

31 May 2022

*To: The independent board committee and the independent shareholders  
of First Tractor Company Limited\**

Dear Sir/Madam,

**(I) DISCLOSEABLE AND CONNECTED TRANSACTION IN RELATION  
TO DISPOSAL OF TARGET ASSETS;  
(II) MAJOR AND CONNECTED TRANSACTION IN RELATION TO  
CAPITAL INCREASE IN SINOMACH FINANCE;  
AND  
(III) DISCLOSEABLE TRANSACTION AND CONTINUING CONNECTED  
TRANSACTIONS IN RELATION TO THE DEPOSIT TRANSACTION**

**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 Disposal, the Capital Increase and the Non-exempt Continuing Connected Transactions (including the relevant annual caps), details of which are set out in the letter from the Board (the “**Board Letter**”) contained in the circular dated 31 May 2022 issued by the Company to the Shareholders (the “**Circular**”), of which this letter forms part. Terms used in this letter shall have the same meanings as defined in the Circular unless the context requires otherwise.

With reference to the Board Letter, on 29 March 2022 (after trading hours), Sinomach, Sinomach Finance, the Company and YTO Finance entered into the Restructuring Framework Agreement in relation to the Restructuring Transactions. Pursuant to the Restructuring Framework Agreement, the relevant parties on the same date also entered into separate agreements, namely the Disposal Agreement, the Investment Agreement (as revised and supplemented by the Supplemental Investment Agreement) and the Financial Services Framework Agreement to effect the Restructuring Transactions.

On 27 May 2022 (after trading hours), the Company and Sinomach Finance entered into the Supplemental Investment Agreement to adjust the contribution amount for the Capital Increase as the filing process of the Sinomach Valuation with the relevant state-owned regulatory authorities has been completed.

Pursuant to the Disposal Agreement, YTO Finance conditionally agreed to dispose of and Sinomach Finance conditionally agreed to purchase the Target Assets.

Pursuant to the Investment Agreement (as revised and supplemented by the Supplemental Investment Agreement), the Company conditionally agreed to make a capital increase in cash to Sinomach Finance. As at the Latest Practicable Date, the Company did not hold any interests in Sinomach Finance. Upon completion of the Capital Increase, the Company will hold approximately 14.29% equity interests in Sinomach Finance.

Pursuant to the Financial Services Framework Agreement, Sinomach Finance agreed to provide financial services (including the Non-exempt Continuing Connected Transactions) to the Group for a period up to 31 December 2024.

With reference to the Board Letter, (i) the Disposal constitutes a discloseable and connected transaction for the Company; (ii) the Capital Increase constitutes a major and connected transaction for the Company; and (iii) the Non-exempt Continuing Connected Transactions constitute a discloseable transaction and continuing connected transactions of the Company, and are therefore subject to reporting, announcement and Independent Shareholders' approval requirements under the Chapter 14 and Chapter 14A of the Hong Kong Listing Rules.

The Independent Board Committee comprising Mr. Edmund Sit, Mr. Wang Shumao and Mr. Xu Liyou (all being independent non-executive Directors) has been established to advise the Independent Shareholders on (i) whether the terms of the Disposal, the Capital Increase and the Non-exempt Continuing Connected Transactions (including the relevant annual caps) are on normal commercial terms and are fair and reasonable; (ii) whether the Disposal, the Capital Increase and the Non-exempt Continuing Connected Transactions (including the relevant annual caps) are in the interests of the Company and the Shareholders as a whole and conducted in the ordinary and usual course of business of the Group; and (iii) how the Independent Shareholders should vote in respect of the resolution(s) to approve the Disposal, the Capital Increase and the Non-exempt Continuing Connected Transactions (including the relevant annual caps) at the EGM. We, Gram Capital Limited, have been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in this respect.

## INDEPENDENCE

During the past two years immediately preceding the Latest Practicable Date, Gram Capital was engaged as independent financial adviser in respect of the discloseable and continuing connected transactions of the Company as set out in the Company's circular dated 12 October 2021. Notwithstanding the aforesaid past engagement, as at the Latest Practicable Date, we were not aware of any relationship or interest between Gram Capital and the Company or any other parties that could be reasonably regarded as a hindrance to Gram Capital's independence to act as the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders.

## BASIS OF OUR OPINION

In formulating our opinion to the Independent Board Committee and the Independent Shareholders, we have relied on the statements, information, opinions and representations contained or referred to in the Circular and the information and representations as provided to us by the Directors. We have assumed that all information and representations that have been provided by the Directors, for which they are solely and wholly responsible, are true and accurate at the time when they were made and continue to be so as at the Latest Practicable Date. We have also assumed that all statements of belief, opinion, expectation and intention made by the Directors in the Circular were reasonably made after due enquiry and careful consideration. 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 opinions expressed by the Company, its advisers and/or the Directors, which have been provided to us. Our opinion is based on the Directors' representation and confirmation that there is no undisclosed private agreement/arrangement or implied understanding with anyone concerning the Disposal, the Capital Increase and the Non-exempt Continuing Connected Transactions. We consider that we have taken sufficient and necessary steps on which to form a reasonable basis and an informed view for our opinion in compliance with Rule 13.80 of the Hong Kong Listing Rules.

We have not made any independent evaluation or appraisal of the assets and liabilities of the Group or Sinomach Finance, and we have not been furnished with any such evaluation or appraisal, save as and except for the valuation report in respect of the Initial Valuation of the Target Assets as at 31 December 2021 as prepared by the Independent Valuer (the "**Initial Assets Valuation Report**"), the summary of which is set out in Appendix II to the Circular, and the Final Sinomach Valuation Report in respect of the Sinomach Valuation as at 31 December 2021, the summary of which is set out in Appendix III to the Circular. Since we are not experts in the valuation of assets or business, we have relied solely upon the Initial Assets Valuation Report for the Initial Valuation of the Target Assets as at 31 December 2021 and the Final Sinomach Valuation Report for the Sinomach Valuation as at 31 December 2021.

The Circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the Hong Kong Listing Rules for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that to the best of their knowledge and belief the information contained in the Circular is accurate and complete in all material respects and not misleading or deceptive, and there are no other matters the omission of which would make any statement therein or the Circular misleading. We, as the Independent Financial Adviser, take no responsibility for the contents of any part of the Circular, save and except for this letter of advice.

We consider that we have been provided with sufficient information to reach an informed view and to provide a reasonable basis for our opinion. We have not, however, conducted any independent in-depth investigation into the business and affairs of the Company, Sinomach, Sinomach Finance, or their respective subsidiaries or associates, nor have we considered the taxation implication on the Group or the Shareholders as a result of the Disposal, the Capital Increase and the Non-exempt Continuing Connected Transactions. Our opinion is necessarily based on the financial, economic, market and other conditions in effect and the information made available to us as at the Latest Practicable Date. Shareholders should note that subsequent developments (including any material change in market and economic conditions) may affect and/or change our opinion and we have no obligation to update this opinion to take into account events occurring after the Latest Practicable Date or to update, revise or reaffirm our opinion. In addition, nothing contained in this letter should be construed as a recommendation to hold, sell or buy any Shares or any other securities of the Company.

Lastly, where information in this letter has been extracted from published or otherwise publicly available sources, it is the responsibility of Gram Capital to ensure that such information has been correctly extracted from the relevant sources while we are not obligated to conduct any independent in-depth investigation into the accuracy and completeness of those information.

#### **PRINCIPAL FACTORS AND REASONS CONSIDERED**

In arriving at our opinion in respect of the Disposal, the Capital Increase and the Non-exempt Continuing Connected Transactions, we have taken into consideration the following principal factors and reasons:

#### **INFORMATION OF THE GROUP**

With reference to the Board Letter, the Group is principally engaged in the production and sale of agricultural machineries and power machineries. The principal products include tractors of hi-powered, mid-powered and low-powered, diesel engines and relevant parts and components.

Set out below are the audited consolidated financial information of the Group for the two years ended 31 December 2021 as extracted from the Company's annual report for the year ended 31 December 2021 (the "2021 Annual Report"):

|  | For the year<br>ended<br>31 December<br>2021<br>RMB | For the year<br>ended<br>31 December<br>2020<br>RMB | Change from<br>2020 to 2021<br>% |
|--|---|---|----------------------------------|
| Total operating revenue  | 9,333,808,881.54                                    | 7,582,476,787.76                                    | 23.10                            |
| Operating profit   | 426,898,016.57                                      | 292,726,445.01                                      | 45.84                            |
| Net profit attributable to shareholders<br>of the parent company | 438,209,215.31                                      | 280,150,740.30                                      | 56.42                            |

As illustrated in the above table, the Group's total operating revenue was approximately RMB9.33 billion for the year ended 31 December 2021 ("FY2021"), representing an increase of approximately 23.10% as compared to that for the year ended 31 December 2020 ("FY2020"). During FY2021, the Group also recorded significant increases of approximately 45.84% and 56.42% in operating profit and net profit attributable to shareholders of the parent company respectively as compared to those for FY2020. With reference to the 2021 Annual Report, the aforesaid increase in revenue was mainly due to increase in sales volume of the Group's major products. In addition, during FY2021, the Company perfected the evaluation mechanism for cost control, strengthened the internal operation management, intensified cost control, capital control and quality control, which made the increase in operating costs lower than the increase in operating revenue, leading to increases in operating profit and net profit attributable to shareholders of the parent company.

With reference to the 2021 Annual Report, in 2022 (being the second year to implement the 14th Five-Year Plan of the PRC), the Company will adhere to the strategic development ideas of "seeking progress while maintaining stability" and "14th Five-Year Plan" to grasp the change trend of industry development and competition pattern. Centering on the business idea of "seizing opportunities, improving capabilities, adapting to the situation, and maintaining steady growth", the Company will accelerate scientific and technological research and development, innovation, breakthrough and upgrading of product technology, further integrating into the new development pattern and promoting steady operation and sustainable development of the Company.

## INFORMATION ON YTO AND SINOMACH

Set out below is the information on YTO and Sinomach as extracted from the Board Letter:

YTO is the immediate controlling shareholder of the Company, holding 548,485,853 A Shares of the Company, representing approximately 48.81% of the issued share capital of the Company as at the date of this announcement. It is principally engaged in the production of specific transport machinery, vehicle products and components.

Sinomach is the controlling shareholder of YTO, having 87.90% shareholding interest in YTO. The remaining 12.10% shareholding interest in YTO is held by Luoyang Guozi State-Owned Assets Management Co., Ltd.\* (洛陽市國資國有資產經營有限公司), which in turn is indirectly wholly owned by Luoyang State-owned Assets Supervision and Administration Commission\* (洛陽市人民政府國有資產監督管理委員會).

Sinomach is principally engaged in the business of research and development and manufacturing of machinery equipment, heavy machineries and engineering projects domestically and internationally, sales of automotive and parts, contracting of international projects and tendering of domestic and international projects, and import and export business.

## INFORMATION ON YTO FINANCE AND THE TARGET ASSETS

With reference to the Board Letter, YTO Finance, a 99.40%-owned subsidiary owned subsidiary of the Company, is a non-banking financial institution approved and regulated by the CBIRC. The remaining 0.60% equity interest is held by YTO. Its principal activities include the provision of non-banking financial services to members of the Group as well as members of YTO Group. It has a registered capital of RMB500 million.

YTO Finance is principally engaged in the provision of financial services including deposits taking, provision of loans, underwriting of corporate bonds, as well as finance leasing, financial and financing consultation, credit certification and related consultation and agency services, settlement services, provision of letters of guarantee and letters of credit, entrusted loan, handling bills acceptance and discounting, and other financial services that may be approved by the CBIRC, to members of the YTO Group and the Group.

The Target Assets comprised of loans and advances to customers, non-current assets due within one year and long term receivables held by YTO Finance with maturity date(s) after 30 September 2022, fixed assets and intangible assets that are directly attributable or related to the continuation of the business of YTO Finance, the value of which would have been appraised.

## INFORMATION ON SINOMACH FINANCE

With reference to the Board Letter, Sinomach Finance is a non-banking financial institution established in 2003 approved by China Banking Regulatory Commission through restructuring the former China CAMC Trust Investment Co., Ltd.\* (中工信託投資有限公司) by Sinomach. As at the Latest Practicable Date, Sinomach Finance is a 79.32% owned subsidiary of Sinomach and the remaining interest are held by member companies within the Sinomach Group. Sinomach Finance is a connected person of the Company.

Sinomach Finance is principally engaged in the provision of financial services including deposits taking, provision of loans, underwriting of corporate bonds, as well as finance leasing, financial and financing consultation, credit certification and related consultation and agency services, settlement services, provision of letters of guarantee and letters of credit, entrusted loans, handling bills acceptance and discounting, and other financial services that may be approved by the CBIRC, to members of the Sinomach Group.

Set out below is the audited financial information of Sinomach Finance for the two financial years ended 31 December 2021 as extracted from the Board Letter:

|                   | For the year<br>ended<br>31 December<br>2021<br>RMB | For the year<br>ended<br>31 December<br>2020<br>RMB | Change from<br>2020 to 2021<br>% |
|-------------------|---|---|----------------------------------|
| Revenue           | 872,497,557   | 950,264,845   | (8.18)                           |
| Profit before tax | 400,589,607   | 395,284,389   | 1.34                             |
| Profit after tax  | 306,198,059   | 296,807,802   | 3.16                             |

As at 31 December 2021, the net assets of Sinomach Finance amounted to RMB3,283,346,400.

## **REASONS FOR AND BENEFITS OF THE DISPOSAL, THE CAPITAL INCREASE AND THE NON-EXEMPT CONTINUING CONNECTED TRANSACTIONS**

With reference to the Board Letter, according to Rule 14 Measures published by the CBIRC, a corporate group can only have one finance company within the same corporate group to provide financial services to companies within the same group. The Sinomach Group currently has two finance companies under its group, namely (i) Sinomach Finance, which is a 79.32%-owned subsidiary of Sinomach; and (ii) YTO Finance which is a 99.40%-owned subsidiary of the Company.

### **The Disposal**

In order to comply with Rule 14 Measures of the PRC regulations, the Disposal represents the first step that the Company must take to achieve the objective. The Disposal represents a continuation of the finance company's business of YTO Finance that will be taken over by Sinomach Finance with the acquisition of the Target Assets. This will provide a smooth transition of YTO Finance's existing business and with Sinomach Finance providing continuous and seamless services to the clients of YTO Finance, this will facilitate more business opportunities for Sinomach Finance in the future. Furthermore, the Disposal will expedite the monetary realisation of the Target Assets which in turn will enhance the liquidity position of YTO Finance for distributing its equity to its shareholders for the Liquidation.

The Group intends to use the proceeds from the Disposal, together with monies to be received from the sale of its remaining assets pursuant to the Liquidation to settle the liabilities of YTO Finance in terms of deposits due to customers and all other liabilities of YTO Finance.

### **The Capital Increase**

With reference to the Board Letter, YTO Finance, being a non-banking financial institution approved by the CBIRC, provides a full range of financial services within the scope approved by the CBIRC, to give financial support to the buyers of the Group in their credit and financing leasing businesses. Its aim is to promote the development of various businesses in the Group by adhering to the Group's objective in "serving the development of the Group through prevention and control of financial risks" (服務集團發展，防控金融風險).

Upon completion of the Disposal and the eventual Liquidation, YTO Finance will cease to be a subsidiary of the Company and the results of its finance services business will no longer be consolidated into the Company's consolidated financial statements. Furthermore, it will no longer be able to provide financial business services to YTO and its subsidiaries, which includes the Group.



Taking into consideration that the Group and the YTO Group will require financial services in their business operations, the Board identified Sinomach Finance as a suitable investment for the Company to achieve the objective. With its strong capital base and comprehensive business operations, Sinomach Finance has long been the major integrated financial services platform of the Sinomach Group, providing financial support to the business development of the members of the Sinomach Group. In addition, the capital base of Sinomach Finance and its ability to serve its members companies will be further enhanced after it takes over the related business and assets of YTO Finance. The Capital Increase will also enhance the economic returns of the Group from its investment. With the financial business services being centralised into Sinomach Finance, the Group will be able to better utilise the financial resources of Sinomach Finance to provide high quality financial services support to the Group, thereby maintain the sustainability and stable development of the Group's business activities.

In addition, the Capital Increase will enable the Group to leverage on the comprehensive financial business services provided by Sinomach Finance to continue serving its clientele whilst giving the opportunity for the Company to participate in the growth of Sinomach Finance and enjoy the returns of its investment, thereby compensating the impact of the Liquidation on the Group's performance.

#### **Continuing Connected Transactions (including the Non-exempt Continuing Connected Transactions)**

With reference to the Board Letter, following the Business Cessation Date, YTO Finance can no longer provide financial services to the other member companies of the Group and the Group intends to procure the financial services from Sinomach Finance, which is the non-banking financial institution under the Sinomach Group that is regulated by the CBIRC. The Company is of the view that the Financial Services Framework Agreement could provide an effective framework to regulate the provision and receipt of financial services between the Group and/or its member companies and Sinomach Finance and ensure a smooth transition for the business operations of the Group.

In considering the reasons and benefits for entering into the Financial Services Framework Agreement between the Company and Sinomach Finance, the Board has also considered the following key factors:

- (i) Sinomach Finance, a non-banking financial institution approved by the CBIRC, is capable of providing comprehensive financial services to member companies of the Sinomach Group and has safe and stable operation and strong performance capability;
- (ii) as an intra-group service provider, Sinomach Finance generally has better and more efficient communication with the Group compared with the other independent commercial banks and financial institutions; and

- (iii) Upon completion of the integration of YTO Finance and Sinomach Finance, the Company can leverage on the comprehensive and quality services, in-depth industry expertise and substantial financial resources of Sinomach Finance to provide good financial support, including the continued provision of high-quality financial service and products to the members companies of the Group, which is conducive to sustaining the operations and development of the Group.

Detailed reasons for the Disposal, the Capital Increase and the Continuing Connected Transactions (including the Non-exempt Continuing Connected Transactions) are set out under the section headed “REASONS FOR AND BENEFITS OF THE RESTRUCTURING TRANSACTIONS” of the Board Letter.

Having considered the above reasons for and benefits of the Disposal, the Capital Increase and the Non-exempt Continuing Connected Transactions, and the profitability of Sinomach Finance (recorded profit after tax of approximately RMB297 million for FY2020 and approximately RMB306 million for FY2021), we are of the view that (i) although the Disposal and the Capital Increase are not conducted in the ordinary and usual course of business of the Company, they are in the interests in the Company and the Shareholders as a whole; and (ii) the Non-exempt Continuing Connected Transactions are conducted in the ordinary and usual course of business of the Company and in the interests in the Company and the Shareholders as a whole.

#### **PRINCIPAL TERMS OF THE DISPOSAL, THE CAPITAL INCREASE AND THE NON-EXEMPT CONTINUING CONNECTED TRANSACTIONS**

##### **A. THE DISPOSAL**

Summarised below are the principal terms for the Disposal Agreement, details of which are set out under the section headed “2. THE DISPOSAL” of the Board Letter.

##### **Date**

29 March 2022

##### **Parties**

- (1) YTO Finance as vendor; and
- (2) Sinomach Finance as Purchaser

##### **Assets to be disposed of**

Pursuant to the Disposal Agreement, YTO Finance has conditionally agreed to dispose of and Sinomach Finance has conditionally agreed to purchase the Target Assets as at the Business Cessation Date.

The Target Assets comprised of loans and advances to customers, non-current assets due within one year and long term receivables held by YTO Finance with maturity date(s) after 30 September 2022, fixed assets and intangible assets that are directly attributable or related to the continuation of the business of YTO Finance, the value of which would have been appraised.

### **Consideration**

The final consideration will be based on the valuation of the Target Assets on the Business Cessation Date (i.e., 30 June 2022) to be conducted by the Independent Valuer, and after the valuation report has been filed with the relevant state-owned regulatory authorities (i.e., the Final Valuation) and will not be subject to any adjustment. The Board expects the Final Consideration (as defined herein) will not exceed RMB1.8 billion (the “Maximum Consideration”).

As at 31 December 2021, the appraised value of the Target Assets based on the Initial Assets Valuation Report was RMB1,047,263,700 (i.e., the Initial Valuation) and the book value of the Target Assets was RMB1,025,844,400, respectively. The Initial Valuation was based on assets approach with reference to the book value of the Target Assets as at 31 December 2021. The date of 31 December 2021 has been agreed by both parties as the valuation date to conduct the Initial Valuation of the Target Assets, which can be used as a benchmark reference for the consideration for the Disposal.

During the restructuring process, YTO Finance will continue its operations until the Business Cessation Date. Accordingly, it is expected that there will be changes to the value of the Target Assets. Therefore, both parties agreed that the Business Cessation Date (i.e., 30 June 2022) will be the valuation date for the Final Valuation, in which the value stated in the valuation report that would have been filed with the relevant state-owned regulatory authorities (i.e., the Final Valuation Report) will be taken as the final consideration for the Disposal (i.e., the Final Consideration). The assets type of the Target Assets and the valuation methodologies used in the Final Valuation will be similar to that adopted in the Initial Valuation. The work for the Final Valuation will commence two Business Days after the Business Cessation Date.

In the event YTO Finance receives any principal repayment on the Target Assets between the Business Cessation Date and the Disposal Completion Date, such principal repayment amount will be deducted from the Final Consideration payable by Sinomach Finance to YTO Finance. However, any interests payments and handling fees relating to the Target Assets that is received by YTO Finance between the Business Cessation Date and the Disposal Completion Date belongs to YTO Finance and such amount will not be deducted from the Final Consideration payable.

### ***The Initial Assets Valuation Report***

For our due diligence purpose, we reviewed and enquired into (i) the terms of engagement of the Independent Valuer; (ii) the Independent Valuer's qualification in relation to the preparation of the Initial Assets Valuation Report; and (iii) the steps and due diligence measures taken by the Independent Valuer for conducting the Initial Assets Valuation Report. From the mandate letter and other relevant information provided by the Independent Valuer and based on our interview with them, we were satisfied with the terms of engagement of the Independent Valuer as well as their qualification for preparation of the Initial Assets Valuation Report. The Independent Valuer also confirmed that they are independent to the Group and the Sinomach Group.

The Initial Assets Valuation Report was prepared by the Independent Valuer by way of assets approach. Upon our further enquiry with the Independent Valuer, we understood that (i) as there was no identifiable and separate cashflow associated with the Target Assets, income approach was impracticable for the Initial Valuation; (ii) as there was no comparable transaction for the Target Assets, market approach was impracticable for the Initial Valuation; and (iii) assets approach was adopted for the Initial Valuation as there were complete financial and management information regarding the Target Assets and their replacement cost and the conditions for applying assets approach were satisfied.

In respect of the valuation approach, we considered the followings:

- (i) The Target Assets may generate economic benefits for an entity under its operation. Nevertheless, the Target Assets may not generate cashflow on their own (without business operation). It is reasonable that there was no identifiable and separate cashflow associated with the Target Assets on a separated basis.
- (ii) Having considered the nature of the Target Assets, we do not doubt the Independent Valuer's view that there was no comparable transaction for the Target Assets.
- (iii) We obtained certain information of the Target Assets (with supporting documents) as further explained below. Accordingly, we do not doubt the Independent Valuer's basis for adopting assets approach (i.e. there were complete financial and management information regarding the Target Assets and their replacement cost and the conditions for applying assets approach were satisfied).

Accordingly, we consider the adoption of assets approach for conducting the Initial Assets Valuation Report to be reasonable.

Having considered that the income approach and market approach were impracticable for the Initial Valuation and the appropriateness of the assets approach as mentioned above, we did not consider other approaches to assess the Initial Valuation.

We further reviewed and enquired into the Independent Valuer on the methodology adopted and the basis and assumptions adopted in the Initial Assets Valuation Report in order for us to understand the Initial Assets Valuation Report. We also discussed the key assumptions and parameters under the Initial Assets Valuation Report.

Under the Initial Assets Valuation Report, the Target Assets were categorised as (i) loans and advances to customers; (ii) long-term receivables; (iii) fixed assets; (iv) construction in progress; and (v) other intangible assets. We understood the followings from the Initial Assets Valuation Report:

- (i) In respect of loans and advances to customers, (a) in accordance with the Measures for the Administration of Reserve Provision of Financial Enterprises (金融企業準備金計提管理辦法) formulated by the Ministry of Finance and the relevant rules of YTO Finance on provisions for impairment, it recognises and appraises loans risk losses on normal category and focused category based on risk classification for loans and advances to customers; and (b) other loans and advances to customers were classified into the subsequent three categories, namely secondary, suspicious and loss, and were considered as nonperforming assets and it recognises the appraised value after analysing the recoverable value of debts.

For our due diligence purpose, we obtained the calculation, detailed explanation and certain underlying documents (such as copies of loan agreements and repayment undertakings) for the aforesaid appraisals. Based on our observation and discussion with the Independent Valuer, we have no doubt on the aforesaid appraisals.

- (ii) In respect of long-term receivables, (a) in accordance with the Measures for the Administration of Reserve Provision of Financial Enterprises (金融企業準備金計提管理辦法) formulated by the Ministry of Finance and the relevant rules of YTO Finance on provisions for impairment, it recognised and appraised risk losses on normal category and focused category based on risk classification for long-term receivables for the financial leasing business; and (b) other loans and advances to customers were classified into the subsequent three categories, namely secondary, suspicious and loss, and were considered as nonperforming assets and it recognises the appraised value after analysing the recoverable value of debts.

For our due diligence purpose, we obtained the calculation, detailed explanation and certain underlying documents (such as copies of financial lease agreements and repayment undertakings) for the aforesaid appraisals. Based on our observation and discussion with the Independent Valuer, we have no doubt on the aforesaid appraisals.

- (iii) In respect of fixed assets, (a) certain fixed assets were valued by replacement cost times integrated newness rate; and (b) certain fixed assets were valued based on relevant prices in the second-hand market or rejected product prices.

For our due diligence purpose, we obtained the calculation, detailed explanation and certain underlying information (such as replacement costs, market prices and useful life of the fixed assets) for the aforesaid appraisals. Based on our observation and discussion with the Independent Valuer, we have no doubt on the aforesaid appraisals.

- (iv) In respect of other intangible assets, they were valued after taking into account replacement cost and depreciation rate.

For our due diligence purpose, we obtained the calculation, detailed explanation and certain underlying information (such as replacement costs and useful life of the intangible assets) for the aforesaid appraisals. Based on our observation and discussion with the Independent Valuer, we have no doubt on the aforesaid appraisals.

- (v) In respect of construction in progress, (a) for projects completed with construction costs settled or construction costs payable confirmed on the Valuation Date, they were appraised using the valuation approach for fixed assets; and (b) for construction in progress with the commencement date within half a year before the Valuation Date, the verified book value was adopted as the appraised value.

As confirmed by the Independent Valuer, only method (b) above was adopted as the commencement dates of all construction in progress under appraisal were within half a year before the Valuation Date. For our due diligence purpose, we obtained the detailed explanation and certain underlying information (such as book value of the other assets (construction in progress)) for the aforesaid appraisals. Based on our observation and discussion with the Independent Valuer, we have no doubt on the aforesaid appraisals.

We also obtained the detailed explanation of the Initial Assets Valuation Report from the Valuer and further understood the detailed workings in arriving the Initial Valuation.

During our discussion with the Independent Valuer and based on our understanding on the detailed workings in arriving the Initial Valuation, we did not identify any major factor which caused us to doubt the fairness and reasonableness of the methodology, principal bases, assumptions and parameters adopted for the Initial Assets Valuation Report.

Having considered our independent work performed on the Initial Assets Valuation Report and that (i) the value stated in the Final Valuation Report that would have been filed with the relevant state-owned regulatory authorities will be taken as the Final Consideration; and (ii) the assets type of the Target Assets and the valuation methodologies used in the Final Valuation will be similar to that adopted in the Initial Valuation, we are of the view that the Final Consideration is fair and reasonable.

Given that the Initial Valuation was approximately RMB1,047 million as at 31 December 2021, we consider that the Maximum Consideration of RMB1.8 billion to be justifiable as it implied sufficient buffer.

#### **Payment of the consideration**

Within five Business Days upon completion of filing of the Final Valuation Report, YTO Finance will commence the transfer of the Target Assets to Sinomach Finance. Within two Business Days upon the transfer of the Target Assets relating to credit assets of the members companies of the Group, Sinomach Finance will pay 90% of the Final Consideration. The balance of the Final Consideration will be payable by Sinomach Finance within two Business Days upon the transfer of the Target Assets other than the credit assets of the members companies of the Group.

Taking into account the principal terms of the Disposal as set out above, we consider that the terms of the Disposal are fair and reasonable.

#### **Possible financial effects of the Disposal**

With reference to the Board Letter, it is estimated that the Group will record a gain of RMB21,419,300 from the Disposal, after taking into account the appraised value and the book value of the Target Assets as at 31 December 2021 of approximately RMB1,047,263,700 and RMB1,025,844,400 respectively. It should be noted that the actual gain on the Disposal to be recorded by the Group will depend on the Final Consideration and the book value of the Target Assets as at the Business Cessation Date.

## **B. THE CAPITAL INCREASE**

Summarised below are the principal terms for the Investment Agreement (as revised and supplemented by the Supplemental Investment Agreement), details of which are set out under the section headed “3. THE CAPITAL INCREASE” of the Board Letter.

#### **Date**

Investment Agreement: 29 March 2022

Supplemental Investment Agreement: 27 May 2022

#### Parties

- (1) The Company; and
- (2) Sinomach Finance

#### Capital Increase

Pursuant to the Investment Agreement, the Company has conditionally agreed to make a capital increase in cash to Sinomach Finance (the “Contribution Amount”) of RMB558,168,900 to subscribe for additional registered capital of RMB250,000,000 in Sinomach Finance, representing approximately 14.29% of the enlarged share capital of Sinomach Finance after the Capital Increase. RMB250,000,000 will be credited as registered capital and RMB308,168,900 will be credited as contributed surplus in Sinomach Finance.

In the event there are further changes to the Sinomach Valuation after the valuation report has been filed with the relevant state-owned regulatory authorities, the final Contribution Amount for the Capital Increase to be payable by the Company shall be adjusted accordingly, on condition that the Company’s shareholding in Sinomach Finance remains unchanged at approximately 14.29% upon completion of the Capital Increase.

With reference to the Board Letter, pursuant to the Supplemental Investment Agreement and the Final Sinomach Valuation Report as filed with the relevant state-owned regulatory authorities, both parties agreed and confirmed that the Contribution Amount was adjusted from RMB558,168,900 to RMB554,776,100, of which RMB250,000,000 will be credited as registered capital and RMB304,776,100 will be credited as contributed surplus in Sinomach Finance.

The Company shall be entitled to nominate one director candidate to the board of directors of Sinomach Finance. Subject to compliance with the qualification requirements under the relevant laws and regulations, Sinomach shall, and shall procure other shareholders of Sinomach Finance to take necessary action to, elect the director candidate nominated by the Company to become a director of Sinomach Finance.

#### Contribution amount

The Contribution Amount shall be payable by the Company to Sinomach Finance within five Business Days of the Investment Agreement (as revised and supplemented by the Supplemental Investment Agreement) becoming effective and shall be settled fully in cash. Following completion of the Capital Increase, the registered capital of Sinomach Finance will increase from RMB1,500,000,000 to RMB1,750,000,000.

The Contribution Amount is determined based on the valuation of entire shareholders’ equity of Sinomach Finance as at 31 December 2021 appraised by the Independent Valuer (i.e., the Sinomach Valuation).



The Independent Valuer used both market approach and income approach to conduct the valuation, and the valuation results from the market approach was used as the valuation conclusion. As at 31 December 2021, being the valuation date, the appraised value of the Sinomach Valuation using market approach was RMB3,328,656,600.

#### ***The Final Sinomach Valuation Report***

For our due diligence purpose, we reviewed and enquired into (i) the terms of engagement of the Independent Valuer; (ii) the Independent Valuer's qualification in relation to the preparation of the Final Sinomach Valuation Report; and (iii) the steps and due diligence measures taken by the Independent Valuer for conducting the Final Sinomach Valuation Report. From the mandate letter and other relevant information provided by the Independent Valuer and based on our interview with them, we were satisfied with the terms of engagement of the Independent Valuer as well as their qualification for preparation of the Final Sinomach Valuation Report. As aforementioned, the Independent Valuer also confirmed that they were independent to the Group and the Sinomach Group.

As aforementioned, the Independent Valuer used both market approach and income approach to conduct the Sinomach Valuation, and the valuation results from the market approach was used as the valuation conclusion. Upon our further enquiry with the Independent Valuer, we understood the followings:

- (i) Asset-based approach cannot quantify the value of the brand in respect of the financial services of Sinomach Finance as a financial enterprise. The provisions made by the financial enterprise have significant impact on net assets while accounting standards only set out the scope and bottom-line requirements for the provisions without quantifying the specific proportions. Hence, the asset-based approach does not take into consideration the impact of the provisions for risks on valuation result.
- (ii) As future cashflow can better reflect the value of Sinomach Finance's income, income approach was used to conduct the Sinomach Valuation. Nevertheless, the subject of valuation was a finance company of a group, serving members of the group and was heavily reliant on members of the group. Its development plans and operation budget were determined by related policies of the group and future incomes will be significantly affected by relevant factors with high uncertainties, which impose limitations on the application of the income approach.
- (iii) Under market approach, the value of the valuation subject was appraised with reference to subjects in realistic market, which was characterised by direct valuation perspectives, visualised valuation processes, direct valuation data from the market, convincing valuation results and can objectively reflect the value of the valuation subject. Accordingly, market approach was adopted to conduct and conclude the Sinomach Valuation.

In respect of the valuation approach, we considered the followings:

- (i) Asset-based approach, market approach and income approach are three most commonly used approaches for valuation.
- (ii) Sinomach Finance recorded profit after tax of approximately RMB297 million for FY2020 and approximately RMB306 million for FY2021. In addition to the limitations of asset-based approach as stated above, asset-based approach may not reflect a company's potential in generating future revenue or income.
- (iii) In light of Sinomach Finance's profitability as stated above, it is reasonable for the Independent Valuer to adopt income approach to reflect the value of Sinomach Finance's income. Nevertheless, there are limitations of income approach as stated above.
- (iv) The market approach can objectively reflect the value of the valuation subject and there were comparable transactions available.

Accordingly, we consider that it is reasonable for the Independent Valuer to (i) adopt the market approach and income approach for conducting the Sinomach Valuation; and (ii) conclude the Sinomach Valuation with market approach.

We noticed that the Sinomach Valuation would be approximately 0.22% less should income approach were adopted instead of market approach. Given (i) that the Independent Valuer prepared the Final Sinomach Valuation Report by ways of two approaches (i.e. the market approach and income approach) which derived similar results; (ii) the disadvantage of the assets approach as mentioned above; and (iii) asset-based approach, market approach and income approach are three most commonly used approaches for valuation, we did not consider other approaches to be appropriate for assessing the Sinomach Valuation.

We further reviewed and enquired into the Independent Valuer on the methodology adopted and the basis and assumptions adopted in the Final Sinomach Valuation Report in order for us to understand the Final Sinomach Valuation Report. We also discussed the key assumptions and parameters under the Final Sinomach Valuation Report.

With reference to the Final Sinomach Valuation Report, transaction comparison was applied for the Sinomach Valuation and the Valuer selected comparable transactions with the following selection criteria:

- (i) the period of the valuation date was from 1 January 2019 until present date;
- (ii) parties to the transactions involved listed companies and the valuation reports were publicly published, (i.e. the relevant financial indicators of the target finance companies were publicly available); and

- (iii) there was no special transaction background or abnormal operating conditions from publicly available information and it was believed that the transaction prices fully reflect the market-based results.

Based on the above criteria, the Independent Valuer selected three comparable transactions. As the selection criteria enable the Independent Valuer to identify transactions with target companies that mainly operates in the same activity (the provision of financial services) and geographical region (the PRC) as Sinomach Finance, with sufficient data publicly available for the Independent Valuer to conduct the valuation, we do not doubt the selection criteria adopted by the Independent Valuer in identifying the comparable transactions. Having also considered the information of the comparable transactions as contained under the Final Sinomach Valuation Report, we do not doubt the selection of the comparable transactions.

With reference to the Final Sinomach Valuation Report, finance company is a typical capital-driven enterprise, and is subject to restrictions imposed by regulatory authorities on capital. Therefore, net asset size is an important factor to the determination of the asset value and scale of income of finance company, and is relatively stable since it is less affected by macroeconomic policy and industry life cycle. Therefore, net asset size could better represent enterprise value of a finance company. In view of the above, price to book (“P/B”) ratio was selected as the value ratio in the valuation, while adjustment coefficients included transaction date, asset size, profitability, growth ability, operation ability and other indicators. The Independent Valuer then adopted the average adjusted P/B ratio of the comparable transactions and multiply it by the net asset value of Sinomach Finance to arrive the Sinomach Valuation.

For our due diligence purpose, we obtained the calculation of the aforementioned P/B ratios, the average adjusted P/Bs (with details of the underlying adjustment coefficients) of the comparable transactions and the Sinomach Valuation. Based on our observation and discussion with the Independent Valuer, we have no doubt on the aforesaid appraisals.

We also obtained the detailed explanation of the Final Sinomach Valuation Report from the Valuer and further understood the detailed workings in arriving the Sinomach Valuation.

During our discussion with the Independent Valuer, we did not identify any major factor which caused us to doubt the fairness and reasonableness of the methodology, principal bases, assumptions and parameters adopted for the Final Sinomach Valuation Report.

Set out below is our quantitative assessment on the Contribution Amount:

| Items   | RMB           |
|---|---------------|
| Sinomach Valuation as at 31 December 2021                       | 3,328,656,600 |
| Contribution Amount   | 554,776,100   |
| Sum of Sinomach Valuation and Contribution Amount               | 3,883,432,700 |
| 14.29% of the sum of Sinomach Valuation and Contribution Amount | 554,942,533   |

As illustrated in the above table, the Contribution Amount is slightly lower than 14.29% of the sum of Sinomach Valuation and Contribution Amount. Besides, based on the Sinomach Valuation of RMB3,328,656,600 as at 31 December 2021 and the existing registered capital of Sinomach Finance (i.e., RMB1,500,000,000), the appraised value per RMB1 registered capital of Sinomach Finance is approximately RMB2.2191, which is the same with the “price” per RMB1 registered capital increase in Sinomach Finance based on the Contribution Amount of RMB554,776,100, among which RMB250,000,000 will be credited as registered capital of Sinomach Finance.

Having considered the above and our independent work performed on the Final Sinomach Valuation Report and based on our understanding on the detailed workings in arriving the Sinomach Valuation, we are of the view that the Contribution Amount is fair and reasonable.

Taking into account the principal terms of the Capital Increase as set out above, we consider that the terms of the Capital Increase are fair and reasonable.

#### **Possible financial effects of the Capital Increase**

Based on the 2021 Annual Report, the audited consolidated total equity attributable to shareholders of the Company was approximately RMB5.4 billion as at 31 December 2021. The Directors expect that the Capital Increase would not have material impact on the NAV of the Group.

Based on the unaudited pro forma financial information of the Group as set out in Appendix IV to the Circular, the consolidated total equity attributable to shareholders of the Company would remain unchanged as if the Capital Increase had been completed on at 31 December 2021.

It should be noted that the aforementioned analyses are for illustrative purposes only and do not purport to represent how the financial position of the Group will be upon completion of the Capital Increase.

### C. NON-EXEMPT CONTINUING CONNECTED TRANSACTIONS

Summarised below are the principal terms for the Financial Services Framework Agreement (including the Non-exempt Continuing Connected Transactions), details of which are set out under the section headed “5. FINANCIAL SERVICES FRAMEWORK AGREEMENT” of the Board Letter.

#### **Date**

29 March 2022

#### **Parties**

- (1) The Company, on behalf of the Group; and
- (2) Sinomach Finance

#### **Services to be provided**

The Group will from time to time, utilise the financial services available from Sinomach Finance on a non-exclusive basis as it deems necessary. Such services include, amongst others, deposit services (including but not limited to demand deposit, agreement deposit, call deposit and time deposit in both domestic currency and foreign currency) (i.e., the Non-exempt Continuing Connected Transactions).

#### **Term**

The transactions contemplated under the Financial Services Framework Agreement will become effective upon the conditions to the Financial Services Framework Agreement being fulfilled. The Financial Services Framework Agreement will expire on 31 December 2024.

#### **Fees and charges**

The interest rate for the deposit of the member companies of the Group with Sinomach Finance shall be determined with reference to the benchmark interest rate for RMB deposit as published by PBOC provided that such rate shall be no less than the deposit rate for the same kind of deposits offered by other commercial banks in the PRC for the same period and no less than the deposit rate for the same kind of deposits provided to other member companies of Sinomach Group, whichever is higher.

With reference to the Board Letter, the Financial Services Framework Agreement entered into between the Company and Sinomach Finance is on a non-exclusive basis. The Company has the right to decide and choose whether to procure the financial services from Sinomach Finance or other commercial banks based on its operating needs. In order to ensure the continuing connected transactions are in compliance with the pricing terms agreed in the Financial Services Framework Agreement and will not exceed the annual caps, the Company has formulated the internal control measures as set out under the section headed “Measure of internal control” of the Board Letter, and the Group’s finance department, office of the Board and internal audit department shall be responsible for the implementation and supervision thereof.

We consider the effective implementation of the aforesaid internal control measures can ensure fair determination of the interest rate for the Non-exempt Continuing Connected Transactions.

#### Proposed annual caps

Set out below are the details of the maximum daily balance of deposits (including accrued interest thereon) placed by the Group with Sinomach Finance (the “Annual Cap(s)”) for the period from the date of the Financial Services Framework Agreement becoming effective to 31 December 2024:

|               | For the period<br>from date of the<br>Financial<br>Services<br>Framework<br>Agreement<br>becoming<br>effective to<br>31 December<br>2022 | For the year<br>ending<br>31 December<br>2023 | For the year<br>ending<br>31 December<br>2024 |
|---------------|--|---|---|
|               | <i>RMB'million</i>   | <i>RMB'million</i>                            | <i>RMB'million</i>                            |
| Annual Cap(s) | 2,000  | 2,000   | 2,000   |

With reference to the Board Letter, the maximum daily balance of deposits placed by the Group with Sinomach Finance (i.e. the Annual Caps) were determined after taking into account the following factors:

- (i) the daily settlement needs of the Group which the daily balance of deposits is required to be maintained at approximately RMB1.4 billion based on the actual balance of deposits placed by member companies of the Group in YTO Finance for settlement purpose (apart from the bill acceptance business purpose stated in (ii) below) for the three years ended 31 December 2021;
- (ii) the highest historical bill acceptance transaction amounts between the Group and YTO Finance for the two years ended 31 December 2021 were RMB1.65 billion and RMB1.8 billion respectively. It is expected that the scale of the Group's bill acceptance business in Sinomach Finance will maintain similar level as it was in YTO Finance for the three years ending 31 December 2024. Based on the Group's past experience, the deposit required for the bill acceptance business will generally account for 30% of the transaction amounts. As such the maximum balance of deposits regarding the bill acceptances business is estimated at RMB510 million, RMB510 million and RMB540 million for the three years ending 31 December 2024; and
- (iii) the expected deposit interest rates offered by Sinomach Finance.

Given the above, we consider the Annual Cap of RMB2 billion is necessary to cover the Group's possible maximum deposit to be placed with Sinomach Finance, together with possible accrued interest (i.e. the sum of approximately RMB1.4 billion and RMB0.54 billion plus possible accrued interest).

In light of the above, we consider that the Annual Caps are fair and reasonable.

Shareholders should note that as the Annual Caps are relating to future events and were estimated based on assumptions which may or may not remain valid for the entire period up to 31 December 2024, and they do not represent forecasts of amounts of the Group's deposit to be placed with Sinomach Finance. Consequently, we express no opinion as to how closely the actual amounts of the Group's deposit to be placed with Sinomach Finance will correspond with the Annual Caps.

Having considered the principal terms of the Non-exempt Continuing Connected Transactions as set out above, we are of the view that the terms of the Non-exempt Continuing Connected Transactions (including the Annual Caps) are on normal commercial terms and are fair and reasonable.

### Hong Kong Listing Rules implication

The Directors confirmed that the Company shall comply with the requirements of Rules 14A.53 to 14A.59 of the Hong Kong Listing Rules pursuant to which (i) the values of the Non-exempt Continuing Connected Transactions must be restricted by the Annual Caps; (ii) the terms of the Non-exempt Continuing Connected Transactions (including Annual Caps) must be reviewed by the independent non-executive Directors annually; (iii) details of independent non-executive Directors' annual review on the terms of the Non-exempt Continuing Connected Transactions must be included in the Company's subsequent published annual reports. Furthermore, it is also required by the Hong Kong Listing Rules that the auditors of the Company must provide a letter to the Board confirming, among other things, whether anything has come to their attention that causes them to believe that the Non-exempt Continuing Connected Transactions (i) have not been approved by the Board; (ii) were not entered into, in all material respects, in accordance with the relevant agreement governing the transactions; and (iii) have exceeded the Annual Caps. In the event that the total amounts of the Non-exempt Continuing Connected Transactions are anticipated to exceed the Annual Caps, or that there is any proposed material amendment to the terms of the Non-exempt Continuing Connected Transactions, as confirmed by the Directors, the Company shall comply with the applicable provisions of the Hong Kong Listing Rules governing continuing connected transaction.

Given the above stipulated requirements for continuing connected transactions pursuant to the Hong Kong Listing Rules, we are of the view that there are adequate measures in place to monitor the Non-exempt Continuing Connected Transactions and thus the interest of the Independent Shareholders would be safeguarded.

### RECOMMENDATION

Having taken into consideration the factors and reasons as stated above, we are of the opinion that (i) the terms of the Disposal, the Capital Increase and the Non-exempt Continuing Connected Transactions are on normal commercial terms and are fair and reasonable; (ii) although the Disposal and the Capital Increase are not conducted in the ordinary and usual course of business of the Group, they are in the interests of the Company and the Shareholders as a whole; and (iii) the Non-exempt Continuing Connected Transactions are conducted in the ordinary and usual course of business of the Group and are in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Board Committee to advise the Independent Shareholders to vote in favour of the resolutions to be proposed at the EGM to approve the Disposal, the Capital Increase and the Non-exempt Continuing Connected Transactions and we recommend the Independent Shareholders to vote in favour of the resolutions in this regard.

Yours faithfully,  
For and on behalf of  
Gram Capital Limited



**Graham Lam**  
Managing Director

*Note: Mr. Graham Lam is a licensed person registered with the Securities and Futures Commission and a responsible officer of Gram Capital Limited to carry out Type 6 (advising on corporate finance) regulated activity under the SFO. He has over 25 years of experience in investment banking industry.*

\* For identification purpose only