

16 January 2023

To the Independent Board Committee and the Independent Shareholders

Dear Sirs,

**CONTINUING CONNECTED TRANSACTIONS AND MAJOR TRANSACTIONS
REVISION OF ORIGINAL ANNUAL CAPS AND ENTERING INTO OF
THE SUPPLEMENTAL CONTINUING CONNECTED TRANSACTIONS
FRAMEWORK AGREEMENTS**

INTRODUCTION

We refer to our appointment as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the Transactions, details of which are set out in the letter from the Board (the “**Letter from the Board**”) contained in the circular dated 16 January 2023 issued by the Company (the “**Circular**”) of which this letter forms part. Terms used in this letter shall have the same meanings as those defined in the Circular unless the context requires otherwise.

References are made to the announcement of the Company dated 21 August 2020 (the “**2020 Announcement**”) and the circular of the Company dated 10 November 2020 (the “**2020 Circular**”) in relation to the renewal of the Existing Continuing Connected Transactions Framework Agreements. References are also made to the announcement of the Company dated 10 June 2022 and the circular of the Company dated 29 September 2022 in relation to the acquisition and absorption of AVIC Electromechanical by AVIC Avionics.

In view of the acquisition and absorption of AVIC Electromechanical by AVIC Avionics, the Board envisages that the scope of businesses and scale of operation of the Group will increase and the scope of goods and services to be provided/obtained by the Group under the Existing Continuing Connected Transactions Framework Agreements will be insufficient. Therefore, on 28 October 2022 (after trading hours), the Company entered into the Supplemental Continuing Connected Transactions Framework Agreements to amend the scope of goods and services to be provided/obtained by the Group under the Existing Mutual Product and Service Supply and Guarantee Agreement as well as the maximum daily deposit amount under the Existing Financial Service Framework Agreement. All other terms and conditions under the Existing Continuing Connected Transactions Framework Agreements shall remain the same.

Furthermore, the Board also envisages that the Original Annual Caps under the Existing Continuing Connected Transactions Framework Agreements will be insufficient. Therefore, the Board also proposes to revise and increase the annual caps under the Existing Continuing Connected Transactions Framework Agreements.

As at the Latest Practicable Date, AVIC is a controlling shareholder of the Company holding directly and indirectly 62.30% of all issued Shares. AVIC Finance is a subsidiary of AVIC and AVIC Avionics is a connected subsidiary of the Company by virtue of being directly and indirectly owned as to over 10% by AVIC. Accordingly, each of AVIC, AVIC Finance and AVIC Avionics is a connected person of the Company pursuant to Chapter 14A of the Hong Kong Listing Rules. The transactions contemplated under the Existing Continuing Connected Transactions Framework Agreements and the Supplemental Continuing Connected Transactions Framework Agreements and the Proposed Annual Caps therefore constitute continuing connected transactions of the Company.

As the highest applicable percentage ratio in respect of each of the proposed annual caps (the “**Non-Exempt Annual Caps**”) of: (i) the transactions contemplated under the Existing Mutual Product Supply Agreement; (ii) the expenditure transactions contemplated under the Supplemental Mutual Product and Service Supply and Guarantee Agreement; and (iii) the Deposit Services contemplated under the Supplemental Financial Services Framework Agreement exceeds 5%, such continuing connected transactions are subject to reporting, announcement and Independent Shareholders’ approval requirements under Chapter 14A of the Hong Kong Listing Rules.

As the highest applicable percentage ratio in respect of the Deposit Services under the Supplemental Financial Services Framework Agreement exceeds 25%, the Deposit Services also constitute major transactions of the Company and are subject to the reporting, announcement and Shareholders’ approval requirements under Chapter 14 of the Hong Kong Listing Rules.

The Independent Board Committee comprising all independent non-executive Directors has been formed to advise and provide recommendations to the Independent Shareholders in respect of the Transactions. We, Maxa Capital, have been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in this regard.

OUR INDEPENDENCE

As at the Latest Practicable Date, we were independent from the Company in accordance with Rule 13.84 of the Hong Kong Listing Rules and, accordingly, are considered eligible to give independent advice on the Transactions. Apart from normal professional fees payable to us in connection with this appointment, no arrangement exists whereby we will receive any fees or benefits from the Company. Save for this appointment as the Independent Financial Adviser in respect of the Transactions, we were appointed once as the independent financial adviser in the last two years in relation to the acquisition and absorption of AVIC Electromechanical by AVIC Avionics, details of which were set out in the circular of the Company dated 29 September 2022. The aforesaid previous appointment was limited to providing one-off independent advisory service, for which Maxa Capital received normal professional fees. Accordingly, we do not consider such previous appointment gives rise to any conflict of interest for Maxa Capital in acting as the Independent Financial Adviser in respect of the Transactions.

BASIS OF OUR OPINION

In formulating our opinion, we have relied on the statements, information, opinions and representations contained in the Circular and the information and representations provided to us by the Directors and the management of the Company (the “**Management**”). We have reviewed, inter alia, the statements, the information, opinions and representations contained or referred to in the Circular and the information and representations as provided to us by the Directors and the Management. We consider that we have reviewed sufficient and relevant information and documents and have taken reasonable steps as required under Rule 13.80 of the Hong Kong Listing Rules to reach an informed view and to provide a reasonable basis for our recommendation. We have assumed that (i) all statements, information and representations provided by the Directors and the Management; and (ii) the information referred to in the Circular, for which they are solely responsible, were true and accurate at the time when they were provided and continued to be so as at the Latest Practicable Date and the Shareholders will be notified of any material changes to such information and representations before the EGM. We have also assumed that all statements of belief, opinion, intention and expectation made by the Directors in the Circular were reasonably made after due enquiry and careful consideration.

The Company confirmed that they have, at our request, provided us with all currently available information and documents which are available under present circumstances to enable us to reach an informed view and we have relied on the accuracy of the information contained in the Circular so as to provide a reasonable basis for our opinion. We have no reason to suspect that any material facts or information have been withheld or to doubt the truth, accuracy and completeness of the information and facts contained in the Circular, or the reasonableness of the representation and opinions expressed by the Company, its advisers, the Directors and the Management. We have not, however, conducted any independent verification of the information included in the Circular and provided to us by the Directors and the Management nor have we conducted any form of in-depth investigation into the business and affairs or the future prospects of the Company, AVIC, AVIC Avionics, AVIC Finance and each of their respective subsidiaries or associates.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion in respect of the Transactions, we have taken into consideration the following principal factors and reasons:

1. Background of the Transactions

1.1 Information of the Group

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.

Set out below is the summarised financial information of the Group for (i) the year ended 31 December 2019 (“FY2019”), prepared in accordance with the International Financial Reporting Standards; and (ii) the two years ended 31 December 2021 respectively and six months ended 30 June 2022, prepared in accordance with the China Accounting Standards for Business Enterprises, as extracted from the 2022 interim report, 2021 annual report and 2020 annual report of the Company:

	For the year ended 31 December			For six months ended 30 June	
	2019	2020	2021	2021	2022
	(restated)	(restated)	(audited)	(unaudited)	(unaudited)
	RMB	RMB	RMB	RMB	RMB
	(million)	(million)	(million)	(million)	(million)
Revenue	43,831.76	50,929.90	60,296.28	27,897.39	25,812.63
Net profit attributable to owners	1,347.17	1,932.99	2,369.28	1,199.15	1,153.51

	As at 31 December			As at 30 June	
	2019	2020	2021	2021	2022
	(restated)	(restated)	(audited)	(unaudited)	(unaudited)
	RMB (million)	RMB (million)	RMB (million)	RMB (million)	RMB (million)
	Total assets	107,816.13	115,648.59	133,889.14	134,498.20
Total liabilities	67,975.36	69,498.58	79,122.63	78,286.31	
Total equity	39,840.77	46,150.00	54,766.50	56,211.88	

As shown in the table above, the Group recorded steady growth in the revenue during the three years ended 31 December 2021. For the year ended 31 December 2021 (“FY2021”), the Group’s revenue amounted to approximately RMB60,296.28 million, representing an increase of approximately 18.39% as compared to that for the year ended 31 December 2020 (“FY2020”), and it is mainly attributable to the increase in revenue of the Group’s aviation entire aircraft business of approximately 6.97% and the increase in revenue of the Group’s aviation ancillary system and related business of approximately 30.00%. For FY2020, the Group recorded a revenue of approximately RMB50,929.90 million, representing an increase of approximately 16.19% as compared to that for FY2019, and it is mainly attributable to the increase of sales volume of helicopter products and connector products. The Group recorded profit attributable to owners of approximately RMB2,369.28 million in FY2021, representing an increase of approximately 22.57% as compared to that for FY2020, and it is mainly attributable to the increase of revenue and the growth of gross profit. The Group’s profit attributable to owners for FY2020 amounted approximately RMB1,932.99 million, representing an increase of approximately 43.49% as compared to that for FY2019, and it is mainly attributable to the increase of operating profit and decrease in the finance cost. For six months ended 30 June 2022, the Group recorded decrease in revenue and net profit attributable to owners of approximately 7.47% and 3.81% respectively as compared to that for the same period of 2021, mainly due to the decrease in sales volume of certain helicopters affected by the adjustment of helicopter products structure.

The Group's net assets have been increasing stably during FY2019, FY2020 and FY2021. The Group's net asset as at 31 December 2021 increased by approximately 18.67% as compared to that as at 31 December 2020. The Group's net asset value as at 31 December 2020 increased by approximately 15.84% as compared to that as at 31 December 2019. As at 30 June 2022, the Group's net assets recorded a growth of approximately 2.64% as compared to that as at 31 December 2021.

1.2 Information of AVIC

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 Latest Practicable Date.

1.3 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 Latest Practicable Date, the Company owns 39.50% 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.

1.4 Information of AVIC Finance

AVIC Finance is a limited liability company incorporated in the PRC on 8 April 2007 and a subsidiary of AVIC as at the Latest Practicable Date. It is licensed by the CBIRC and is engaged in the provision of financial services which principally include deposit taking, provision of loans, issue of corporate debentures, inter-bank lending, as well as other financial services such as finance leasing, bills acceptance and discounting, entrustment loans and entrustment investment to member companies, arrangement of buyer's credit for member companies' products, underwriting of corporate debentures of member companies, provision of financial advisory services, credit certification and other advisory agency services and security to member companies, and other financial services as may be approved by the CBIRC.

2. Reasons for and benefits of the Transactions

On 10 June 2022, AVIC Avionics and AVIC Electromechanical entered into a share swap and absorption agreement, pursuant to which AVIC Avionics agreed to issue its shares to certain shareholders of AVIC Electromechanical in exchange for the entire shares of AVIC Electromechanical held by these shareholders. Upon completion of the Share Swap and Absorption, 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. For further details, please refer to the announcement of the Company dated 10 June 2022 and the circular of the Company dated 29 September 2022.

AVIC Electromechanical is a company principally engaged in development, production, sales and service of airborne electromechanical systems and equipment for all types of aircraft and engines. Therefore, it is expected that upon completion of the Share Swap and Absorption, there will be an increase in the scope

of goods and services to be provided/obtained by the Group under the Existing Continuing Connected Transactions Framework Agreements. Furthermore, it is expected that there will be an increase in transaction amounts under the Existing Continuing Connected Transactions Framework Agreements as a result of the continued growth and increase in scale of operation of the Group. Therefore, the revision of annual caps will allow the Group to cope with its increasing operation and business demands as a result of the Share Swap and Absorption.

Taking into account the historical connection and long-term cooperation relationship among the parties, the Directors are of the view that the transactions contemplated under the Supplemental Continuing Connected Transactions Agreements will continue to facilitate the overall operations and growth of the Group's business upon completion of the Share Swap and Absorption. Also, the entering into of the Supplemental Continuing Connected Transactions Agreements and the revision of the Original Annual Caps serve to better manage the Group's continuing connected transactions upon the completion of the Share Swap and Absorption and to cap the relevant transaction amounts. Due to the abovementioned reasons, the Company considers the entering into of the Supplemental Continuing Connected Transactions Framework Agreements and the revision of the Original Annual Caps will be beneficial to the Group.

Having considered the above, we concur with the Directors' view that the transactions contemplated under the Supplemental Continuing Connected Transactions Framework Agreements are conducted in the ordinary and usual course of business of the Group, as enlarged by the Share Swap and Absorption, and the Non-Exempt Annual Caps are in the interests of the Company and the Shareholders as a whole.

3. Principal terms of the Supplemental Continuing Connected Transactions Framework Agreements

3.1 The Supplemental Mutual Product and Service Supply and Guarantee Agreement

Date: 28 October 2022

Parties: The Company; and

AVIC Avionics

Subject matter: Pursuant to the Supplemental Mutual Product and Service Supply and Guarantee Agreement:

1. the Group will supply to AVIC Avionics Group aviation parts and components, raw materials, related manufacturing, labour and guarantee services, and engineering technology (including but not limited to planning, consultation, design and supervision), project engineering main contracting and equipment main contracting services, etc.; and

2. AVIC Avionics Group will supply to the Group aviation electronic products, electromechanical products, parts and components, related manufacturing and labour services, and engineering and equipment subcontracting services.

If matters agreed in the Supplemental Mutual Product and Service Supply and Guarantee Agreement (i.e. the products and services to be supplied: (i) by the Group to AVIC Avionics Group; and (ii) by AVIC Avionics Group to the Group) are inconsistent with the Existing Mutual Product and Service Supply and Guarantee Agreement, the Supplemental Mutual Product and Service Supply and Guarantee Agreement prevails. Otherwise, the terms of the Existing Mutual Product and Service Supply and Guarantee Agreement (including the term of the Existing Mutual Product and Service Supply and Guarantee Agreement, pricing principles, payment and other major terms as disclosed in the circular of the Company dated 10 November 2020) shall prevail.

Other Terms:

The Supplemental Mutual Product and Service Supply and Guarantee Agreement shall become effective on, whichever is later:

1. completion of internal approval procedures by both parties to the agreement in accordance with the relevant laws and the articles of association of the parties to the agreement; or
2. completion date of Share Swap and Absorption,

and shall end on 31 December 2023.

3.2 The Supplemental Financial Services Framework Agreement

Date: 28 October 2022

Parties: The Company; and
AVIC Finance

Subject matter: AVIC Finance has agreed to provide the Group with the Deposit Services with a maximum daily deposit amount (including accrued interest) shall not exceed RMB45,000 million.

If matter agreed in the Supplemental Financial Services Framework Agreement (i.e. the proposed annual caps for the Deposit Services with effect from the effective date of the Supplemental Financial Services Framework Agreement to 31 December 2023) is inconsistent with the Existing Financial Services Framework Agreement, the Supplemental Financial Services Framework Agreement prevails. Otherwise, the terms of the Existing Financial Services Framework Agreement (including the term of the Existing Financial Services Framework Agreement, service scope, pricing principles and other major terms as disclosed in the circular of the Company dated 10 November 2020) shall prevail.

Other Terms:

The Supplemental Financial Services Framework Agreement shall become effective on the date of completion of internal approval procedures by both parties to the agreement in accordance with relevant laws (including the applicable listing rules) and the articles of association of both parties to the agreement and shall end on 31 December 2023.

As there has been no change in the scope of services under the Existing Financial Services Framework Agreement as a result of the Share Swap and Absorption, the effective date of the Supplemental Financial Services Framework Agreement is not subject to the completion of the Share Swap and Absorption. Also, it is expected that the Share Swap and Absorption will be completed in the first quarter of 2023.

3.3 Assessment of the terms of the Supplemental Continuing Connected Transactions Framework Agreements

According to our discussion with the Management and review of the Existing Mutual Product and Service Supply and Guarantee Agreement, the Existing Financial Services Framework Agreement and the Supplemental Continuing Connected Transactions Framework Agreements, we noted that saved for (i) the inclusion of electromechanical products for the scope of products to be supplied by AVIC Avionics under the Supplemental Mutual Product and Service Supply and Guarantee Agreement; (ii) the revision on the maximum daily deposit amount (including accrued interest) under the Supplemental Financial Services Framework Agreement; and (iii) the effective terms of the Supplemental Continuing Connected Transactions Framework Agreements, all other terms under the Existing Mutual Product and Service Supply and Guarantee Agreement and the Existing Financial Services Framework Agreement, as disclosed in 2020 Announcement and 2020 Circular and approved on the extraordinary general meeting of the Company held on 11 December 2020, remain unchanged.

Having considered (i) the principal business of AVIC Electromechanical; (ii) the background of the Share Swap and Absorption, which has been approved on the extraordinary general meeting of the Company held on 26 October 2022; (iii) our assessment on the pricing principles as disclosed in

the section headed “4.4 Our assessment”; and (iv) the analysis performed on the Non-Exempt Annual Caps in the section headed “5.3 Assessment to the Non-Exempt Annual Caps” of this letter, we are of the view that the terms of Supplemental Continuing Connected Transactions Framework Agreements are fair and reasonable, on the normal commercial terms and in the interest of the Company.

4. Pricing Principles

4.1 The Existing Mutual Product Supply Agreement

The pricing principles of the Existing Mutual Product Supply Agreement are summarised as follows:

Key transaction principles:

If any independent third party can supply the same type of products on the same terms, AVIC Group or the Group (as the case may be) shall give preference to use products supplied by the Group or AVIC Group (as the case may be). If any independent third party can supply the same type of products at a better price than AVIC Group or the Group (as the case may be) offers, the Group or AVIC Group (as the case may be) shall be entitled to procure products from that independent third party. The quality standard of the products and the terms and conditions of supply given by AVIC Group to the Group shall not be less favorable than those offered by the independent third parties under comparable conditions.

Pricing principles:

The price of the products and ancillary services will be determined as follows: (i) as most products under the Existing Mutual Product Supply Agreement are designated aviation products, the Government-prescribed Price shall apply; (ii) if there is no Government-prescribed Price, the Market Price as determined by tender procedures or other means (as the case may be) shall apply; and (iii) if there is no Market Price, the Contractual Price shall apply.

Payment:

Specific payment terms (including time and method of payment) are to be agreed between the parties by entering into the specific product supply agreement under each transaction.

4.2 The Existing Mutual Product and Service Supply and Guarantee Agreement and the Supplemental Mutual Product and Service Supply and Guarantee Agreement

The pricing principles of the Existing Mutual Product and Service Supply and Guarantee Agreement and the Supplemental Mutual Product and Service Supply and Guarantee Agreement are summarised as follows:

Pricing principles:

The price of products and/or services under the Existing Mutual Product and Service Supply and Guarantee Agreement and the Supplemental Mutual Product and Service Supply and Guarantee Agreement will be determined as follows: (i) as most products (including electromechanical products) under the Existing Mutual Product and Service Supply and Guarantee Agreement and the Supplemental Mutual Product and Service Supply and Guarantee Agreement are designated aviation products, the Government-prescribed Price shall apply; (ii) if there is no Government-prescribed Price, the Market Price as determined by tender procedures or other means (as the case may be) shall apply; (iii) if there is no Market Price, the Contractual Price shall apply; (iv) for power supply services such as the provision of electricity, water, steam, etc., if such power was originally procured at the Government-prescribed Price or the Government-guidance Price, the Government-prescribed Price or the Government-guidance Price shall apply; (v) for production, labour, leasing and guarantee services where Market Price is available, the Market Price as determined through tender procedures or other means (as the case may be) shall apply; if there is no Market Price, the Contractual Price shall apply; and (vi) for engineering technology services (including design, consultation and supervision services), project engineering main contracting and equipment main contracting services, and engineering and equipment subcontracting services, the Market Price or (if applicable) the Market Price as determined by tender procedures shall apply. Such tender procedures shall be in compliance with the relevant PRC laws and regulations relating to tender and bidding (which set out, among other things, specific requirements for the bidders and construction projects which require tender and bidding).

Payment:

The parties will make payment of the price according to the Existing Mutual Product and Service Supply and Guarantee Agreement and the Supplemental Mutual Product and Service Supply and Guarantee Agreement and the specific contracts entered into by the relevant member of the Group and AVIC Avionics Group for the provision of products or services.

4.3 The Existing Financial Services Framework Agreement and the Supplemental Financial Services Framework Agreement

The pricing principles of the Deposit Services under the Existing Financial Services Framework Agreement and the Supplemental Financial Services Framework Agreement are summarised as follows:

Pricing principles:

Interest rates for the Group's deposits with AVIC Finance shall not be lower than (a) the minimum benchmark interest rates promulgated by the PBOC for the same type of deposit; (b) the interest rates for the same type of deposits offered by two to three major commercial banks of the PRC to the Group; and (c) the interest rates for the same type of deposits offered by AVIC Finance to any other member of AVIC Group.

4.4 Our assessment

We noted that the pricing principles of the Non-Exempt Annual Caps are identical to those used under the Existing Mutual Product Supply Agreement, the Existing Mutual Product and Service Supply and Guarantee Agreement and the Existing Financial Services Framework Agreement, which were disclosed in 2020 Announcement and 2020 Circular and have been approved on the extraordinary general meeting of the Company held on 11 December 2020.

Government-prescribed Price

Government-prescribed Price is the price jointly determined by the relevant price control authorities, the industry regulators in the PRC and the relevant manufacturing enterprises involved in the particular transactions, which mainly comprise the relevant costs plus profit margin. The relevant costs will be proposed by the relevant manufacturing enterprises, and confirmed by the relevant price control authorities and the industry regulators in the PRC. The profit margin shall be determined according to the requirements of the relevant authorities. As advised by the Management, aviation products (including electromechanical products) of the Group are mainly prescribed by the PRC government and such Government-prescribed Price will not be published and is not publicly available.

Market Price

Market Price is the price as determined in the following sequence: (i) where there are comparable market prices or charging rates standards determined by independent third parties under normal commercial terms for the transaction, the transaction price shall be determined at such price or standard (the Company will obtain at least two to three such price or standard from independent third parties); or (ii) if there are no such comparable market prices of independent third parties, the transaction price shall be fixed by the price of non-connected transactions between the Company and independent third parties: (a) where the Company is the buyer, through tender procedures in accordance with the relevant PRC laws and regulations relating to tender and bidding or by choosing the most favorable price among at least two to three selected suppliers after taking into account the suppliers' manufacturing qualifications and delivery time, and business relationship between the Company and suppliers according to the Company's internal procurement policy; or (b) where the Company is the supplier, agreeing with the clients within prescribed price range, which is determined according to the Company's internal sales policy with reference to: (i) the transaction volume and business relationship between the Company the purchaser; and (ii) the prices of similar products and services purchased from the Company by not less than two Independent Third Parties. The Market Price will be determined or approved by the authorised departments/persons of the specific entities within the Group in particular transactions.

As advised by the Management, for the Market Price to be determined by tender procedures, the Group strictly follows the relevant PRC laws and regulations in relation to tender procedures, in particular the Law of the People's Republic of China on Tenders and Bids (中華人民共和國招標投標法). In addition, we noted that the Company's internal procurement and sales policies apply to both connected parties and independent third parties.

In view of the above, we consider that there are adequate procedures in place to ensure the fairness and reasonableness of the transactions conducted under the reference of the Market Price.

Contractual Price

Contractual Price is the price to be agreed between the relevant parties for the supply of the aviation products, raw materials and related services (as the case may be), which shall be the reasonable costs incurred in supplying the same plus not more than 8% of such costs, which is determined after taking into account the average profit margin of approximately 7% among industrial enterprises, the average profit margin in the aviation industry and the profits previously received by the Group or AVIC Group for similar products, raw materials or services. The 8% margin used to determine the Contractual Price is the maximum profit margin under the relevant continuing connected transactions agreements and specific prices will be determined under separate agreements in each transaction.

We have reviewed the industry data released by the National Bureau of Statistics in the PRC (http://www.stats.gov.cn/tjsj/zxfb/202201/t20220127_1827067.html) and noted that the enterprise above designated size (i.e., with an annual revenue of RMB20 million or above) of the industrial industry recorded an average profit margin of approximately 6.8% for FY2021. We have also reviewed the 2021 annual report of the Company and noted that the Group recorded a net profit margin of approximately 7.5% and 8.0% for FY2020 and FY2021, respectively. In view of the above and given parties of the Existing Mutual Supply of Products Agreement and the Supplemental Mutual Product and Service Supply and Guarantee Agreement can charge to counter parties on the same basis, we consider the margin of not more than 8.0% is fair and reasonable.

Based on the above, given that (i) the Government-prescribed Price is determined, or subject to approval, by the relevant price control authorities and the industry regulators in the PRC; (ii) the Market Price is determined with reference to the terms of comparable transactions with independent third parties or by tender procedures in accordance with the relevant PRC laws and regulations or other means; (iii) the Contractual Price is determined with reference to the historical profit margin of the Group and the average profit margin of industrial enterprises; and (iv) the Deposit Services are conducted on a non-exclusive basis and the interest rates offered by AVIC Finance will be not lower than those offered by major commercial banks in the PRC for the same type of deposits and those offered by AVIC Finance to any other group member of AVIC Group for the same type of deposits, we are of the view that the pricing principles are fair and reasonable, on normal commercial terms and in the interest of the Company.

5. Non-Exempt Annual Caps

5.1 Original Annual Caps and Non-Exempt Annual Caps

The following table sets forth the Original Annual Caps and the Non-Exempt Annual Caps for the year ending 31 December 2023 (“FY2023”).

<i>RMB million</i>	Original Annual Caps for FY2023	Non-Exempt Annual Caps for FY2023
<i>Existing Mutual Product Supply Agreement</i>		
- Expenditure transactions of the Group	20,600	23,640
- Revenue transactions of the Group	23,190	34,516
<i>Supplemental Mutual Product and Service Supply and Guarantee Agreement</i>		
- Expenditure transactions of the Group	1,810	3,830
<i>Supplemental Financial Services Framework Agreement</i>		
- Maximum daily outstanding balances of deposits (including accrued interests) for Deposit Services	35,000	45,000

5.2 Basis of determining the Non-Exempt Annual Caps

5.2.1 The Existing Mutual Product Supply Agreement

The proposed annual cap for the expenditure transaction for the year ending 31 December 2023 is derived based on the sum of the original annual cap for the year ending 31 December 2023 and the expected additional purchase costs for the production of electromechanical products as a result of the Share Swap and Absorption. The original annual cap for the year ending 31 December 2023 is used as the basis of the proposed annual cap as it is estimated that in consideration of the demand for ancillary purchases of components for some of the Group's aviation entire aircraft products in the year of 2023, the estimated expenditure transaction amount under the Existing Mutual Product Supply Agreement (excluding the expected additional purchase costs for the production of electromechanical products as a result of the Share Swap and Absorption) may reach the original annual cap for the year ending 31 December 2023. The expected additional purchase costs for the production of electromechanical products as a result of the Share Swap and Absorption is approximately RMB3,040 million for the year ending 31 December 2023, which is determined with reference to the historical transaction amount of similar nature of approximately RMB1,848 million and RMB758 million between AVIC Electromechanical Group and AVIC Group in the financial year ended 31 December 2021 and the six months ended 30 June 2022, as well as the expected growth of relevant business in 2023.

The proposed annual cap for the revenue transaction for the year ending 31 December 2023 is determined based on the sum of the original annual cap for the revenue transaction for the year ending 31 December 2023 and the expected additional sales volume of electromechanical products as a result of the Share Swap and Absorption. The original annual cap is used as the basis for the calculation of the proposed annual cap as it is expected

that taking into account the cap utilisation rate in 2021 and the expected operating conditions in 2023, the revenue transaction amount under the Existing Mutual Product Supply Agreement will increase in the year of 2023 compared with the historical transaction amount disclosed above, resulting in the estimated revenue transaction amount under the Existing Mutual Product Supply Agreement (excluding the expected additional sales volume of electromechanical products as a result of the Share Swap and Absorption) reaching the original annual cap for the year ending 31 December 2023. The expected additional sales volume of electromechanical products as a result of the Share Swap and Absorption is approximately RMB11,326 million for the year ending 31 December 2023, which is determined with reference to the historical transaction amount of similar nature of approximately RMB6,799 million and RMB4,599 million between AVIC Electromechanical Group and AVIC Group in the financial year ended 31 December 2021 and the six months ended 30 June 2022, as well as the expected growth of relevant business in 2023.

5.2.2 The Existing Mutual Product and Service Supply and Guarantee Agreement and the Supplemental Mutual Product and Service Supply and Guarantee Agreement

The proposed annual cap for the expenditure transaction for the year ending 31 December 2023 is determined based on the sum of the original annual cap for the expenditure transactions for the year ending 31 December 2023 and the expected additional purchase costs of electromechanical products as a result of the Share Swap and Absorption. The original annual cap is used as the basis for the calculation of the proposed annual cap as it is expected that in consideration of the demand for ancillary purchases of aviation electronic products from AVIC Avionics Group for some of the Group's aviation entire aircraft products in the year of 2023, the estimated expenditure transaction amount under the Existing Mutual Product and Service Supply and Guarantee Agreement (excluding the expected additional purchase costs of electromechanical products as a result of the Share Swap and Absorption) may reach the original annual cap for the year ending 31 December 2023. The expected additional purchase costs of electromechanical products as a result of the Share Swap and Absorption is approximately RMB2,020 million for the year ending 31 December 2023, which is determined with reference to the historical transaction amount of similar nature of approximately RMB1,093 million and RMB609 million between AVIC Electromechanical Group and the Group in the financial year ended 31 December 2021 and the six months ended 30 June 2022, as well as the expected growth of relevant business in 2023.

5.2.3 The Existing Financial Services Framework Agreement and the Supplemental Financial Services Framework Agreement

The proposed annual cap for the Deposit Services for the year ending 31 December 2023 is determined based on the sum of the original annual cap for the Deposit Services for the year ending 31 December 2023 and the expected increase in the deposit amount by AVIC Avionics Group as a result of the Share Swap and Absorption. The original annual cap is used as the basis of calculation of the proposed annual cap as the prepayments from customers for bulk purchase contracts for some products are expected to be settled in 2023, resulting in an increased demand for Deposit Services and therefore the maximum daily outstanding balance of deposits (including the accrued interests) under the Existing Financial Services Framework

Agreement (excluding the expected increase in the deposit amount as a result of the Share Swap and Absorption) is expected to reach the original annual cap for the financial year ending 31 December 2023. The expected increase in the deposit amount by AVIC Avionics Group as a result of the Share Swap and Absorption is approximately RMB10,000 million for the year ending 31 December 2023, such amount is determined with reference to the maximum daily outstanding balance of deposits (including the accrued interests) of AVIC Electromechanical Group in AVIC Finance of approximately RMB8,071 million and RMB5,816 million for the financial year ended 31 December 2021 and the six months ended 30 June 2022, as well as the expected growth of relevant business in 2023.

5.3 Assessment to the Non-Exempt Annual Caps

In assessing the fairness and reasonableness of the Non-Exempt Annual Caps, we have reviewed the calculation of the Non-Exempt Annual Caps and noted that (i) the Non-Exempt Annual Caps is calculated as the sum of the Original Annual Caps and the expected increase on the respective annual caps as a result of the Share Swap and Absorption; and (ii) such increase on the respective annual caps is determined with reference to the historical transaction amount of similar nature between AVIC Electromechanical Group and the respective counter connected parties or the maximum daily outstanding balance of deposits (including the accrued interests) of AVIC Electromechanical Group in AVIC Finance as well as the expected growth of relevant business in 2023. In this regard, we have obtained and reviewed the relevant historical transaction amounts of AVIC Electromechanical Group for the two years ended 31 December 2021 and the forecast model for the two years ending 31 December 2022 (“**FY2022**”) and 2023 (collectively known as the “**Documents**”).

5.3.1 The Existing Mutual Product Supply Agreement

In respect of the proposed annual cap for the expenditure transaction for FY2023, we noted that there is an increase of RMB3,040 million as compared with the corresponding original annual cap for FY2023. As advised by the Management, such increase is the expected additional purchase cost for the production of electromechanical products as a result of the Share Swap and Absorption. We further noted that (i) the aforementioned difference between the proposed annual cap and the original annual cap for FY2023 is in line with the expected transaction amount as stated in the Documents; (ii) the relevant historical transaction amount for FY2021 has increased by approximately 43.1% as compared with that for FY2020, which is higher than the expected annual growth rate of approximately 37.1% and approximately 20.0% for FY2022 and FY2023, respectively.

In respect of the proposed annual cap for the revenue transaction for FY2023, we noted that there is an increase of RMB11,326 million as compared with the corresponding original annual cap for FY2023. As advised by the Management, such increase is the expected addition sales volume of electromechanical products as a result of the Share Swap and Absorption. We further noted that (i) the aforementioned difference between the proposed annual cap and the original annual cap for FY2023 is in line with the expected transaction amount as stated in the

Documents; and (ii) the relevant historical transaction amount for FY2021 has increased by 49.0% as compared with that for FY2020, which is higher than the expected annual growth rate of 38.8% and 20.0% for FY2022 and FY2023, respectively.

In view of the above, we consider the proposed annual caps under the Existing Mutual Product Supply Agreement are fair and reasonable.

5.3.2 The Supplemental Mutual Product and Service Supply and Guarantee Agreement

In respect of the proposed annual cap for the expenditure transaction for FY2023, we noted that there is an increase of RMB2,020 million as compared with the corresponding original annual cap for FY2023. As advised by the Management, such increase is the expected addition purchase costs of electromechanical products as a result of the Share Swap and Absorption. We further noted from the Documents that the relevant historical transaction amount for FY2021 has increased by 25.6% as compared with that for FY2020, which is lower than the expected annual growth rate of 36.9% and 35.0% for FY2022 and FY2023, respectively. We have discussed with the Management and understood such increase in the annual growth rate of the transaction amounts is mainly due to the expected increase in demand for ancillary purchases of electromechanical products from AVIC Electromechanical Group for some of the Group's aviation entire aircraft products in the year of 2022 and 2023. We also noted that the revenue of the Group's aviation ancillary system and related business increased by approximately 30.0% for FY2021 as compared with that for FY2020. In view of the above, we consider the proposed annual cap for the expenditure transaction for FY2023 under the Supplemental Mutual Product and Service Supply and Guarantee Agreement is fair and reasonable.

5.3.3 The Supplemental Financial Services Framework Agreement

In respect of the proposed annual cap for the Deposit Services for FY2023, we noted that there is an increase of RMB10,000 million as compared with the corresponding original annual cap for FY2023. As advised by the Management, such increase is the expected increase in deposit amount by AVIC Avionics Group as a result of the Share Swap and Absorption. We further noted that (i) the aforementioned difference between the proposed annual cap and the original annual cap for FY2023 is in line with the expected transaction amount as stated in the Documents; and (ii) the relevant historical transaction amount for FY2021 has increased by 87.4% as compared with that for FY2020, which is higher than the expected annual growth rate of 11.5% and 11.1% for FY2022 and FY2023, respectively. In view of the above, we consider the proposed annual cap for the Deposit Services for FY2023 under the Supplemental Financial Services Framework Agreement is fair and reasonable.

6. Internal control

As advised by the Management, the Company will apply the same set of internal control mechanism under the Existing Continuing Connected Transactions Framework Agreements, details of which are included in the sections headed “VI. INTERNAL CONTROL MECHANISM” in the letter form the board as disclosed in the 2020 Circular, to the Supplemental Continuing Connected Transactions Framework Agreements.

Pursuant to Rules 14A.55 and 14A.56 of the Hong Kong Listing Rules, the independent non-executive Directors and auditor of the Company will conduct annual review and provide confirmation letter regarding the continuing connected transactions of the Company each year. We have reviewed the annual report of the Company for FY2021 and noted that the independent non-executive Directors and the auditor of the Company have reviewed the continuing connected transactions during such years and provided the relevant confirmation letter. As confirmed with the Company, the Company will continue to comply with the relevant annual review requirement under the Hong Kong Listing Rules on an on-going basis.

Based on the above, we are of the view that the Group has effective internal policies in place to continue to monitor the continuing connected transactions under the Supplemental Continuing Connected Transactions Framework Agreements and the Non-Exempt Annual Caps, therefore the interests of the Company and its Shareholders would be safeguarded.

RECOMMENDATION

Having considered the above factors and reasons, we are of the opinion that (i) the continuing connected transactions under the Supplemental Continuing Connected Transactions Framework Agreements are conducted in the ordinary and usual course of business of the Company and on normal commercial terms; and (ii) the terms of the Supplemental Continuing Connected Transactions Framework Agreements and the Non-Exempt Annual Caps are fair and reasonable and in the interests of the Company and its Shareholders as a whole. Accordingly, we advise the Independent Board Committee to recommend and we also recommend the Independent Shareholders to vote in favour of the resolutions in relation to the Transactions to be proposed at the EGM.

Yours faithfully,
For and on behalf of
Maxa Capital Limited



Dian Deng
Managing Director

Ms. Dian Deng is a licensed person registered with the Securities and Futures Commission of Hong Kong and a responsible officer of Maxa Capital to carry out type 6 (advising on corporate finance) regulated activities under the SFO and has over 14 years of experience in corporate finance industry.