted AVIC Avionics A Shares (including the original AVIC Avionics A Shares held by AVIC Airborne Systems, the AVIC Avionics A Shares obtained as a result of the Share Swap and Absorption from the original AVIC Electromechanical A Shares held by AVIC Airborne Systems and all new AVIC Avionics A Shares to be acquired by AVIC Airborne Systems subsequent to the signing of the Entrusted Voting Arrangement Agreement under any transfer, allotment or placing of AVIC Avionics A Shares by AVIC Avionics) held by AVIC Airborne Systems for an indefinite period until such arrangement is terminated by the Company and AVIC Airborne Systems by mutual agreement.

As disclosed in the section headed “H. Effect of The Share Swap and Absorption and the Subscription on The Shareholding Structure of AVIC Avionics” below, after the Entrusted Voting Arrangement becoming effective, the Company will be able to exercise approximately 47.54% voting right in AVIC Avionics (comprising the approximately 42.45% voting right in AVIC Avionics held by the Company and AVIC Airborne Systems and approximately 5.10% voting right in AVIC Airborne Systems held by AVIC and Hanzhong Aviation Industry (Group) Co., Ltd.\* (漢中航空工業(集團)有限公司)(“**Hanzhong Aviation Industry**”) pursuant to the acting in concert agreement entered into AVIC, Hanzhong Aviation Industry and AVIC Airborne Systems), which is higher than the original voting rights of AVIC Avionics held by the Company. AVIC Avionics will continue to be a subsidiary of the Company and consolidated in the financial statements of the Company after Completion and completion of the Subscription.

Shareholders should note that there is no notifiable transaction or connected transaction implications under the Listing Rules in relation to the Entrusted Voting Arrangement. However, the Entrusted Voting Arrangement will allow the Company to exercise approximately 47.54% voting right in AVIC Avionics and continue to consolidate AVIC Avionics in the financial statements of the Company. Therefore, the Board decided to also disclose the Entrusted Voting Arrangement in this circular as it will allow Shareholders to understand the Company's shareholding in AVIC Avionics after Completion and completion of the Subscription.

For further details of the Entrusted Voting Arrangement, please refer to the announcement published by the Company on 10 June 2022.

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## LETTER FROM THE BOARD

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### **E. INFORMATION OF THE COMPANY, AVIC, AVIC AVIATION INDUSTRY INVESTMENT, AVIC SHENFEI, CHENGDU AIRCRAFT INDUSTRY AND AVIC AIRBORNE SYSTEMS**

The Company is a joint stock limited liability company established in the PRC, whose H shares are listed on the Stock Exchange. The Company is mainly engaged in the research, development, manufacture and sales of aviation products, and relevant engineering services.

AVIC is controlled by the State Council of the PRC, and is mainly engaged in the development and manufacture of aviation products and non-aviation products. AVIC is the controlling Shareholder of the Company, holding 62.30% equity interest in the Company directly and indirectly as at the date of this circular.

AVIC Aviation Industry Investment is a limited liability company established in the PRC. It is an indirectly non-wholly owned subsidiary of AVIC. It is primarily engaged in strategic investments and merger and acquisitions in aviation-related and science and technology innovation-related businesses.

AVIC Shenfei is a joint stock limited company established in the PRC with its shares listed on the Shanghai Stock Exchange. As at the date of this circular, AVIC Shenfei is a non-wholly owned subsidiary of AVIC which owns 66.10% equity interest directly and 3.07% equity interest indirectly in AVIC Shenfei. AVIC Shenfei is principally engaged in aviation products manufacturing, including products such as aviation defence equipment and civil aviation products.

Chengdu Aircraft Industry is a limited liability company established in the PRC. It is a wholly-owned subsidiary of AVIC. It is primarily engaged in development, production and export of aviation weapons and equipment and manufacture of civil aircraft components.

AVIC Airborne Systems is a limited liability company established in the PRC and a wholly-owned subsidiary of AVIC. AVIC Airborne Systems is mainly engaged in investment and management of the development, production and sales of airborne electromechanical systems and equipment supporting various types of aircraft and engines.

### **F. INFORMATION OF AVIC AVIONICS**

AVIC Avionics is a joint stock limited liability company established in the PRC, whose A shares are listed on the Shanghai Stock Exchange. As at the date of this circular, the Company owns 39.43% equity interest in AVIC Avionics and it is a non-wholly owned subsidiary of the Company. It is mainly engaged in the manufacture of avionics products and related accessories.

#### **Financial information of AVIC Avionics**

Set out below is a summary of the consolidated financial information of AVIC Avionics for the three years ended 31 December 2021 and five months ended 31 May 2022, prepared in accordance with the China Accounting Standards for Business Enterprises:

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**LETTER FROM THE BOARD**

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	For the year ended 31 December			for the five months ended 31 May 2022
	2019	2020	2021	May 2022
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
	<i>(million)</i>	<i>(million)</i>	<i>(million)</i>	<i>(million)</i> (unaudited)
Revenue	8,352.19	8,746.61	9,839.30	3,722.10
Net Profit before tax	631.11	719.48	881.09	340.50
Net Profit after tax	578.61	655.34	817.72	319.02
				As at
				31 May
	2019	2020	2021	2022
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
	<i>(million)</i>	<i>(million)</i>	<i>(million)</i>	<i>(million)</i> (unaudited)
Net assets attributable to owners	7,840.42	10,626.33	11,236.85	11,394.28

Please refer to Appendix II of this circular for the financial information of AVIC Avionics.

**G. INFORMATION OF AVIC ELECTROMECHANICAL**

AVIC Electromechanical is a joint stock limited liability company established in the PRC on 5 December 2000 with its shares listed on the Shenzhen Stock Exchange. AVIC Electromechanical is mainly engaged in development, production, sales and service of airborne electromechanical systems and equipment for all types of aircraft and engines. As at the date of this circular, AVIC Electromechanical is a connected person of the Company by virtue of being owned as to 51.97% by AVIC (i.e. the controlling shareholder of the Company), directly and indirectly through several of its subsidiaries. The Company has no interest in AVIC Electromechanical as at the date of this circular. At the time of establishment of AVIC Electromechanical, Life Saving Research Institute subscribed for 25.30 million shares at a consideration of RMB38.5 million for 84.33% of equity interest in AVIC Electromechanical. At the time of establishment of AVIC Electromechanical, Life Saving Research Institute was controlled by China Aviation Industry Corporation I (中國航空工業第一集團). In 2008, China Aviation Industry Corporation I merged with China Aviation Industry Corporation II (中國航空工業第二集團) to form AVIC and AVIC has since become the actual controller of Life Saving Research Institute.

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## LETTER FROM THE BOARD

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### Financial information of AVIC Electromechanical and its subsidiaries

Set out below is a summary of the consolidated financial information of AVIC Electromechanical and its subsidiaries for the three years ended 31 December 2021 and five months ended 31 May 2022, respectively, prepared in accordance with the China Accounting Standards for Business Enterprises:

	For the year ended 31 December			For the five months ended
	2019	2020	2021	31 May
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
	<i>(million)</i>	<i>(million)</i>	<i>(million)</i>	<i>(million)</i>
Revenue	12,131.38	12,224.10	14,992.20	6,712.69
Net Profit before tax	1,244.38	1,346.58	1,529.35	631.70
Net Profit after tax	1,058.42	1,143.80	1,351.83	550.27
				As at
				31 May
	2019	2020	2021	2022
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
	<i>(million)</i>	<i>(million)</i>	<i>(million)</i>	<i>(million)</i>
Net assets attributable to owners	9,749.62	12,913.06	13,991.10	13,983.45

Please refer to Appendix IV of this circular for the accountants' report of AVIC Electromechanical and its subsidiaries.

### H. EFFECT OF THE SHARE SWAP AND ABSORPTION AND THE SUBSCRIPTION ON THE SHAREHOLDING STRUCTURE OF AVIC AVIONICS

Assuming: (i) no Opposing AVIC Avionics Shareholders and Opposing AVIC Electromechanical Shareholders have exercised their Appraisal Rights; (ii) the Subscription Price is RMB18.32 per share (being the average trading price of AVIC Avionics A Shares for the 20 trading days prior to the price determination date of the Subscription adjusted with ex-rights and ex-dividend events); and (iii) the proceeds from the Subscription is RMB5,000 million, of which the total subscription amount of the AVIC Subscribers (as defined below) is RMB1.16 billion, the shareholding of AVIC Avionics after the Share Swap and Absorption and the Subscription will be as follows:

## LETTER FROM THE BOARD

Name of shareholders	Before the Share Swap and Absorption and the Subscription		After the Share Swap and Absorption but before the Subscription		After the Share Swap and Absorption and the Subscription	
	Number of shares	Percentage of shareholding	Number of shares	Percentage of shareholding	Number of shares	Percentage of shareholding
	('million)	(%)	('million)	(%)	('million)	(%)
the Company	760.32	39.43	760.32	16.86	787.61	16.47
AVIC Airborne Systems	316.51	16.41	1,242.77	27.55	1,242.77	25.98
AVIC	142.29	7.38	184.01	4.08	184.01	3.85
Hanzhong Aviation Industry <sup>1</sup>	59.63	3.09	59.63	1.32	59.63	1.25
China Aviation Industry Supply and Marketing Co., Ltd.* (中國航空工業供銷有限公司) <sup>2</sup>	1.19	0.06	1.19	0.03	1.19	0.02
China Aviation Life Saving Research Institute* (中國航空救生研究所) ("Life Saving Research Institute")	-	-	267.80	5.94	267.80	5.60
AVIC Aviation Industry Investment	-	-	77.46	1.72	93.84	1.96
AVIC Investment Holdings Co., Ltd.* (中航投資 控股有限公司)	-	-	22.68	0.50	22.68	0.47
Guizhou Gaike Aviation Electromechanical Co., Ltd.* (貴州蓋克航空機電有限責任公司)	-	-	6.15	0.14	6.15	0.13
AVIC Shenfei	-	-	-	-	9.83	0.21
Chengdu Aircraft Industry	-	-	-	-	9.83	0.21
Other independent shareholders	648.27	33.62	1,888.45	41.87	2,098.06	43.86
<b>Total:</b>	<b>1,928.21</b>	<b>100</b>	<b>4,510.46</b>	<b>100</b>	<b>4,783.38</b>	<b>100</b>

*Notes:*

1. Hanzhong Aviation Industry is an indirect non-wholly-owned subsidiary of AVIC.
2. China Aviation Industry Supply and Marketing Co., Ltd. is an indirect non-wholly-owned subsidiary of AVIC.
3. Life Saving Research Institute is a national defence science and technology institute initiated by AVIC.
4. AVIC Investment Holdings Co., Ltd. is an indirect non-wholly-owned subsidiary of AVIC.
5. Guizhou Gaike Aviation Electromechanical Co., Ltd. is an indirect non-wholly-owned subsidiary of AVIC.

### I. FINANCIAL EFFECTS OF THE SHARE SWAP AND ABSORPTION AND THE SUBSCRIPTION

Upon Completion and completion of the Subscription, AVIC Avionics will take over all the assets, liabilities, business operation, employees, contracts and other rights and obligation of AVIC Electromechanical and its subsidiaries, and AVIC Electromechanical will apply to delist from the Shenzhen Stock Exchange and deregistration. Furthermore, upon completion of the Subscription and the Entrusted Voting Arrangement becomes effective, the Company will hold approximately 47.54% voting right in AVIC Avionics and AVIC Avionics will continue to be a subsidiary of the Company.

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## LETTER FROM THE BOARD

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It is expected that the total revenue, assets and liabilities of the Group will increase. Based on the current information available, it is also expected that upon Completion and the completion of the Subscription, the earnings attributable to owners of the Company contributed by AVIC Avionics will increase slightly.

### **Revenue**

For the year ended 31 December 2021, the revenue of the Group was approximately RMB60,296 million. Assuming the Share Swap and Absorption and the Subscription was completed on 1 January 2021, the revenue of the Enlarged Group would increase by approximately 23.07% to approximately RMB74,207 million. For further details, please refer to Appendix V of this circular for the unaudited pro forma financial information of the Enlarged Group.

### **Assets and liabilities**

The assets and liabilities of the Group are estimated to be increased by approximately RMB36,251.88 million and increased by approximately RMB16,100.86 million respectively after the Completion and the completion of the Subscription. The estimated increase in assets and increase in liabilities of the Group after the Completion and the completion of the Subscription are arrived at by inclusion of the assets and liabilities of AVIC Electromechanical and its subsidiaries as at 31 May 2022, assuming the Share Swap and Absorption and the Subscription took place on 30 June 2022.

For details, please refer to note 4-note 7 of the pro forma adjustments set out from page 439 of the Appendix V to this circular.

### **Earnings**

For the year ended 31 December 2021, the Group recorded net profit attributable to owners of approximately RMB2,369 million and earnings per Share of approximately RMB0.307. Based on Appendix V to the circular, it is estimated that upon the Completion and the completion of the Subscription, the net profit attributable to owners of the Enlarged Group would be approximately RMB2,435 million, representing an increase of approximately 2.78% as compared to the net profit attributable to owners of the Group for the year ended 31 December 2021, and earnings per Share would be approximately RMB0.316, representing an increase of approximately 2.93% as compared to the earning per Share of the Group for the year ended 31 December 2021.

Shareholders should note that the financial effects are shown for reference only and the actual amount of gain or loss as a result of the Share Swap and Absorption and the Subscription will be assessed based on the financial position of the Company as at Completion and completion of the Subscription, which will be audited, and eventually be recognised in the consolidated financial statements of the Company.

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## LETTER FROM THE BOARD

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### **J. REASONS FOR AND BENEFITS OF THE SHARE SWAP AND ABSORPTION AND THE SUBSCRIPTION**

The Share Swap and Absorption and the Subscription will help the Company to expand the scale, optimise the aviation industry chain and enhance the market value of the Company and its subsidiaries in accordance with the established strategy of optimising the industrial structure, promote the investment and integration of aviation ancillary systems. Pursuant to the Outline of the Fourteenth Five-Year Plan for the National Economic and Social Development and the Long-Range Objectives Through the Year 2035” (國民經濟和社會發展第十四個五年規劃和2035年遠景目標綱要), the new generation of aviation equipment has become a key development direction of the PRC, which also drives the development of aviation equipment industry chain. As an important part of the aviation equipment industry and the core area of aviation equipment upgrading, airborne systems have ushered in a good opportunity for development. As the main supplier and leading enterprise in the avionics system and aviation electromechanical market, the integration of AVIC Avionics and AVIC Electromechanical will realise the professional integration of avionics systems and electromechanical systems, which is conducive to improving the efficiency of resource allocation, and laying a good foundation for the systemisation, integration and intelligentisation development of the aviation and airborne industry, thereby further improve the professional level and core competitiveness of the Group to build an aviation and airborne industry with international competitiveness. Furthermore, the integration of AVIC Avionics and AVIC Electromechanical could generate product, customer and market and technology, research and development synergies, illustrated as follows:

#### **Product synergy**

From a global perspective, the aviation airborne industry has shown a development trend of systematisation, integration and intelligentisation, and some of the major players in the international aviation industry have formed a specialised airborne research and production system. In recent years, AVIC Avionics and AVIC Electromechanical have carried out the professional integration of their respective segments through capital injections and trusteeships. The Board believes that the Share Swap and Absorption and the Subscription will realise the deep integration of avionics system and electromechanical system at the level of airborne industry, which is in line with the global trend and will further enhance the overall strength of the Group’s airborne system.

#### **Customer and market synergy**

The major market of China's avionics and aviation electromechanical industries include the Aviation OEMs manufacturers in the aviation field, defense field. The major customers of AVIC Avionics and AVIC Electromechanical are similar. After the Completion and completion of the Subscription, the Enlarged Group may fully integrate internal sales channel resources, share customers and enhance aviation airborne system solutions for customers, which is conducive to further market expansion.

#### **Technology, research and development synergy**

The Share Swap and Absorption and the Subscription is in line with the global aviation airborne industry trend and sets a good example to the integration model of aviation industry. After the Completion and completion of the Subscription, the Enlarged Group may develop digitalised

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## LETTER FROM THE BOARD

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system research and development, build a collaborative research and development cloud, congregate research and development resources and realise technology, research and development synergy, which will help to improve the overall development level and strength of China's airborne systems, accelerate major breakthroughs in the key technology areas of airborne systems, enhance our ability to undertake major national airborne tasks, and ensure our supply capacity to downstream enterprises in the aviation industry chain in order to promote the development of aviation industry.

Furthermore, the Subscription would allow AVIC Avionics to improve its capital structure and financial situation. Assuming the completion of the Subscription took place in early 2021, as at 31 May 2022 the assets to liabilities ratio of AVIC Avionics would decrease from 52.46% before the Subscription to 48.49% after the Subscription.

Furthermore, the project constructions and the general working capital will further the business development of AVIC Avionics and provide the Enlarged Group with capital support for the research and production, improve research and production capability and enhance its productivity, thereby improving the competitiveness of products and expanding the market share and enhancing the profitability.

The Directors (excluding the independent non-executive Directors who will form their view after considering the advice of the Independent Financial Adviser) consider that the terms under the Share Swap and Absorption Agreement and the Subscription Agreements which are negotiated on an arm's length basis are on normal commercial terms or better, and the Share Swap and Absorption and the Subscription by the Company are fair and reasonable and in the interests of the Company and the Shareholders as a whole. Furthermore, the Directors (including the independent non-executive Directors) consider that the Subscription by AVIC Aviation Industry Investment, AVIC Shenfei and Chengdu Aircraft Industry are fair and reasonable and in the interests of the Company and the Shareholders as a whole.

### K. LISTING RULES IMPLICATIONS

#### **Acquisition of AVIC Electromechanical and Deemed Disposal**

As the highest applicable percentage ratio calculated pursuant to Chapter 14 of the Listing Rules in respect of the acquisition of AVIC Electromechanical under the Share Swap and Absorption exceeds 100%, the Share Swap and Absorption, if materialised, will constitute a very substantial acquisition for the Company under Chapter 14 of the Listing Rules.

Furthermore, upon Completion, the shareholding of the Company in AVIC Avionics will reduce from 39.43% to 16.86%. Therefore, the Share Swap and Absorption will also constitute a Deemed Disposal of AVIC Avionics under the Listing Rules. As the highest applicable percentage ratio calculated pursuant to Chapter 14 of the Listing Rules in respect of the Deemed Disposal exceeds 75%, the Deemed Disposal of AVIC Avionics will constitute a very substantial disposal for the Company under Chapter 14 of the Listing Rules.

As at the date of this circular, AVIC Electromechanical is a connected person of the Company by virtue of being owned as to 51.97% by AVIC (i.e. the controlling shareholder of the Company), directly and indirectly through its subsidiaries. The Company has no interest in AVIC Electromechanical as at the date of this circular. Therefore, the Share Swap and Absorption



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## LETTER FROM THE BOARD

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constitutes a connected transaction of the Company under Chapter 14A of the Listing Rules and is subject to the relevant reporting, announcement, circular and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

### **Subscription of AVIC Avionics A Shares by the Company**

Upon completion of the Subscription, the shareholding the Company in AVIC Avionics will reduce from 16.86% to 16.47%. Therefore, the Subscription by the Company will constitute a Deemed Disposal of AVIC Avionics under Chapter 14 of the Listing Rules. As the highest applicable percentage ratio calculated pursuant to Chapter 14 of the Listing Rules in respect of the Subscription by the Company exceeds 5% but below 25%, the Subscription, if materialised, will constitute a discloseable transaction of the Company under Chapter 14 of the Listing Rules.

As at the Latest Practicable Date, AVIC Avionics is a subsidiary of the Company. Furthermore, it is also a connected subsidiary of the Company by virtue of being owned as to 16.41% by AVIC Airborne Systems, a wholly-owned subsidiary of AVIC. Therefore, the Subscription of AVIC Avionics A Shares by the Company, if materialised, will constitute a connected transaction of the Company under Chapter 14A of the Listing Rules. As the highest of the applicable percentage ratio (other than the profits ratio) in respect of the Subscription of AVIC Avionics A Shares by the Company exceeds 5%, the Subscription of AVIC Avionics A Shares by the Company is subject to the relevant reporting, announcement, circular and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

The Share Swap and Absorption and Subscription were approved by the Board. Mr. Zhang Minsheng, an executive Director and chairman of the Board, who is a chief accountant of AVIC, and Mr. Li Xichuan, a non-executive Director, who is a deputy department chief of AVIC Industry-Finance Holdings Co., Ltd.\* (中航工業產融控股股份有限公司), which is a non-wholly owned subsidiary of AVIC, had abstained from voting on the relevant Board resolution approving the Share Swap and Absorption and Subscription in accordance with the Company Law of the PRC and the Listing Rules.

Save as disclosed above, none of the other Directors has or is deemed to have a material interest in such transactions.

## **L. PROPOSED CHANGE OF DIRECTOR**

### **The Resignation**

The Board hereby announces that, due to change in work arrangement, Mr. Li Xichuan ("Mr. Li") applied to the Board for resignation from his position as the non-executive Director and the member of Development and Strategy Committee with effect upon the appointment of the candidate for new Director has been approved at the EGM of the Company. Mr. Li has confirmed that he has no disagreement with the Board and there is no matter that needs to be brought to the attention of the Board and the Shareholders in respect of the resignation.

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## LETTER FROM THE BOARD

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The Company would like to express its sincere gratitude to Mr. Li for his valuable contributions to the Company during his term of service.

### **Proposed appointment of director**

The Board is pleased to announce that at the Board meeting held on 30 August 2022, Mr. Liu Bingjun (“Mr. Liu”) has been nominated as the candidate for non-executive Director with a term of office commencing from the date on which his proposed appointment is approved at the EGM until the date on which the resolution relating to the election of the Board will be considered at the annual general meeting to be convened in 2024. The salary of Mr. Liu will be determined by the Remuneration Committee of the Company by reference to his qualifications, experience and the prevailing market conditions, subject to the authorization of the EGM. As at the date of this circular, no director service contract has been entered into between Mr. Liu and the Company. Details of the remuneration of Directors will be disclosed in the Company’s annual reports.

The biographical details of Mr. Liu are set out as follows:

Mr. Liu Bingjun (劉秉鈞), 46, a master degree holder. Mr. Liu has served as the director of Asset Enterprise Management Department of China Aviation Industry Corporation II (中國航空工業第二集團公司); senior business manager of Capital Operation Department of AVIC; director of Listing Office and vice director of Securities Affairs Department of AVIC Helicopter; vice director of Planning and Development Department, vice president and board secretary of AVICOPTER; and vice director of Compliance and Risk Control Department of the Company. Since April 2022, Mr. Liu has served as vice director of the Capital Operation Department of AVIC.

As far as the Directors are aware, save as disclosed above, as at the date of this circular, Mr. Liu does not hold any directorships in other public listed companies. Mr. Liu does not have any relationship with any Director, supervisors, senior management or substantial or controlling Shareholders, and does not have any interests or short positions within the meaning of Part XV of the Securities and Futures Ordinance in the shares, underlying shares or debentures of the Company or any of its associated corporations.

Save as disclosed above, there is no other information that is required to be disclosed pursuant to Rule 13.51(2)(h) to (v) of the Listing Rules nor are there any matters that need to be brought to the attention of the Shareholders in relation to the proposed appointment of Mr. Liu.

### **M. EGM**

The EGM will be held at 9 a.m. on Wednesday, 26 October 2022 at 6/F, Building A, No. 14 Xiaoguan Dongli, Andingmenwai, Chaoyang District, Beijing, the People’s Republic of China. The notice of the EGM is set out on pages EGM-1 to EGM-3 of this circular.

A form of proxy for use at the EGM are also enclosed. Shareholders who intend to appoint a proxy to attend the EGM shall complete and return the enclosed form of proxy in accordance with the instructions printed thereon as soon as possible and in any event no later than 24 hours before the time fixed for the

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## LETTER FROM THE BOARD

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holding of EGM or any adjournment thereof (as the case may be). Completion and return of the form of proxy will not preclude you from attending and voting in person at the EGM or any adjournment thereof (as the case may be).

As at the Latest Practicable Date, AVIC is a controlling Shareholder of the Company, holding directly and indirectly 3,553,069,569 H Shares and 1,250,899,906 domestic shares in the Company, representing 62.30% equity interest in the Company. AVIC and its associates will abstain from voting at the EGM in respect of the ordinary resolutions to be proposed in relation to the Share Swap and Absorption Agreement and Subscription Agreements and the transactions contemplated thereunder.

To the best knowledge of the Directors after having made all reasonable enquiries, apart from AVIC and its associates, holding 3,553,069,569 H Shares and 1,250,899,906 domestic shares in the Company, no other Shareholder has a material interest in the transactions contemplated under the Share Swap and Absorption Agreement, Subscription Agreements and the proposed appointment of Director and therefore no other Shareholder will be required to abstain from voting at the EGM in respect of the ordinary resolutions to be proposed in relation to the Share Swap and Absorption Agreement, Subscription Agreements, the transactions contemplated thereunder and the proposed appointment of Director.

Pursuant to Rule 13.39(4) of the Listing Rules, all votes at the EGM will be taken by poll. The Company will announce the results of the poll in accordance with the Listing Rules following the EGM.

### N. RECOMMENDATION

Your attention is drawn to (i) the letter from the Independent Board Committee set out on page 33 of this circular which contains the recommendation of the Independent Board Committee containing its opinion and recommendations on the Share Swap and Absorption Agreement and Subscription Agreements and the transactions contemplated thereunder; (ii) the letter from Maxa Capital, the Independent Financial Adviser, set out on pages 34 to 57 of this circular which contains its advice on the connected transactions contemplated under the Share Swap and Absorption Agreement and Subscription Agreements to the Independent Board Committee and the Independent Shareholders; and (iii) additional information set out in the appendices to this circular.

The Directors (including the independent non-executive Directors) consider that the proposed appointment of Mr. Liu as the non-executive Director is in the interests of the Company and the Shareholders as a whole. Accordingly, the Directors (including the independent non-executive Directors) recommend the Shareholders to vote in favour of the ordinary resolution to approve the proposed appointment of Mr. Liu as the non-executive Director at the EGM.

The Directors and the Independent Board Committee, having taken into account the advice of Maxa Capital, consider that the ordinary resolutions as set out in the notice of the EGM, in relation to the Share Swap and Absorption Agreement and Subscription Agreements and the transactions contemplated thereunder is fair and reasonable and in the interests of the Company and the Shareholders as a whole. Accordingly, the Directors and the Independent Board Committee recommend the Independent Shareholders to vote in favour of the ordinary resolutions in relation to the Share Swap and Absorption Agreement and the Subscription Agreements and the transactions contemplated thereunder to be proposed at the EGM.

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**LETTER FROM THE BOARD**

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As the completion of the Share Swap and Absorption and Subscription is subject to the fulfilment of conditions precedent of the Share Swap and Absorption Agreement and Subscription Agreements, and may or may not proceed, Shareholders and potential investors are advised to exercise caution when dealing in the H Shares of the Company.

Yours faithfully,

By Order of the Board

**AviChina Industry & Technology Company Limited\***

**Xu Bin**

*Company Secretary*

