**THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION**

**If you are in doubt** as to any aspect of this circular or as to the action to be taken, you should consult your stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

**If you have sold or transferred** all your shares in Chongqing Machinery & Electric Co., Ltd.*, you should at once hand this circular to the purchaser or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser(s).



CQME

# Chongqing Machinery & Electric Co., Ltd.*

# 重慶機電股份有限公司

*(a joint stock limited company incorporated in the People's Republic of China with limited liability)*

(Stock Code: 02722)

## (1) CONTINUING CONNECTED TRANSACTIONS;
## (2) MAJOR TRANSACTIONS AND CONTINUING CONNECTED TRANSACTIONS;
## AND
## (3) NOTICE OF EGM.

**Independent Financial Adviser to the Independent Board Committee and Independent Shareholders**

TC Capital
天財資本

A notice convening the second EGM of Chongqing Machinery & Electric Co., Ltd.* for 2013 to be held at Conference Room 1303, 13/F, Jidian Building, No. 60, Middle Section of Huangshan Avenue, New North Zone, Chongqing City, the PRC on Monday, 30 December 2013 at 9:30 a.m. is set out on pages 72 to 74 of this circular.

A form of proxy for use at the EGM is enclosed with this circular and such form of proxy is also published on the websites of the Stock Exchange (www.hkexnews.hk) and the Company (www.chinacqme.com). Whether or not you intend to attend the EGM, you are requested to complete and return (i) the reply slip enclosed with this circular in accordance with the instructions printed thereon not later than Monday, 9 December 2013 and (ii) the enclosed form of proxy in accordance with the instructions printed thereon not less than 24 hours before the time fixed for holding the EGM or any adjournment thereof (as the case may be). Completion and return of the form of proxy will not preclude you from attending the EGM and voting in person if you so wish.

15 November 2013

* *For identification purposes only*

# CONTENTS

*In this circular, unless the context otherwise requires, the following expressions shall have the following meanings:*

| | |
|---|---|
| "2014-2016 Group Financial Services Framework Agreement" | the financial services framework agreement entered into between the Company and the Finance Company on 14 October 2013, pursuant to which the Finance Company will provide deposits, loans, guarantees and other financial services to the Group during 2014-2016 |
| "2014-2016 Master Sales Agreement" | the master sales agreement entered into between the Company and the Parent Company on 14 October 2013, pursuant to which the Group has agreed to sell certain products such as control valves and parts for steering systems, gears and clutch assemblies and the BV series of electric cables to the Parent Group during 2014-2016 |
| "2014-2016 Master Supplies Agreement" | the master supplies agreement entered into between the Company and the Parent Company on 14 October 2013, pursuant to which the Parent Group has agreed to supply parts and raw materials such as gears, component parts, YB2 series engines, electricity, water and gas to the Group during 2014-2016 |
| "2014-2016 Parent Group Financial Services Framework Agreement" | the financial services framework agreement entered into between the Parent Company and the Finance Company on 14 October 2013, pursuant to which the Finance Company will provide deposits, loans, guarantees and other financial services to the Parent Group during 2014-2016 |
| "Announcement" | the announcement dated 14 October 2013 published by the Company in relation to, the 2014-2016 Master Sales Agreement, the 2014-2016 Master Supplies Agreement, 2014-2016 Master Leasing Agreement, 2014-2016 Group Financial Services Framework Agreement and 2014-2016 Parent Group Financial Services Framework Agreement |

| | |
|---|---|
| "associate(s)" | has the meaning ascribed to it under the Listing Rules |
| "Board" | the board of Directors |
| "CBRC" | China Banking Regulatory Commission (中國銀行業監督管理委員會) |
| "Company" | Chongqing Machinery & Electric Co., Ltd.* (重慶機電股份有限公司) |
| "Controlling Shareholder" | has the meaning ascribed to it under the Listing Rules |
| "Director(s)" | the director(s) of the Company |
| "Domestic Share(s)" | ordinary share(s) of nominal value of RMB1.00 each in the share capital of the Company which are subscribed for or credited as paid up in RMB |
| "Existing Master Leasing Agreement" | the master leasing agreement entered into between the Company and the Parent Company on 16 June 2010 for the leasing of land and buildings from the Parent Group to the Group as offices, production facilities, workshops and staff quarters |
| "Existing Master Sales Agreement" | the master sales agreement entered into between the Company and the Parent Company on 16 June 2010, pursuant to which the Group agreed to sell certain products such as control valves and parts for steering systems, gears and clutch assemblies and the BV series of electric cables to the Parent Group |
| "Existing Master Supplies Agreement" | the master supplies agreement entered into between the Company and the Parent Company on 16 June 2010, pursuant to which the Parent Group agreed to supply parts and raw materials such as gears, component parts, YB2 series engines, electricity, water, gas and electrolytic copper to the Group |

| | |
|---|---|
| "Extraordinary General Meeting" or "EGM" | the second extraordinary general meeting of 2013 to be held by the Company to consider and, if thought fit, to approve, among other things: (1) the 2014-2016 Master Sales Agreement, (2) the 2014-2016 Master Supplies Agreement, (3) the 2014-2016 Group Financial Services Framework Agreement and (4) the 2014-2016 Parent Group financial Services Framework Agreement |
| "Finance Company" | Chongqing Machinery and Electric Holding (Group) Finance Co., Ltd.* (重慶機電控股集團財務有限公司), a limited liability company established in the PRC on 16 January 2013 by the Company, the Parent Company and China Industrial International Trust Limited* (興業國際信託有限公司), which is owned as to 51%, 30% and 19% by the Company, the Parent Company and China Industrial International Trust Limited respectively |
| "Group" | the Company and its subsidiaries |
| "H Share(s)" | the overseas-listed foreign share(s) of the Company with a nominal value of RMB1.00 each, which are listed on the Stock Exchange |
| "HK$" | Hong Kong dollars, the lawful currency of Hong Kong |
| "Hong Kong" | the Hong Kong Special Administrative Region of the PRC |
| "Independent Board Committee" | an independent committee of the Board composed of independent non-executive Directors, namely Mr. Lo Wah Wai, Mr. Ren Xiaochang, Mr. Jin Jingyu and Mr. Yang Zhimin |
| "Independent Financial Adviser" or "TC Capital" | TC Capital Asia Limited, a licensed corporation to carry out type 1 (dealing in securities) and type 6 (advising on corporate finance) regulated activities under the SFO (Chapter 571 of the Laws of Hong Kong), being the independent financial adviser to the Independent Board Committee and the Independent Shareholders in relation to the annual caps for major transactions and continuing connected transactions of the Group |

| | |
|---|---|
| "Independent Shareholder(s)" | has the meaning ascribed to it under Rule 14A.10(5) of the Listing Rules, and in relation to the Company means the Shareholders other than Parent Company and its associates |
| "Latest Practicable Date" | 12 November 2013, being the latest practicable date prior to the printing of this circular for ascertaining certain information in this circular |
| "Listing Rules" | the Rules Governing the Listing of Securities on the Stock Exchange |
| "Parent Company" | Chongqing Machinery and Electronic Holding (Group) Co., Ltd.* (重慶機電控股(集團)公司), a limited liability company established in the PRC on 25 August 2000 and owned by the Chongqing State-owned Assets Supervision and Administration Commission, being one of the Promoters of the Company |
| "Parent Group" | Parent Company and its associates, excluding the Group |
| "PBOC" | the People's Bank of China, the central bank of the PRC |
| "PRC" or "China" | the People's Republic of China, which, for the purpose of this circular, excludes Hong Kong, the Macau Special Administrative Region of the PRC and the Taiwan region |
| "RMB" | Renminbi, the lawful currency of the PRC |
| "SFO" | the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) as amended, supplemented or revised otherwise from time to time |
| "Shares" | the Domestic Shares and/or the H Shares |
| "Shareholder(s)" | holder(s) of the Shares |
| "Stock Exchange" | The Stock Exchange of Hong Kong Limited |
| "Supervisor(s)" | the supervisor(s) of the Company |

# Chongqing Machinery & Electric Co., Ltd.*
# 重慶機電股份有限公司

*(a joint stock limited company incorporated in the People's Republic of China with limited liability)*

(Stock Code: 02722)

*Executive Directors:*
Mr. Wang Yuxiang
Mr. Yu Gang
Mr. Ren Yong
Mr. Chen Xianzheng

*Non-executive Directors:*
Mr. Huang Yong
Mr. Wang Jiyu
Mr. Yang Jingpu
Mr. Deng Yong

*Independent Non-executive Directors:*
Mr. Lo Wah Wai
Mr. Ren Xiaoxhang
Mr. Jin Jingyu
Mr. Yang Zhimin

*Registered office and Principal place of Business in PRC:*
No. 60 Middle Section of Huangshan Avenue
New North Zone, Chongqing City, the PRC

*Principal place of business in Hongkong:*
Suite 2008, 20th Floor, Jardine House, No. 1
Connaught Place, Central
Hong Kong

15 November 2013

*To the Shareholders*

Dear Sir or Madam,

## (1) CONTINUING CONNECTED TRANSACTIONS;
## (2) MAJOR TRANSACTIONS AND CONTINUING TRANSACTIONS;
## AND
## (3) SUPPLEMENTAL NOTICE OF THE EGM.

### 1. INTRODUCTION

Reference is made by the Board to the announcement of the Company dated 14 October 2013, in relation to the 2014-2016 Master Sales Agreement, the 2014-2016 Master Supplies Agreement, the 2014-2016 Master Leasing Agreement, the 2014-2016 Group Financial Services Framework Agreement and the 2014-2016 Parent Group Financial Services Framework Agreement as well as the proposed annual cap amounts for the continuing connected transactions contemplated under such agreements for the three years ending 31 December 2014, 2015 and 2016.

The purpose of this circular is to provide you with information reasonably necessary to enable you to make informed decisions on whether to vote for or against the resolutions to be proposed at the EGM and to provide you with the notice of the EGM.

## 2. CONTINUING CONNECTED TRANSACTIONS

**Background**

References are made to the circulars of the Company dated 28 April 2010 and 18 April 2011, as well as the announcements of the Company dated 28 April 2010 and 14 April 2011, in relation to, among others, the Existing Master Sales Agreement and the Existing Master Supplies Agreement which constitute continuing connected transactions of the Company under Chapter 14A of the Listing Rules and will expire on 31 December 2013.

**2014-2016 Master Sales Agreement**

On 16 June 2010, the Company entered into the Existing Master Sales Agreement, pursuant to which the Group agreed to sell certain products such as control valves and parts for steering systems, gears and clutch assemblies and the BV series of electric cables to the Parent Group.

As the Existing Master Sales Agreement will expire on 31 December 2013, the Company renewed the Existing Master Sales Agreement with the Parent Company under the same terms by entering into the 2014-2016 Master Sales Agreement on 14 October 2013, the major terms of which are set out as follows:

Date:

14 October 2013

Parties:

(i) the Company, as supplier; and

(ii) the Parent Company, as purchaser.

Term:

Subject to the approval being obtained from the Independent Shareholders, commencing from 1 January 2014 and expiring on 31 December 2016.

Nature of Transaction:

The Group sells certain products such as control valves and parts for steering systems, gears and clutch assemblies and the BV series of electric cables to the Parent Group.

Payment terms:

The payment terms will be specified on each separate contract to be agreed by both parties.

The historical transaction records and the annual cap amounts under the Existing Master Sales Agreement are set out below:

| | **For the year ended 31 December 2011** | **For the year ended 31 December 2012** | **For the period from 1 January to 30 September 2013** |
|---|---|---|---|
| | *RMB millions* | *RMB millions* | *RMB millions* |
| Annual cap amount | 155.0 | 185.0 | 210.0 |
| Historical transaction record | 98.3 | 119.2 | 91.2 |
| Utilization rate | 63.4% | 64.4% | 43.4% |

The proposed annual caps for each of the three years ending 31 December 2016 under the 2014-2016 Master Sales Agreement are set out below:

| | **For the year ending 31 December** | | |
|---|---|---|---|
| | **2014** | **2015** | **2016** |
| | *RMB millions* | *RMB millions* | *RMB millions* |
| Proposed annual caps | 220.0 | 250.0 | 310.0 |

The proposed annual caps under the 2014-2016 Master Sales Agreement are determined with reference to:

(i) the estimated demand for the production and sales in relation to vehicle parts and components, power equipment, general machinery and CNC machine tools;

(ii) the estimated sales volume of the Group for each of the three financial years ending 31 December 2016;

(iii) the prospect of the PRC economy and the markets relevant to the Group, in particular, the PRC automobile and power equipment segments;

(iv) the historical amount of the sales transactions for the financial year ended 31 December 2012;

(v) SAIC-IVECO Hongyan Commercial Vehicle Ltd.* (上汽依維柯紅岩商用車有限公司), a non-wholly owned subsidiary of the Parent Group, which has recorded impressive sales over the last few years is expected to continue this growth rate over the next few years. The Group is expected to supply more parts to SAIC-IVECO Hongyan Commercial Vehicle Ltd.* as the Group's capacity increases, and also the business of SAIC-IVECO Hongyan Commercial Vehicle Ltd.* is expected to increase as demand for commercial vehicles increases over the next few years;

(vi) As Qijiang Gear Transmission Co., Ltd.* (綦江齒輪傳動有限公司), a wholly-owned subsidiary of the Company, is currently building a production base with annual capacity of 200,000 units of heavy truck transmissions, which is expected to be put into operation in 2014, its scale of operation will be expanded significantly in the coming three years, thus resulting in greater growth in its sales to connected parties; and

(vii) Chongqing Shengpu Materials Co., Ltd.* (重慶盛普物資有限公司), a wholly-owned subsidiary of the Company, serves as the centralized procurement platform of bulk materials for the Group. In order to achieve synergy and reduce costs, the Group will procure and sell raw materials to the Parent Group through this centralized procurement platform and is expected to see noticeable increase in the coming three years.

The Directors (including the independent non-executive Directors) are of the opinion that the proposed annual caps are fair and reasonable and that the transactions contemplated under the 2014-2016 Master Sales Agreement are entered into on normal commercial terms and in the ordinary and usual course of business of the Group, and the terms of the 2014-2016 Master Sales Agreement are fair and reasonable and in the interest of the Shareholders as a whole.

**PRICING BASIS FOR THE 2014-2016 MASTER SALES AGREEMENT**

The 2014-2016 Master Sales Agreement was entered into in the ordinary and usual course of business of the Group. The terms of the 2014-2016 Master Sales Agreement were negotiated on an arm's length basis and on normal commercial terms. The pricing or consideration of the 2014-2016 Master Sales Agreement will be determined with reference to the following:

(i) according to the price set by the PRC Government (including the municipal government and other regulatory bodies which govern such transactions); or

(ii) if no such price is set by the PRC Government, not lower than the guide prices set by the PRC Government for such transactions; or

(iii) if there is no set price and no guide prices set by the PRC Government, not lower than such open market price between independent parties on normal commercial terms in comparable locality, or if there are no comparable localities, not lower than such open market price between independent parties on normal commercial terms in the PRC generally; or

(iv) if there is no set price and no guide prices set by the PRC Government and there is no open market price for such transactions, the parties are to negotiate on normal commercial terms for such transactions based on the actual or reasonable costs of such transactions (whichever is lower) together with a reasonable profit. A “reasonable profit” is a profit that is agreed between the parties as being no less than the Group’s profit margins of the same products for the previous year.

Products sold by the Group to the Parent Group are priced competitively for the market, with two general pricing strategies, namely: (i) products and general raw materials such as steel, bearings and fuels sold to the Parent Group through the centralized procurement platform of Chongqing Shengpu Materials Co., Ltd.* (重慶盛普物資有限公司) that have open market price will be priced at market rate; while (ii) other products, such as special-purpose vehicle parts and components, wires and cables, including customized products, will be sold at the prices based on actual costs with a reasonable profit. Currently, there is no price or guide price has been set by the PRC Government for the products under the existing Master Sales Agreement. In the unlikely event that the PRC Government decides to set prices or guide prices of products sold by the Group, the Group will comply with the relevant government regulations and price its products accordingly.

After reviewing the relevant basis, the Directors (including the independent non-executive Directors) are of the view that the terms of the 2014-2016 Master Sales Agreement are entered into on normal commercial terms, and are fair and reasonable and in the interests of the Company and the Shareholders as a whole.

**2014-2016 Master Supplies Agreement**

On 16 June 2010, the Company entered into the Existing Master Supplies Agreement with the Parent Company, pursuant to which the Parent Group agreed to supply the Group with parts and raw materials such as gears, component parts, YB2 series engines, electricity, water, gas and electrolytic copper.

As the Existing Master Supplies Agreements will expire on 31 December 2013, the Company renewed the Existing Master Supplies Agreement with the Parent Company under the same terms by entering into the 2014-2016 Master Supplies Agreement on 14 October 2013, the major terms of which are set out below:

Date:

14 October 2013

Parties:

(i) the Company, as purchaser; and

(ii) the Parent Company, as supplier.

Term:

Subject to the approval being obtained from the Independent Shareholders, commencing from 1 January 2014 and expiring on 31 December 2016.

Nature of transaction:

The Parent Group supplies the Group with parts and raw materials such as gears, component parts, YB2 series engines, electricity, water and gas.

Payment terms:

The payment terms will be specified on each separate contract to be agreed by the parties.

The historical transaction records and the annual cap amounts for the Existing Master Supplies Agreement are set out below:

| | **For the year ended 31 December 2011** *RMB millions* | **For the year ended 31 December 2012** *RMB millions* | **For the period from 1 January to 30 September 2013** *RMB millions* |
|---|---|---|---|
| Annual cap amount | 410.0 | 480.0 | 550.0 |
| Historical transaction record | 248.0 | 310.0 | 50.3 |
| Utilization rate | 60.5% | 64.6% | 9.1% |

The proposed annual caps for each of the three years ending 31 December 2016 under the 2014-2016 Master Supplies Agreement are set out below:

| | For the year ending 31 December | | |
|---|---|---|---|
| | **2014** | **2015** | **2016** |
| | *RMB millions* | *RMB millions* | *RMB millions* |
| Proposed annual cap amount | 160.0 | 84.0 | 99.0 |

The Directors (including the independent non-executive Directors) are of the opinion that the proposed annual caps are fair and reasonable and that the transactions contemplated under the 2014-2016 Master Supplies Agreement are entered into on normal commercial terms and in the ordinary and usual course of business of the Group, and the terms of the 2014-2016 Master Supplies Agreement are fair and reasonable and in the interest of the Shareholders as a whole.

The proposed annual caps under the 2014-2016 Master Supplies Agreement are determined with reference to:

(i) the estimated demand for the supplies in relation to vehicle parts and components, power equipment, general machinery and CNC machine tools;

(ii) the estimated sales and procurement volume of the Group for each of the three financial years ending 31 December 2016;

(iii) the prospect of the PRC economy and the markets relevant to the Group, in particular, the PRC automobile and power equipment segments;

(iv) the historical amount of the supplies transactions for the year ended 31 December 2012;

(v) the historical transaction records under the Master Supplies Agreement for the nine months ended 30 September 2013 decreased significantly as compared with those for the twelve months ended 31 December 2012, mainly because: (a) Chongqing Huahao Smelting Co., Ltd.* (重慶華浩冶煉有限公司), a wholly-owned subsidiary of the Company, stopped purchasing electrolytic copper from Chongqing Metallurgy & Copper Industry Co., Ltd.* (重慶重冶銅業有限公司), a subsidiary of the Parent Company owned as to 51% by the Parent Company, as the latter has ceased production; (b) the procurement volume of Qijiang Gear Transmission Co., Ltd.* (綦江齒輪傳動有限公司), a wholly-owned subsidiary of the Company, from the members of the Parent Group such as Chongqing Changjiang Bearing Co., Ltd.* (重慶長江軸承股份有限公司), an associate of the Parent Company, which is owned as to 37.86% by the Parent Company, dropped greatly. The increase in annual caps in 2014 is also attributable to the Company's expectation of acquiring remaining assets of Chongqing Metallurgy & Copper Industry Co., Ltd.* (重慶重冶銅業有限公司); and

(vi) The annual cap amount of relevant procurement for 2014 is substantially higher than those for the following two years because of the relatively significant increase in procurement of equipment such as cranes by certain subsidiaries of the Company as a result of their massive concerted move under the environmental relocation project in 2014. The relocation projects that were disclosed in the announcements of the Company dated 5 February 2013 and 19 March 2013, are expected to incur construction investment of approximately RMB1,391 million and RMB151 million, respectively. The Company expects that the relocation projects will be completed by the end of 2014 and therefore, the procurements of equipment are expected to decrease to less than RMB2 million in 2015 and 2016. Therefore, the proposed annual cap amount for the year of 2015 decreases by 47.5% when comparing to the year of 2014.

**PRICING BASIS FOR THE 2014-2016 MASTER SUPPLIES AGREEMENT**

The 2014-2016 Master Supplies Agreement was entered into in the ordinary and usual course of business of the Group. The terms of the 2014-2016 Master Supplies Agreement were negotiated on an arm's length basis and on normal commercial terms. The pricing or consideration of the 2014-2016 Master Supplies Agreement will be determined with reference to the following:

(i) according to the price set by the PRC Government (including the municipal government and other regulatory bodies which govern such transactions); or

(ii) if no such price is set by the PRC Government, not lower than the guide prices set by the PRC Government for such transactions; or

(iii) if there is no set price and no guide prices set by the PRC Government, not higher than such open market price between independent parties on normal commercial terms in comparable locality, or if there are no comparable localities, not higher than such open market price between independent parties on normal commercial terms in the PRC generally; or

(iv) if there is no set price and no guide prices set by the PRC Government and there is no open market price for such transactions, the parties are to negotiate on normal commercial terms for such transactions based on the actual or reasonable costs of such transactions (whichever is lower) together with a reasonable profit. A "reasonable profit" is a profit that is agreed between the parties as being no more than the Parent Group's profit margin of the same products for the previous year.

Products sold by the Parent Group to the Group are mainly vehicle parts and components, lifting equipment, and electrical equipment that are priced according to market forces. The products purchased by the Group from Parent Group are usually priced according to comparable market pricing of similar products found in their respective localities. Products without a comparable market pricing would be priced according to their cost with a reasonable profit, based on historical profit margins, for the Parent Group. Currently, there is no price or guide price has been set by the PRC Government for the products under the existing Master Supplies Agreement. In the unlikely event that the PRC Government decides to set prices or guide price of products sold by the Parent Group, the Parent Group will comply with the relevant government regulations and price its products accordingly.

After reviewing the relevant basis, the Directors (including the independent non-executive Directors) are of the view that the terms of the 2014-2016 Master Supplies Agreement are entered into on normal commercial terms, and are fair and reasonable and in the interests of the Company and the Shareholders as a whole.

**Reasons for, and Benefits of, the Transactions contemplated under the 2014-2016 Master Sales Agreement and the 2014-2016 Master Supplies Agreement**

The Group has been purchasing from the Parent Group parts and raw materials such as gears, component parts, YB2 series engines, electricity, water and gas from time to time. As a result of the Group's long-term business relationship with the Parent Group, the Parent Group is familiar with the Group's product specifications and has been able to respond quickly and in a cost efficient manner to any new requirements that the Group may request.

In addition, from the perspective of the Group, the sales of the products to the Parent Group would secure a reliable customer base and a stable income and ensure punctual payment for the products sold.

## INTERNAL CONTROL

The Company has implemented the following measures regarding its internal control system for the connected transactions:

(i) The Company has established a special office with dedicated personnel in place to monitor and manage the connected transactions; and

(ii) The special office will review the implementation of the caps of the connected transactions and of pricing terms monthly to ensure both annual caps and pricing have been fully complied with.

(iii) The audit committee of the Company will review the implementation of connected transactions regarding sales and supplies monthly.

**IMPLICATIONS UNDER THE LISTING RULES**

**2014-2016 Master Sales Agreement and 2014-2016 Master Supplies Agreement**

As the Parent Company is the Controlling Shareholder of the Company, holding 52.22% equity interest in the Company, the Parent Group is a connected person of the Group under the Listing Rules. Therefore, the transactions contemplated under each of the 2014-2016 Master Sales Agreement and the 2014-2016 Master Supplies Agreement constitute continuing connected transactions of the Company. As the highest applicable percentage ratios calculated in accordance with Chapter 14A of the Listing Rules in respect of the respective annual caps under the 2014-2016 Master Sales Agreement and the 2014-2016 Master Supplies Agreement exceed 5% and such annual caps exceed HK$10,000,000, each of the 2014-2016 Master Sales Agreement and the 2014-2016 Master Supplies Agreement constitutes a non-exempted continuing connected transaction of the Company under Chapter 14A of the Listing Rules and is subject to the reporting, announcement and Independent Shareholders' approval requirements under the Listing Rules.

## 3. MAJOR TRANSACTIONS AND CONTINUING CONNECTED TRANSACTIONS

**Background**

References are made to the announcements of the Company dated 17 February 2013 and 13 March 2013, as well as the circular of the Company dated 15 March 2013 in relation to, among others, the Group Financial Services Framework Agreement (as amended by the Group Financial Services Framework Supplemental Agreement) and the Parent Group Financial Services Framework Agreement (as amended by the Parent Group Financial Services Framework Supplemental Agreement) which constitute major transactions and continuing connected transactions of the Company under Chapter 14 and Chapter 14A of the Listing Rules and will expire on 31 December 2013.

**2014-2016 Group Financial Services Framework Agreement**

On 14 October 2013, the Group and the Finance Company entered into the 2014-2016 Group Financial Services Framework Agreement, pursuant to which, the Finance Company will provide financial services to the Group, including loan services, guarantee services and other financial services and, subject to the approval being obtained from the Independent Shareholders, deposit services. The Group is not under any obligation to obtain any or all of the financial services provided by the Finance Company and may obtain such financial services based on its business needs.

The major terms of deposit services under the 2014-2016 Group Financial Services Framework Agreement are set out below:

Date:

14 October 2013

Parties:

(i) the Company; and

(ii) the Finance Company.

Term:

Subject to the approval being obtained from the Independent Shareholders, the terms of deposit services under the 2014-2016 Group Financial Services Framework Agreement will become effective from 1 January 2014 and will expire on 31 December 2016. The terms of loan services, guarantee services and other financial services under the 2014-2016 Group Financial Services Framework Agreement will become effective from 1 January 2014 and will expire on 31 December 2016.

Services:

Pursuant to the 2014-2016 Group Financial Services Framework Agreement, the Finance Company agreed to provide financial services to the Group, including deposit services, loan services, guarantee services and other financial services.

The Finance Company undertakes under the 2014-2016 Group Financial Services Framework Agreement that the terms of any financial services to be provided by the Finance Company to the Group will be no less favourable than those of similar financial services provided by independent third parties to the Group (subject to no violation of relevant laws and regulations).

The Group is not under any obligation to obtain any or all of the financial services provided by the Finance Company and may obtain such financial services based on its business needs.

Payment terms:

The payment terms will be specified on each separate contract to be agreed by the parties.

Pricing standards:

The pricing standards of the financial services provided by the Finance Company are as follows:

Deposit services

The interests of deposits provided by the Finance Company will not be lower than the interest rates for deposits of similar nature and under similar terms provided to the Group by other independent commercial banks in the PRC.

The Company will obtain the interest rates for deposits of similar nature and under similar terms from at least two banks among the national commercial banks in the PRC and local commercial banks in Chongqing that have business relations with the Company, and compare with the interest rates provided by the Finance Company to the Group for deposits of similar nature and under similar terms to ensure that the interests the Group will receive on its deposits are in compliance with the above pricing standards for deposit services.

**Proposed Annual Cap Amounts and the Basis for the Financial Services under the 2014-2016 Group Financial Services Framework Agreement**

Deposits services

The historical transaction records and the annual cap amounts for the deposit services under the Group Financial Services Framework Agreement are set out below:

| | **For the period from 10 April to 30 September 2013**<br>*RMB millions* |
|---|---|
| Annual cap amount of maximum daily balance (including corresponding interest) | 1,250.0 |
| Maximum daily balance of deposits (including corresponding interest) | 1,230.6 |
| Utilization rate | 98.5% |

The proposed annual caps for the deposit services under the 2014-2016 Group Financial Services Framework Agreement for each of the three years ending 31 December 2016 are set out below:

| | **For the year ending 31 December 2014** | **For the year ending 31 December 2015** | **For the year ending 31 December 2016** |
|---|---|---|---|
| | *RMB millions* | *RMB millions* | *RMB millions* |
| Annual cap amount of maximum daily balance (including corresponding interest) | 1,600.0 | 1,840.0 | 2,116.0 |

As at 31 December 2011, 31 December 2012 and 30 June 2013, the Group had cash and cash equivalents of RMB2,789,570,000, RMB2,628,884,000 and RMB1,970,913,000, respectively.

The Group's cash and cash equivalents are expected to be approximately RMB2,000,000,000 at the end of 2013. From 2014 to 2016, the closing cash and cash equivalents of the Group are expected to grow at the same compound annual growth rate ("CAGR") of approximately 15% as per the Group's operation scale for the past five years, and the highest deposit ratio in the Finance Company is expected to be about 80%.

The proposed annual caps of maximum daily balance for the deposit services under the 2014-2016 Group Financial Services Framework Agreement are determined with references to: (a) the data set out above; (b) the expectation of the Group's capital needs for the period from now up to 31 December 2016; (c) the financial ability of the Finance Company; and (d) the historical transaction records of the deposit services under the Group Financial Services Framework Agreement.

The Directors (including the independent non-executive Directors) are of the opinion that the proposed annual caps and pricing of the 2014-2016 Group Financial Services Framework Agreement are fair and reasonable and that the transactions contemplated under it are entered into on normal commercial terms and in the ordinary and usual course of business of the Group, and the terms of the 2014-2016 Group Financial Services Framework Agreement are fair and reasonable and in the interest of the Company and the Shareholders as a whole.

**2014-2016 Parent Group Financial Services Framework Agreement**

On 14 October 2013, the Parent Company and the Finance Company entered into the 2014-2016 Parent Company Financial Services Framework Agreement, pursuant to which, the Finance Company will provide financial services to the Parent Group, including deposit services and other financial services and, subject to the approval of the Independent Shareholders, loan services and guarantee services. The Finance Company is not under any obligation to provide any or all of the financial services to the Parent Group and may offer such financial services based on its business needs.

The major terms of the loan services and guarantee services contemplated under 2014-2016 Parent Group Financial Services Framework Agreement are set out below:

Date:

14 October 2013

Parties:

(i) the Parent Company; and

(ii) the Finance Company.

Term:

Subject to the approval being obtained from the Independent Shareholders, the terms of loan services and guarantee services under the 2014-2016 Parent Group Financial Services Framework Agreement will become effective from 1 January 2014 and expire on 31 December 2016. The terms of deposit services and other financial services under the 2014-2016 Parent Group Financial Services Framework Agreement will become effective from 1 January 2014 and expire on 31 December 2016.

Services:

Pursuant to the 2014-2016 Parent Group Financial Services Framework Agreement, the Finance Company has agreed to provide the financial services to the Parent Group, including deposit services, loan services, guarantee services and other financial services.

The Finance Company is not under any obligation to provide any or all of the financial services to the Parent Group and may provide such financial services based on its business needs.

Payment terms:

The payment terms will be specified on each separate contract to be agreed by the parties.

Pricing standards:

The pricing standards of the financial services provided set by the Finance Company are as follows:

Loan services

The interest rates for loans provided to the Parent Group by the Finance Company will not be lower than the interest rates for loans of similar nature and under similar terms charging the Parent Group by other independent commercial banks in the PRC.

The Company will make inquiries to at least two banks among the national commercial banks in the PRC and the local commercial banks in Chongqing that have business relations with the Company in respect of loan services of similar nature and under similar terms with reference to the credit characteristics of the relevant company with the Parent Group, and submit the results to the Finance Company. The Finance Company will then make the final assessments and determine the final interest rates provided to the Parent Group by reference to the Parent Group's business risks, comprehensive returns, capital cost of the Finance Company and regulatory indictors and others factors, so as to ensure that the interests of loans provided by the Finance Company to the Parent Group are in compliance with the above pricing standards for loan services.

Guarantee services

The fees charged by the Finance Company for provision of guarantee services to the Parent Group will not be lower than the fees charged by any independent third party on the Parent Group for the same type of services or the fees charged by the Finance Company on any third party of same credit rating for the same type of services.

The Company will making inquiries to at least two banks or guarantee institutions among the national commercial banks in the PRC as well as the local commercial banks or guarantee institutions in Chongqing, which have business relations with the Company, in respect of guarantee services of similar nature and under similar terms and submit the results to the Finance Company. The Finance Company will then make the final assessments and determine the final price for guarantee services provided to the Parent Group by reference to the Parent Group's business risks, comprehensive returns, capital cost of the Finance Company and regulatory indictors and others factors, so as to ensure that the fees charged by the Finance Company are in compliance with the above pricing standards for guarantee services.

**Proposed Annual Cap Amounts and the Basis for the Financial Services under the 2014-2016 Parent Group Financial Services Framework Agreement**

Loan services

The historical transaction records and the annual cap amounts for the loan services under the Parent Group Financial Services Framework Agreement are set out below:

| | **For the period from 10 April to 30 September 2013** *RMB millions* |
|---|---|
| Annual cap amount of maximum daily loan balance (including corresponding interest) | 1,170.0 |
| Maximum daily balance of loans (including corresponding interest) | 950.2 |
| Utilization rate | 81.2% |

The proposed annual caps for the loan services under the 2014-2016 Parent Group Financial Services Framework Agreement for each of the three years ending 31 December 2016 are set out below:

| | **For the year ending 31 December 2014** *RMB millions* | **For the year ending 31 December 2015** *RMB millions* | **For the year ending 31 December 2016** *RMB millions* |
|---|---|---|---|
| Annual cap amount of maximum daily loan balance (including corresponding interest) | 1,570.0 | 2,130.0 | 2,500.0 |

As at 31 December 2011, 31 December 2012 and 30 June 2013, the borrowings and loans of the Parent Group amounted to RMB3,494,030,000, RMB4,950,560,000 and RMB5,109,320,000, respectively.

As at 30 June 2013, the Parent Group has current borrowings of approximately RMB4 billion out of the RMB5.1 billion borrowings and loans outstanding. Based on its current level of short term loan, the Finance Company estimates that it will only be able to obtain a maximum of 40% of the Parent Group's existing short term loans. The reason for the limited amount of loans being assumed from the Parent Group is due to the Parent Group's needs to maintain a certain level of business relationship with existing banks and financial institutions to obtain preferential rates and treatment for other financial services offered by these independent third party banks. Furthermore, some of the existing non-current borrowings have yet to mature and the transfer of loan business to the Finance Company can only occur when the Parent Group needs to rollover these non-current borrowings. The Finance Company estimates that as business of the Finance Company matures, it will be able to provide a higher percentage of the existing current loan from the Parent Group, namely 50% and 60% for the years ending 2015 and 2016, respectively.

The proposed annual caps for the loan services under the 2014-2016 Parent Group Financial Services Framework Agreement are determined with reference to (a) the data set out above; (b) the expectation of the Parent Group's capital needs for the period from now up to 31 December 2016; (c) the Finance Company's financial ability; and (d) the historical transaction records of the loan services.

Guarantee services

The historical transaction records and the annual cap amounts for the guarantee services under the Parent Group Financial Services Framework Agreement are set out below:

| | **For the period from 10 April to 30 September 2013** *RMB millions* |
|---|---|
| Annual cap amount (including corresponding fees) | 618.0 |
| Historical transaction record (including corresponding fees) | 102.5 |
| Utilization rate | 16.6% |

The proposed annual caps for the guarantee services under the 2014-2016 Parent Group Financial Services Framework Agreement for each of the three years ending 31 December 2016 are set out below:

| | For the year ending 31 December 2014<br>*RMB millions* | For the year ending 31 December 2015<br>*RMB millions* | For the year ending 31 December 2016<br>*RMB millions* |
|---|---|---|---|
| Annual cap amount (including corresponding fees) | 618.0 | 618.0 | 618.0 |

According to the requirements of the Provisional Measures for Risk Regulation Indicators Assessment of Finance Companies of Enterprise Groups (《企業集團財務公司風險監管指標考核暫行辦法》) issued by the CBRC, the ratio of guarantee exposures against the total assets of the Finance Company shall be not higher than 100%. As such, the annual caps of the registered capital of the Finance Company can only be equal to RMB600,000,000 and guarantee fees that maybe incurred amounting to approximately RMB18,000,000.

As at 31 December 2011, 31 December 2012 and 30 June 2013, guarantees provided by the Parent Company for its subsidiaries amounted to approximately RMB2,254,000,000, RMB 1,975,264,000 and RMB2,432,000,000, respectively.

Based on the existing levels of guarantees used by the Parent Group, the Parent Group could easily utilize the entire annual cap available for guarantee provided by Finance Company. However, the usage of guarantee is highly subjected to the acceptance by the counterparty of the guarantee provided by the Finance Company. As the Finance Company has just begun operations this year, it has not established itself in the market and only known in the industry as a new guarantee company. As such, the usage of its guarantee facilities has not been high and has not achieved the projected goals set by the Finance Company. However, the Finance Company will actively promote itself within the Parent Group's subsidiaries and in the guarantee industry in hopes of fully utilizing the proposed annual caps.

The proposed annual caps for the guarantee services under the 2014-2016 Parent Group Financial Services Framework Agreement are determined with reference to (a) the above requirements and data; (b) the historical transaction records for the guarantee services.

The Directors (including the independent non-executive Directors) are of the opinion that the proposed annual caps and pricing of the 2014-2016 Parent Group Financial Services Framework Agreement are fair and reasonable and that the transactions contemplated under it are entered into on normal commercial terms and in the ordinary and usual course of business of the Group, and the terms of the 2014-2016 Group Financial Services Framework Agreement are fair and reasonable and in the interest of the Company and the Shareholders as a whole.

**Internal Controls and Risk Management**

In order to safeguard the interests of the Shareholders, the Group and the Finance Company provide for the following risk management measures:

***(a) Capital requirement of the Finance Company***

Pursuant to the relevant regulations set by CBRC, financial institutions in the PRC have to comply with certain requirements, which include, among other things, the minimum total capital requirement of a capital adequacy ratio of not less than 10% as set out by CBRC. Based on the registered capital of RMB600,000,000 of the Finance Company and that the Finance Company shall provide the financial services not exceeding the proposed annual caps, the Finance Company sets its capital adequacy ratio for the period of 2014 to 2016 at not less than 10% , which is in compliance with relevant provisions of the CBRC. The minimum registered capital of the Finance Company is RMB300,000,000.

***(b) Internal control of the Finance Company***

The establishment of the Finance Company as a non-bank financial institution was authorized by CBRC, which carries out on-going stringent supervision over the businesses of the Finance Company. The Finance Company is required to provide regulatory report to CBRC on a monthly basis.

The Finance Company has established its own credit policies and credit approval procedures for the loan applications, bills discounting services and bills acceptance services, which are designed in accordance with the relevant PBOC and CBRC regulations. Such measures are able to ensure that the various financial services provided by the Finance Company shall not exceed the proposed annual caps approved.

The Group has adopted the internal control procedures and corporate governance procedures to monitor the status of the financial conditions of the Finance Company (in the case of deposit services, loan services, guarantee services and other financial services). The audit committee of the Company will review the finance, operation, risk management system and regulatory compliance of the Company, particularly the implementation of connected transactions, monthly.

***(c)*** ***Qualifications of the Finance Company***

The management of the Finance Company has extensive experience in the financial industry where the Group operates and/or financial management. The Finance Company has certain key committees and departments in maintaining the internal control environment and the risk management functions, including, the risk management committee/department, the loan approval committee and the supervisory committee. The risk management committee of the Finance Company has established the risk management and control strategies and policies, and monitors the implementation of the relevant policies of the Finance Company while the supervisory committee of the Finance Company will ensure the Finance Company's compliance with the relevant rules and regulations, and to monitor its operational activities.

***(d)*** The audit committee of the Company will review the implementation of connected transactions under the 2014-2016 Group Financial Services Framework Agreement and the 2014-2016 Parent Group Financial Services Framework Agreement monthly.

Set out below are reasons for, and benefits of, the 2014-2016 Group Financial Services Framework Agreement between the Company and the Finance Company:

(a) The Finance Company will gradually become the capital settlement center, capital management center, financing support center, capital operation center and information service center of the Group, which would be able to enhance the financial management and control practices, reduce operational risk and consolidate internal resources of the Group;

(b) The Finance Company is regulated by the PBOC and the CBRC and is required to provide its services in accordance with the rules and operational requirements of these regulatory authorities. In addition, capital risk could be reduced through the risk management measures;

(c) The interest rates for the capital deposited by the Group with the Finance Company will not be lower than interest rates for deposits of similar nature and under similar terms provided to Group by other independent commercial banks in the PRC. Such arrangement will enable the Group to increase its interest income more effectively; and

(d) The Group is able to obtain loans from the Finance Company at an interest rate not higher than the interest rates for loans of similar nature and under similar terms charging the Group by other independent commercial banks in the PRC, which could effectively lower its financing costs.

Based on the reasons set out above, the Directors (including members of the Independent Board Committee) are of the view that the terms of the 2014-2016 Group Financial Services Framework Agreement are fair and reasonable and in the interests of the Company and the Shareholders as a whole.

Set out below are reasons for, and benefits of, the 2014-2016 Parent Group Financial Services Framework Agreement between the Parent Company and the Finance Company:

(a) It will expand the business scale of the Finance Company, thus benefiting the development of the Finance Company;

(b) It will consolidate cash resources, enhance the capital utilization efficiency and lower the finance cost;

(c) It will enlarge the operation scale of the Group, thus enhancing the profitability of the Group; and

(d) The Company through its direct 51% equity interest in the Finance Company will be able to share the profits of the Finance Company, obtained through provision of loan and guarantee services under the 2014-2016 Parent Group Financial Services Framework Agreement.

Based on the reasons set out above, the Directors (including members of the Independent Board Committee) are of the view that the terms of the 2014-2016 Parent Group Financial Services Framework Agreement are fair and reasonable and in the interests of the Company and the Shareholders as a whole.

## GENERAL INFORMATION

### The Group

The Group is principally engaged in manufacturing and sales of vehicle parts and components, power equipment, general machinery and CNC machine tools.

### The Parent Group

The Parent Group is principally engaged in automobiles and ancillary automobile business (including special purpose vehicles, compartments and transmission axles), electronic information business and other business.

### The Finance Company

The Finance Company is a non-bank financial institution established in January 2013 under the PRC laws and with the approval of CBRC. It is subject to the regulation of the PBOC and CBRC. Its principal business is provision of financial services (including but not limited to deposit services, loan services, guarantee services and other financial services) to the Group and the Parent Group.

## IMPLICATIONS UNDER THE LISTING RULES

### 2014-2016 Group Financial Services Framework Agreement

As disclosed in the Announcement, as the Parent Company is the Controlling Shareholder of the Company, holding 52.22% equity interest in the Company, the Parent Group is a connected person of the Group under the Listing Rules. The Finance Company, which is owned as to 30% by the Parent Company, is an associate of the Parent Company and a connected person of the Company. Therefore, the transactions contemplated under the 2014-2016 Group Financial Services Framework Agreement constitute continuing connected transactions of the Company.

As one or more of the applicable percentage ratios calculated in accordance with the Listing Rules in respect of the maximum daily amount of the deposit services exceed 5% and the annual caps exceeds HK$10,000,000, the deposit services under the 2014-2016 Group Financial Services Framework Agreement are subject to the reporting, announcement and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules. Furthermore, as one or more of the applicable percentage ratios calculated in respect of the maximum daily deposit amount exceed 25% but are less than 100%, such transactions also constitute major transactions of the Company under Rule 14.06(3) of the Listing Rules and are subject to the notification, publication and Shareholders' approval requirements for major transactions under Chapter 14 of the Listing Rules.

Although one or more of the applicable percentage ratios calculated in respect of the maximum daily loan amount exceed 5% and the annual caps exceeds HK$10,000,000, the loan services to be provided by the Finance Company to the Group is a financial assistance provided by a connected person for the benefit of a listed issuer. As the loan services will be on normal commercial terms with no security over the assets of the Group granted in respect of the loan services, the loan services is a connected transaction exempted from reporting, announcement and Independent Shareholders' approval requirements under Rule 14A.65(4) of the Listing Rules. Accordingly, no resolutions will be proposed to Shareholders to vote on in respect of the loan services under the 2014-2016 Group Financial Services Framework Agreement.

**2014-2016 Parent Group Financial Services Framework Agreement**

As disclosed in the Announcement, as the Parent Company is the Controlling Shareholder of the Company, holding 52.22% equity interest in the Company, the Parent Group is a connected person of the Group under the Listing Rules. The Finance Company, which is owned as to 51% by the Company, is a subsidiary of the Company. Pursuant to the Listing Rules, the Parent Group is a connected person of the Company. Therefore, the transactions contemplated under the 2014-2016 Parent Group Financial Services Framework Agreement constitute continuing connected transactions of the Company.

As one or more of the applicable percentage ratios calculated in accordance with the Listing Rules in respect of the maximum daily amount of the loan services exceed 5% and the annual cap exceeds HK$10,000,000, the loan services under the 2014-2016 Parent Group Financial Services Framework Agreement are subject to the reporting, announcement and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules. Furthermore, as one or more of the applicable percentage ratios calculated in respect of the maximum daily loan amount exceed 25% but are less than 100%, such transactions also constitute major transactions of the Company under Rule 14.06(3) of the Listing Rules and are subject to the notification, publication and Shareholders' approval requirements for major transactions under Chapter 14 of the Listing Rules.

As one or more of the applicable percentage ratios calculated in accordance with the Listing Rules in respect of the maximum daily amount of the guarantee services exceed 5% and the annual cap exceeds HK$10,000,000, the guarantee services under the 2014-2016 Parent Group Financial Services Framework Agreement are subject to the reporting, announcement and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

**GENERAL INFORMATION**

The Independent Board Committee comprising all independent non-executive Directors has been formed in accordance with the Listing Rules to advise the Independent Shareholders on the 2014-2016 Master Sales Agreement, the 2014-2016 Master Supplies Agreement, the terms of deposit services under the 2014-2016 Group Financial Services Framework Agreement, and the terms of loan services and guarantee services under the 2014-2016 Parent Group Financial Services Framework Agreement. The Independent Financial Adviser has been appointed to advise the Independent Board Committee and the Independent Shareholders as to whether the terms and conditions of the agreements for the above non-exempted continuing connected transactions, the transactions contemplated thereunder and their respective annual caps are fair and reasonable so far as the Independent Shareholders are concerned and in the interests of the Company and the Shareholders as a whole.

The EGM will be convened by the Company at which resolutions will be proposed to seek approval from the Independent Shareholders for the 2014-2016 Master Sales Agreement, the 2014-2016 Master Supplies Agreement, the deposit services under the 2014-2016 Group Financial Services Framework Agreement and the loan services and guarantee services under the 2014-2016 Parent Group Financial Services Framework Agreement and their respective proposed annual caps for the three years ending 31 December 2016. The Parent Company and its associates will abstain from voting on the relevant resolutions to be proposed at the EGM.

Mr. Wang Yuxiang (chairman of the Parent Company), Mr. Huang Yong (president of the Parent Company), Mr. Wang Jiyu (vice president of the Parent Company), Mr. Yu Gang (director of the Parent Company) and Mr. Ren Yong (director of the Parent Company) hold management positions in the Parent Company. Therefore, they are deemed to have material interests in the transactions contemplated under the 2014-2016 Master Sales Agreement, the 2014-2016 Master Supplies Agreement, the 2014-2016 Master Leasing Agreement, the 2014-2016 Group Financial Services Framework Agreement and the 2014-2016 Parent Group Financial Services Framework Agreement and have abstained from voting on the relevant Board resolutions to approve the above agreements.

## 4. EGM AND PROXY ARRANGEMENT

The notice of the EGM is set out on pages 72 to 74 of this circular. At the EGM, resolutions will be proposed to approve, inter alia, (i) the 2014-2016 Master Sales Agreement, (ii) the 2014-2016 Master Supplies Agreement, (iii) the deposit services under the 2014-2016 Group Financial Framework Agreement, and (iv) the loan services and guarantee services under the 2014-2016 Parent Group Financial Framework Agreement.

A form of proxy for use at the EGM is enclosed with this circular and such form of proxy is also published on the websites of the Stock Exchange (www.hkexnews.com.hk) and the Company (www.chinacqme.com). Whether or not you intend to attend the EGM, you are requested to complete and return (i) the reply slip enclosed with this circular in accordance with the instructions printed thereon not later than Monday, 9 December 2013 and (ii) the enclosed form of proxy in accordance with the instructions printed thereon not less than 24 hours before the time fixed for holding the EGM or any adjournment thereof (as the case may be). Completion and return of the form of proxy will not preclude you from attending and voting at the EGM in person if you so wish.

To the best of the Director's knowledge, information and belief and having made all reasonable enquires, save and except the Parent Company and its associates are required to abstain from voting on the resolutions as set out in the notice of the EGM, no Director or Shareholder has a material interest in the resolutions proposed at the EGM, and no Shareholder is required to abstain from voting on any of the resolutions at the EGM.

## 5. PROCEDURES FOR VOTING AT THE EGM

According to the Rule 13.39(4) of the Listing Rules, any vote at an extraordinary general meeting must be taken by poll.

## 6. RECOMMENDATION

The Directors consider that the proposed resolutions in connection with (i) the 2014-2016 Master Sales Agreement, (ii) the 2014-2016 Master Supplies Agreement, (iii) the deposit services under the 2014-2016 Group Financial Framework Agreement, and (iv) the loan services and guarantee services under the 2014-2016 Parent Group Financial Framework Agreement are in the interests of the Company and the Shareholders as a whole. Accordingly, the Directors recommend that all the Shareholders should vote in favor of the resolutions in relation to such issues to be proposed at the EGM.

Yours faithfully,
By Order of the Board
**Chongqing Machinery & Electric Co., Ltd.***
**Wang Yuxiang**
*Executive Director and Chairman*

* *For identification purposes only*

**Chongqing Machinery & Electric Co., Ltd.***
**重慶機電股份有限公司**

*(a joint stock limited company incorporated in the People's Republic of China with limited liability)*
(Stock Code: 02722)

15 November 2013

*To the Independent Shareholders*

Dear Sir or Madam,

Reference is made to the circular issued by the Company to the Shareholders dated 15 November 2013 (the "Circular") of which this letter forms a part. Unless otherwise specified, capitalised terms used herein shall have the same meanings as those defined in the Circular.

We have been appointed by the Board to advise you on the 2014-2016 Master Sales Agreement, 2014-2016 Master Supplies Agreement, the terms of the deposit services under the 2014-2016 Group Financial Services Framework Agreement and the terms of loan services and guarantee services under the 2014-2016 Parent Group Financial Services Framework Agreement. TC Capital has been appointed as the Independent Financial Adviser to advise you and us in this regard. Details of its advice, together with the principal factors and reasons it has taken into consideration in giving such advice, are set out on pages 27 to 61 of the Circular and the additional information is set out in the appendices thereto.

Having considered the 2014-2016 Master Sales Agreement, 2014-2016 Master Supplies Agreement, the terms of deposit services under the 2014-2016 Group Financial Services Framework Agreement and the terms of loan services and guarantee services under the 2014-2016 Parent Group Financial Services Framework Agreement, and taking into account the independent advice of TC Capital, in particular the principal factors, reasons and recommendations set out in its letter on pages 29 to 61 of the Circular, we consider that the 2014-2016 Master Sales Agreement, 2014-2016 Master Supplies Agreement, the terms of deposit services under the 2014-2016 Group Financial Services Framework Agreement and the terms of loan services and guarantee services under the 2014-2016 Parent Group Financial Services Framework Agreement are fair and reasonable so far as the Independent Shareholders are concerned, and are in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend you to vote in favor of the ordinary resolutions to be proposed at the second EGM for 2013 to approve the annual caps for such transactions for the three years ending 31 December 2016.

Yours faithfully,
*the Independent Board Committee*
**Lo Wah Wai, Ren Xiaochang, Jin Jingyu and Yang Zhimin**

TC Capital Asia Limited
天財資本亞洲有限公司

15 November 2013

*The Independent Board Committee and the Independent Shareholders*
*Chongqing Machinery & Electric Co., Ltd.**

Dear Sir/Madam,

# (1) CONTINUING CONNECTED TRANSACTIONS; AND (2) MAJOR TRANSACTIONS AND CONTINUING CONNECTED TRANSACTIONS

## INTRODUCTION

We refer to our appointment as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in relation to (a) the 2014-2016 Master Sales Agreement; (b) the 2014-2016 Master Supplies Agreement (together the "**Master Agreements**"); (c) the deposit services contemplated under the 2014-2016 Group Financial Services Framework Agreement; and (d) the loan services and guarantee services contemplated under the 2014-2016 Parent Group Financial Services Framework Agreement, together with the corresponding proposed annual cap amounts for the three years ending 31 December 2016. Details of the terms and the proposed annual cap amounts for each of the aforesaid transactions contemplated under the Master Agreements, the 2014-2016 Group Financial Services Framework Agreement and the 2014-2016 Parent Group Financial Services Framework Agreement (together the "**Framework Financial Services Agreements**") are set out in the letter from the Board (the "**Board Letter**") contained in the circular of the Company dated 15 November 2013 issued to the Shareholders (the "**Circular**"), of which this letter forms part. Capitalised terms used in this letter shall have the same meanings as those defined in the Circular, unless otherwise specified.

Our role as Independent Financial Adviser is to give our opinion as to whether the Master Agreements and Framework Financial Services Agreements, and their respective proposed annual cap amounts for the three years ending 31 December 2016 are in the ordinary and usual course of business of the Company, on normal commercial terms, fair and reasonable insofar as the Independent Shareholders are concerned, and in the interests of the Company and the Shareholders as a whole.

As stated in the Board Letter, the Parent Company holds approximately 52.22% equity interest in the Company and is therefore a Controlling Shareholding of the Company as defined under the Listing Rules. As such, the Parent Company is a connected person of the Company within the meaning of the Listing Rules. The Finance Company, which is owned as to 30% by the Parent Company and 51% by the Company, is an associate of the Parent Company and a subsidiary of the Company, respectively. Therefore, the Master Agreements, the Framework Financial Services Agreements and the transactions contemplated thereunder thus constitute continuing connected transactions of the Company under Chapter 14A of the Listing Rules.

Furthermore, as one or more of the applicable percentage ratios calculated in respect of the maximum daily balance for the deposit services under the 2014-2016 Group Financial Services Framework Agreement, and the maximum daily loan balance under the 2014-2016 Parent Group Financial Services Framework Agreement exceed 25% but are less than 100%, such transactions also constitute major transactions of the Company under Rule 14.06(3) of the Listing Rules, and are subject to the notification, publication and Shareholders' approval requirements for major transactions under Chapter 14 of the Listing Rules.

In formulating our opinion and recommendation, we have considered, among other things, (a) the Master Agreements and the Framework Financial Services Agreements; (b) the Company's 2012 annual report and 2013 interim report; and (c) other information as set out in the Circular. We have also relied on all relevant information, opinions and facts supplied and represented by the Company, the Directors and the management of the Company. We have assumed that all such information, opinions, facts and representations contained or referred to in the Circular, for which the Company is fully responsible, were true and accurate in all respects as at the date hereof and may be relied upon. We have no reason to doubt the truth, accuracy and completeness of the information and representations provided to us by the Company, and the Company has confirmed that no material facts have been withheld or omitted from the information provided and referred to in the Circular, which would make any statement therein misleading.

We consider that we have reviewed sufficient information currently available to reach an informed view and to justify our reliance on the accuracy of the information contained in the Circular so as to provide a reasonable basis for our recommendation. We have not, however, carried out independent verification of the information provided by the Directors and the representatives of the Company, nor have we conducted any form of in-depth investigation into the businesses, affairs, operations, financial position or future prospects of each of the Group, the Parent Group, the Finance Company and any of their respective subsidiaries and associates.

## PRINCIPAL FACTORS AND REASONS CONSIDERED

In formulating our opinions in respect of the entering into of the Master Agreements, the Framework Financial Services Agreements, and the corresponding terms and proposed annual cap amounts contemplated thereunder, we have taken into consideration the following principal factors and reasons:

### I. Information on the Group, the Parent Group and the Finance Company

#### *(a) The Group*

The Group is principally engaged in manufacturing and sales of automotive parts and components, general machinery, power equipment and CNC machine tools.

As stated in the Board Letter, we note that the Company has established a special office with dedicated personnel in place to conduct the monitoring and management of its connected transactions. The personnel of this special office reviews and evaluates the usage of the annual cap amounts, as well as the implementation of the internal assessments to ensure the adoption of the pricing principles according to the terms of the existing agreements monthly. As advised by the Director, the Company has complied with the established internal control measures for the connected transactions without any occurrence of violations against the terms of the approved connected transactions. Furthermore, as stated in the Board Letter, the Audit Committee of the Company (comprising three independent non-executive Directors and one non-executive Director) will independently review the implementation of the connected transactions under the Master Agreements monthly. Accordingly, we are of the view that there are sufficient internal control measures in place to ensure the terms, in particular the pricing principles, and the annual cap amounts to be fully complied with.

#### *(b) The Parent Group*

The Parent Group is principally engaged in automobiles and ancillary automobile business (including special purpose vehicles, compartments and transmission axle), electronic information business and other business.

***(c) The Finance Company***

The Finance Company was established in January 2013 and has commenced its operation since April 2013. It is a joint venture company to be established by the Parent Company, the Company and the China Industrial International Trust Limited as a non-bank financial institution according to the PRC laws and with the approval of CBRC. Its principal business is the provision of financial services (including but not limited to deposit services, loan services, guarantee services and other financial services) to the Group and the Parent Group. The Parent Company and the Company hold 30% and 51% equity interests in the Finance Company, respectively. As a licensed non-bank financial institution in the PRC, the Finance Company is under supervision of the PBOC and the CBRC.

The Finance Company is regulated under the stringent regulations promulgated by the PBOC and the CBRC. Accordingly, the Company and the Finance Company have adopted various internal control and risk management measures in relation to the provision of financial services by the Finance Company in order to ensure protection of the interest of the Shareholders since the establishment of the Finance Company in January 2013. Please refer to the section headed "Internal Controls and Risk Management" in the Board Letter for details. As advised by the management of the Company, the Finance Company has complied with the rules and regulations set up by the PBOC and the CBRC, and also the above adopted internal control and risk management measures since its commencement of operation.

The following is a summary table of the key financial information of the Finance Company as extracted from the management accounts for the nine months ended 30 September 2013 prepared in accordance with the PRC accounting principles:

| | **For the nine months ended 30 September 2013** *RMB million* (unaudited) |
|---|---|
| Turnover | 63.8 |
| Profits before tax | 38.6 |
| Net Profit | 28.9 |

| | As at 30 September 2013 *RMB million* (unaudited) |
|---|---|
| Total current assets | 2,107.2 |
| Total assets | 2,109.9 |
| Net assets | 628.9 |

The total paid-in capital of the Finance Company is RMB600 million. From the above financial information of the Finance Company, its total current asset balance represented approximately 99.9% of its total assets as at 30 September 2013. As advised by the Company, the capital adequacy ratio of the Finance Company was approximately 41.7% as at 30 September 2013, which is in compliance with relevant provisions of the CBRC. Based on the above financial information, we considered that the Finance Company has satisfactory financial condition to fulfill its obligations contemplated under the Framework Financial Services Agreements.

Furthermore, as stated in the Board Letter, the Audit Committee (comprising three independent non-executive Directors and one non-executive Director) will independently review the implementation of the connected transactions under the Framework Financial Services Agreements.

Taking into the account the above factors, we concur with the Directors' view that the Finance Company is eligible to provide the financial services contemplated under the Framework Financial Services Agreements, and we are not aware of any matter that would cause us to question the adequacy and efficiency of the monitoring system regarding the provision of the financial services by the Finance Company or the financial condition of the Finance Company, that may endanger the interests of the Company and the Shareholders as a whole.

## II. Backgrounds of and reasons for entering into the Master Agreements

On 14 October 2013, the Company entered into the Master Agreements with the Parent Group. The Group has been carrying out transactions with the Parent Group to facilitate its production, operations and sales under previous agreements since its initial listing of the Shares on the Stock Exchange in 2008. References are made to the announcements of the Company dated 22 April 2009, 28 April 2010 and 14 April 2011 regarding, among other things, the continuing connected transactions between the Group and the Parent Group for the (a) supply to the Group with parts and raw materials such as gears, component parts, YB2 series engines, electricity, water, gas and electrolytic copper; and (b) sell to the Parent Group certain products such as control valves and parts for steering systems, gears and clutch assemblies and the BV series of electric cables. As advised by the management of the Company, as a result of the long-term and solid business relationships between the Group and the Parent Group, they are both familiar with each other's standards and product specifications, and thus will be able to respond quickly and in a cost efficient manner to any new requirements that either party may request.

The Parent Group has been one of the Group's long-term customers and its sales of the products to the Parent Group amounted to approximately RMB119.2 million, representing approximately 1.1% of the Group's revenue for the year ended 31 December 2012. By entering into the 2014-2016 Master Sales Agreement, the sale of the products to the Parent Group allows the Company to secure a reliable and steady customer, a stable income and timely payment for its products sold.

By entering into the 2014-2016 Master Supplies Agreement, the Company will be able to secure a continuing and reliable supply of products with a prescribed standard of quality. The Group will not have to incur extra time to source supplies from other suppliers and thus affecting its normal operations and sales. Pursuant to the 2014-2016 Master Supplies Agreement, the Parent Group is obligated to supply the products contracted at a level and standard which is not lower than the level and standard supplied to other parties by the Parent Group.

Having considered the above factors, we concur with the Directors' view that the entering into of the Master Agreements are in the ordinary and usual course of the business of the Company, on normal commercial terms and are in the interests of the Company and Shareholders as a whole.

**III. Backgrounds of and reasons for entering into the Framework Financial Services Agreements**

The Finance Company entered into the Group Financial Services Framework Agreement (as amended by the Group Financial Services Framework Supplemental Agreement) with the Company, and the Parent Group Financial Services Framework Agreement (as amended by the Parent Group Financial Services Framework Supplemental Agreement) with the Parent Company on 17 February 2013 and 13 March 2013. On 14 October 2013, the Company and the Finance Company entered into the 2014-2016 Group Financial Services Framework Agreement. Pursuant to which, the Finance Company will provide financial services to the Group, including deposit services, for the three years ending 31 December 2016. On the even date, the Parent Company and the Finance Company entered into the 2014-2016 Parent Group Financial Services Framework Agreement. Pursuant to which, the Finance Company will provide financial services to the Parent Group, including loan services and guarantee services, for the three years ending 31 December 2016.

***(a) The 2014-2016 Group Financial Services Framework Agreement***

The Company considers that the entering into the 2014-2016 Group Financial Services Framework Agreement will benefit the Group and the Finance Company for the following reasons:

(1) The Finance Company is gradually becoming the capital settlement, capital management, financing support, capital operation and information service center of the Group according to the development plan of the Finance Company, which would be able to enhance the financial management and control practices, reduce operational risk and consolidate internal resources of the Group;

(2) The Finance Company is regulated by the PBOC and the CBRC and is required to provide its services in accordance with the rules and operational requirements of these regulatory authorities. In addition, capital risk could be reduced through the risk management measures possessed by the Finance Company; and

(3) The capital deposited by the Group with the Finance Company will receive interest at a rate not lower than the interest rates for deposits of similar nature and under similar terms offered to the Group by other independent commercial banks in the PRC. Such arrangement will enable the Group to increase its interest income more effectively.

As disclosed in the Company's 2013 interim report, the Company plans to carry out the technological upgrading projects at a faster pace and push ahead with work on joint ventures and mergers and acquisitions projects in an orderly fashion. As advised by the Directors, the aforesaid plans are expected to bring forth stronger cash flow, which will intensify the need for fund management within the Group in an efficient and effective manner. The arrangement under the existing Group Financial Services Framework Agreement is able to promote the liquidity among the Group, thus enhances the overall ability of the Group to repay debts, assist in monitoring and controlling financial risks, and consolidate the internal resources of the Group.

As advised by the management of the Company, the Company utilizes the finance services provided by the Finance Company on a voluntary and non-exclusive basis and is not obliged to engage the Finance Company to any particular services, or at all under the 2014-2016 Group Financial Services Framework Agreement. The Finance Company is merely one of the financial institutions which provides financial services to the Group. On this basis, the Directors consider that the use of the Finance Company provides an additional important platform for the Group to implement efficient capital management and will therefore be beneficial to the Group as a whole.

Having considered the above reasons, we are of the view that the entering into of the 2014-2016 Group Financial Services Framework Agreement, in particular the deposit services, is in the ordinary and usual course of business of the Company, fair and reasonable so far as the Company and the Independent Shareholders are concerned.

***(b) The 2014-2016 Parent Group Financial Services Framework Agreement***

The Company considers that the entering into the 2014-2016 Parent Group Financial Services Framework Agreement will benefit the Group and the Finance Company for the following reasons:

(1) It helps to expand the business scale of the Finance Company, thus benefiting the development of the Finance Company. As the Company directly holds 51% equity interest in the Finance Company, the Company will be able to share the profits of the Finance Company, which in turn helps to enlarge the Group's operation scale and enhance its profitability; and

(2) It helps to consolidate cash resources, enhance the capital utilization efficiency, and lower the finance costs.

The interests and fees generated from the provision of loan services and guarantee services to the Parent Group will be credited to the Finance Company instead of other independent commercial banks in the PRC, which allows the Group to have direct financial benefits due to its direct 51% equity interest in the Finance Company. The Parent Group is one of the top 500 companies and one of top 500 manufacturing enterprises in the PRC in 2012 according to the China Enterprise Confederation. Accordingly, we concur with the Directors' view that, through the 2014-2016 Parent Group Financial Services Framework Agreement, the Finance Company will benefit from the Parent Group's business scale and its own flexibility to consolidate the cash resources of the Parent Group, which is therefore able to expand the business scale and financial performance of the Finance Company. This in turns enlarges the operation scale of the Group as the Company being a Controlling Shareholder of the Finance Company, and thus benefits the Company and the Shareholders as a whole.

As advised by the Company, many companies with the Parent Group are well-established and well managed with good performance and will continue to benefit from various governmental policies. The Directors believe that the provision of financial services, in particular the loan services and guarantee services, especially to these quality companies within the Parent Group would allow the Finance Company to utilize its financial resources more efficiently at relatively lower credit risk.

Having considered the above reasons, we are of the view that the entering into of the 2014-2016 Parent Group Financial Services Framework Agreement, in particular the loan services and guarantee services, is in the ordinary and usual course of business of the Company, fair and reasonable so far as the Company and the Independent Shareholders are concerned.

## IV. Principal terms of the Master Agreements

### *(a) The 2014-2016 Master Sales Agreement*

Key terms of the 2014-2016 Master Sales Agreement are summarized below:

| | | |
|---|---|---|
| Date | : | 14 October 2013 |
| Parties | | the Company, as supplier; and<br>the Parent Company, as purchaser. |
| Term | : | Subject to the approval by the Independent Shareholders, the agreement shall be effective from 1 January 2014 to 31 December 2016. |
| Subject matter | : | The Group agrees to sell certain products such as control valves and parts for steering systems, gears and clutch assemblies and the BV series of electric cables to the Parent Group. |
| Payment terms | : | The payment terms will be specified on each separate contract to be agreed by both parties. |
| Pricing principles | : | The products agreed to be sold to the Parent Group under the 2014-2016 Master Sales Agreement should be priced with reference to the following:<br><br>(1) according to the price set by the PRC government (including the municipal government and other regulatory bodies which govern such transactions); or<br><br>(2) if no such price is set by the PRC government, not lower than the guide prices set by the PRC government for such transactions; or |

(3) if there is no set price and no guide prices set by the PRC government, not lower than such open market price between independent parties on normal commercial terms in comparable locality, or if there are no comparable localities, not lower than such open market price between independent parties on normal commercial terms in the PRC generally; or

(4) if there is no set price and no guide prices set by the PRC government and there is no open market for such transactions, the parties are to negotiate on normal commercial terms for such transactions based on the actual or reasonable costs of such transactions (whichever is lower) together with a reasonable profit. A "reasonable profit" is a profit that is agreed between the parties as being no less than the Group's profit margins of the same products for the previous year.

Non-exclusivity : The Group is at its own discretion to determine whether to sell any products to the Parent Group or independent third parties in any circumstances.

In assessing the fairness and reasonableness of the principle terms of the 2014-2016 Master Sales Agreement, we have obtained and reviewed sample contracts and invoices for the historical sales transactions between the Group and the Parent Group against similar transactions between the Group and other independent customers. We note that the terms, in particular, the pricing and the settlement terms, under the contracts of individual sales of the products by the Group to the Parent Group are no less favorable than the terms with independent third parties. We also notice that the major terms and relevant pricing principles under the 2014-2016 Master Sales Agreement are the same as the corresponding Existing Master Sales Agreement.

For the pricing principles, we are of the view that (1) the prices of the products are determined according to the prices set by the PRC Government or guide prices set by the PRC Government or the market price, which are public information and therefore reflect either the pricing principles which the Group has to abide by or the fair value of the products; and (2) if there is no set price and no guide prices set by the PRC Government and there is no open market for such transactions, which is based on the actual costs together with a profit being no less than the Group's profit margins of the same products for the previous year. We are of the view that by reference to each profit margin of the product in the previous year sold to the Parent Group, the Group will earn a profit margin not lower than the previous year, when all products are aggregated, thus ensuring the Group has an upside profit margin opportunity while maintaining a profit margin floor.

At present, the selling of products and general raw materials, such as steel, bearings and fuels, to the Parent Group through the centralized procurement platform of Chongqing Shengpu Materials Co., Ltd.* (重慶盛普物資有限公司) are priced at market rate, while other products, such as special-purpose vehicle parts and components, wires and cables, including customized products, are at the prices based on actual costs with a reasonable profit.

The Company confirmed to us that there were no relevant PRC government documents in relation to the price for the Company to follow when implementing the Existing Master Sales Agreement. As a result, the Company has adopted the "open market price" and "negotiated prices based on the costs plus a reasonable profit" pricing principles under the Existing Master Sales Agreement. The management of the Company confirmed that the Company will, after implementation of each new separate contract under the 2014-2016 Master Sales Agreement, determine the prices based on the order of the pricing principles as mentioned above and adopt one of them.

Moreover, we also notice that there is a non-exclusivity term, which the Group is at its discretion to determine whether to sell any products to the Parent Group or independent third parties in any circumstances.

Having considered the above reasons, we concur with the Directors' views that the terms (including the pricing principles) under the 2014-2016 Master Sales Agreement are fair and reasonable and on normal commercial terms, and in the interests of the Company and its Shareholders as a whole.

***(b) The 2014-2016 Master Supplies Agreement***

Key terms of the 2014-2016 Master Supplies Agreement are summarized below:

| | | |
|---|---|---|
| Date | : | 14 October 2013 |
| Parties | | the Company, as purchaser; and<br>the Parent Company, as supplier. |
| Term | : | Subject to the approval by the Independent Shareholders, the agreement shall be effective from 1 January 2014 to 31 December 2016. |
| Subject matter | : | The Parent Group agrees to supply the Group with parts and raw materials such as gears, component parts, YB2 series engines, electricity, water and gas. |
| Payment terms | : | The payment terms will be specified on each separate contract to be agreed by the parties. |
| Pricing principles | : | The supplies shall be priced with reference to the following:<br>(1) according to the price set by the PRC government (including the municipal government and other regulatory bodies which govern such transactions); or<br>(2) if no such price is set by the PRC government, not higher than the guide prices set by the PRC government for such transactions; or<br>(3) if there is no set price and no guide prices set by the PRC government, not higher than such open market price between independent parties on normal commercial terms in comparable locality, or if there are no comparable localities, not higher than such open market price between independent parties on normal commercial terms in the PRC generally; or |

(4) if there is no set price and no guide prices set by the PRC Government and there is no open market for such transactions, the parties are to negotiate on normal commercial terms for such transactions based on the actual or reasonable costs of such transactions (whichever is lower) together with a reasonable profit. A "reasonable profit' is a profit that is agreed between the parties as being no more than the Parent Group's profit margins of the same products for the previous year.

Non-exclusivity : The Group is at its own discretion to determine whether to purchase any supplies from the Parent Group or independent third parties in any circumstances.

As advised by the Company, the nature of products purchased or to be purchased from the Parent Company are principally consumed by the Company for the manufacturing of products and normal operation of the Company.

In assessing the fairness and reasonableness of the principal terms of the 2014-2016 Master Supplies Agreement, we have obtained and reviewed the sample contracts and invoices for historical purchasing transactions between the Group and the Parent Group against similar transactions between the Group and other independent suppliers. We note that the terms, in particular, the pricing and settlement terms, under the contracts of individual purchase by the Group from the Parent Group are no less favorable than the terms with the independent third parties. We also notice that the major terms and relevant pricing principles under the 2014-2016 Master Supplies Agreement are the same as the corresponding Existing Master Supplies Agreement.

For the pricing principles, we are of the view that (1) the prices of the supplies are determined according to the prices set by the PRC government or guide prices set by the PRC government or the market price, which are public information and therefore reflect either the pricing principles which the Group has to abide by or the fair value of the products; and (2) if there is no set price and no guide prices set by the PRC government and there is no open market for such transactions, a "reasonable" profit is determined with arm's length negotiations between the Company and the Parent Group, which is based on the actual costs together with a profit being no more than the Parent Group's profit margins of the same products for the previous year.

At present, the purchasing of products from the Parent Group are mainly vehicle parts and components, lifting equipment, and electrical equipment which are priced at market rate. The products purchased by the Group from the Parent Group are usually priced according to the comparable market pricing of similar products found in their respective localities.

The Company confirmed to us that there were no relevant PRC government documents in relation to the price for the Company to follow when implementing the Existing Master Supplies Agreement. As a result, the Company has adopted the "open market price" pricing principle under the Existing Master Supplies Agreement or cost plus a reasonable profit not higher than profit margin of the previous year. The management of the Company confirmed that the Company will, after implementation of each new separate contract under the 2014-2016 Master Supplies Agreement, determine the prices based on the order of the pricing principles as mentioned above and adopt one of them.

We are of the view that the pricing principles of the 2014-2016 Master Supplies Agreement to be fair and reasonable because (1) in the presence of government pricing, goods to be supplied must be priced in accordance to government rulings; (2) in the absence of a control price, the pricing shall not be higher than the market price, which is in the interest of the Group; and (3) for products that are customized where no readily comparable pricing are available, pricing is based on the costs plus a profit margin not higher than the previous year, thus ensuring the Group does not overpay for the products supplied to them. Furthermore, the Company has also presented to us that the products sold by the Parent Group to the Group are highly unlikely to have price controlled by the PRC government. As such, prices will most likely be based on open market prices or a cost plus "reasonable profit" not higher than previous years basis.

Moreover, we also notice that the Group is at its own discretion to determine whether to purchase any products supplied from the Parent Group or independent third parties in any circumstances.

Having considered the above reasons, we consider that the terms (including the pricing principles) under the 2014-2016 Master Supplies Agreement are fair and reasonable and on normal commercial terms, and in the interests of the Company and its Shareholders as a whole.

## V. Principal terms of the Framework Financial Services Agreements

### *(a) The 2014-2016 Group Financial Services Framework Agreement*

Key terms of the 2014-2016 Group Financial Services Framework Agreement are summarized below:

| | | |
|---|---|---|
| Date | : | 14 October 2013 |
| Parties | | the Company, as recipient of services; and<br>the Finance Company, as provider of services. |
| Term | : | The terms of the financial services, in particular the deposit services, contemplated under the 2014-2016 Group Financial Services Framework Agreement shall become effective from 1 January 2014 to 31 December 2016, subject to the approval of the independent Shareholders. |
| Nature of services provided | : | The Finance Company agrees to provide the Group with a range of financial services including the deposit services, loan services, guarantee services and other financial services. |
| Payment terms | : | The payment terms will be specified on each separate contract to be agreed by the parties. |
| Pricing principles | : | Deposit services:<br><br>The interest rates of deposits provided by the Finance Company will not be lower than the interest rates for deposits of similar nature and under similar terms provided to the Group by other independent commercial banks in the PRC. |

The Company will obtain the interest rates for deposits of similar nature and under similar terms from at least two banks among the national commercial banks in the PRC and local commercial banks in Chongqing that have business relations with the Company, and compare with the interest rates provided by the Finance Company to the Group for deposits of similar nature and under similar terms to ensure that the interests the Group will receive on its deposits are in compliance with the above pricing standards for deposit services.

| | | |
|---|---|---|
| Non-exclusivity | : | The Group is not under any obligation to obtain any or all of the financial services provided by the Finance Company and may obtain such financial services based on its business needs. |

In respect of the deposit services, we are advised that the Company has an internal assessment mechanism which is established based on the fair market principle. Analysis and assessment will be conducted by the Company by comparing the market interest rates offered to the Group from at least two independent commercial banks with the interest rates offered by the Finance Company in order to ensure that the Group will be able to receive a favorable interest rate according to the pricing principles. Therefore, we are of the view that there are sufficient procedures under the deposit services to ensure that the Company will receive an interest rate by the Finance Company that is no less favorable than that provided to the Group by other independent third parties.

For the deposit services, we have obtained and reviewed the sample contracts entered into between the subsidiary of the Company and the Finance Company, including the interest payment invoices received from the Finance Company. We also discussed with the management of the Company regarding the implementation of the internal assessment mechanism of the pricing principles. Based on our reviews and discussions, we note that the Company and the Finance Company has followed the aforesaid pricing principles to determine the interest rates for the deposit services.

The Finance Company has also undertaken that the terms of the financial services provided by the Finance Company to the Group will be no less favorable than those offered by other independent financial institutions in the PRC for providing services of similar natures and under similar terms (subject to no violation of relevant laws and regulations).

Having considered the aforesaid reasons, we are of the view that the respective terms (including the pricing principles) in relation to the deposit services contemplated under the 2014-2016 Group Financial Services Framework Agreement are on normal commercial terms, and are fair and reasonable so far as the Company and the Independent Shareholders are concerned.

***(b) 2014-2016 Parent Group Financial Services Framework Agreement***

Key terms of the 2014-2016 Parent Group Financial Services Framework Agreement are summarized below:

| | | |
|---|---|---|
| Date | : | 14 October 2013 |
| Parties | | the Parent Company, as recipient of services; and<br>the Finance Company, as provider of services. |
| Term | : | The terms of the financial services, in particular the loan services and guarantee services, contemplated under the 2014-2016 Parent Group Financial Services Framework Agreement shall become effective from 1 January 2014 to 31 December 2016 subject to the approval of the Independent Shareholders. |
| Nature of services provided | : | The Finance Company will provide the Parent Group with a range of financial services including the deposit services, loan services, guarantee services and other financial services. |
| Payment terms | : | The payment terms will be specified on each separate contract to be agreed by the parties. |
| Pricing principles | : | (1) Loan services:<br><br>The interest rates of loans provided by the Finance Company to the Parent Company will not be lower than the interest rates for loans of similar nature and under similar terms charged to the Parent Group by other independent commercial banks in the PRC. |

(2) Guarantee services:

The fees charged by the Finance Company for provision of guarantee services to the Parent Group will not be lower than the fees charged by any independent third party on the Parent Group for the same type of services, or the fees charged by the Finance Company on any third party of same credit rating for the same type of services.

Non-exclusivity : The Finance Company is not under any obligation to provide any or all of the financial services to the Parent Group and may provide such financial services based on its business needs.

In respect of the loan services to be provided by the Finance Company to the Parent Group, we have discussed with the management of the Company and understand that the Parent Group will continue to refer to the list of the interest rates of the loans agreed between the Parent Group and the Finance Company in determining the interest rates of the loans. We are advised that the Company has adopted the internal assessment in order to ensure the Parent Group will be able to receive the loan interest rates according to the pricing principles that will be not be lower than the interest rates for loans of a similar nature and under similar terms charged to the Parent Group by other independent commercial banks in the PRC. The Company will make inquiries to at least two banks among the national commercial banks in the PRC and local commercial banks in Chongqing, which have business relations with the Company in respect of loan services of similar nature and under similar terms with reference to the credit characteristics of the relevant company with the Parent Group, and submit the results to the Finance Company. The Finance Company will then determine the final interest rates to be provided to the Parent Group based on such results as well as by reference to the respective subsidiaries of the Parent Group's credit rating, cashflow position, gearing ratio and business risks. Aside from assessing the lending target, the Finance Company will also consider the comprehensive returns of the Finance Company, capital cost of the Finance Company and regulatory indictors and others factors. Therefore, we are of the view that there are sufficient procedures in place to ensure that the Parent Group will obtain the loan rates from the Finance Company that will not be lower than the interest rates for loans of similar nature and under similar terms charged to the Parent Group by other independent commercial banks in the PRC.

In respect of the guarantee services to be provided by the Finance Company to the Parent Group, the Company will make inquiries from at least two banks or guarantee institutions among the national commercial banks in the PRC, as well as the local commercial banks and guarantee institutions in Chongqing, which have business relations with the Company in respect of guarantee services of similar nature and under similar terms and submit the results to the Finance Company. This helps to ensure the Finance Company will be able to receive guarantee fees according to the pricing principles that are not less favorable than the fees offered by the independent commercial banks or guarantee institutions. We are advised that the guarantee fees charged by the Finance Company to the Parent Group shall also be subjected to assessment of the credit risk of the respective subsidiaries. In any case, the Company also presented to us that the Parent Group would undertake to repay any of its subsidiaries' debt thus implying the subsidiaries would have a credit risk similar to the Parent Group. Therefore, we are of the view that there are sufficient procedures in place to ensure that the Finance Company will charge guarantee fees that are no less favorable than the market rate.

For the loan services, we have obtained and reviewed the sample contracts entered into between by the subsidiary of the Parent Company and the Finance Company. We have compared the interest rate of the loan contract against the benchmark interest rates published by PBOC and the loan interest rates charged by other independent commercial banks in the PRC. For the guarantee services, we have obtained and reviewed the sample contract entered into between the subsidiary of the Parent Company and the Finance Company. We also discussed with the management of the Company regarding the implementation of the internal assessment mechanism for monitoring the pricing principles. Based on our reviews and discussions, we note that the Company and the Finance Company have followed the aforesaid pricing principles to determine the interest rates for the loan services and the fees of guarantee services charged by the Finance Company.

Having considered the aforesaid reasons, we are of the view that the respective terms (including the pricing principles) in relation to loan services and guarantee services contemplated under the 2014-2016 Parent Group Financial Services Framework Agreement are on normal commercial terms, and are fair and reasonable so far as the Company and the Independent Shareholders are concerned.

## VI. Historical transactions and proposed annual caps

### *(a) The 2014-2016 Master Sales Agreement*

The table below sets forth (1) the historical aggregated transaction amounts under the Existing Master Sales Agreement; (2) the corresponding utilization rates; and (3) the proposed annual cap amounts under the 2014-2016 Master Sales Agreement for the three years ending 31 December 2016:

| | Historical transaction amounts | | | | Utilization rates | | | Proposed annual cap amounts | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | For the year ended 31 December | | For the nine months ended 30 September | Existing annual cap for the year ending 31 December | For the year ended 31 December | | | For the year ending 31 December | For the year ending 31 December | For the year ending 31 December |
| | 2011 | 2012 | 2013 | 2013 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
| | *RMB million* | *RMB million* | *RMB million* | *RMB million* | % | % | % | *RMB million* | *RMB million* | *RMB million* |
| The 2014 -2016 Master Sales Agreement | 98.3 | 119.2 | 91.2 | 210.0 | 63.4 | 64.4 | 57.9 *(Note 1)* | 220.0 | 250.0 | 310.0 |

*Note 1:* The estimated utilization rate for the year ending 31 December 2013 is based on the annualized historical transaction amounts for the year ending 31 December 2013.

As stated in the Board Letter, the proposed annual cap amounts for the three years ending 31 December 2016 have been worked out based on the management's internal projection on the expected amounts and values of the products to be sold to the Parent Company and its subsidiaries after taking into the consideration of (1) the estimated demand for the production and sales in relation to vehicle parts and components, power equipment, general machinery and CNC machine tools; (2) the estimated sales volume of the Group for each of the three years ending 31 December 2016; (3) the prospect of the PRC economy and the markets relevant to the Group, in particular, the PRC automobile and power equipment segments; and (4) the historical amount of sales transactions for the two years ended 31 December 2012.

In order to determine the fairness and reasonableness of the above proposed annual cap amounts under the 2014-2016 Master Sales Agreement, we have considered the following factors:

(1) As stated in the Board Letter, Qijiang Gear Transmission Co., Ltd.* (綦江齒輪傳動有限公司), a wholly-owned subsidiary of the Company, has been constructing a new production base for an annual output of 200,000 gear boxes for heavy-duty trucks and is expected to commence its operation in 2014.

The production capacity of Qijiang Gear Transmission Co., Ltd.* at the existing plant is 5,000 gear boxes for medium and heavy-duty trucks and 100,000 gear boxes for coaches. As discussed with the management of the Company, the new production base of Qijiang Gear Transmission Co., Ltd.* will increase an additional 200,000 units of gear boxes for heavy-duty trucks starting in 2014. This new production facility is expected to contribute approximately RMB10 million sales of gear boxes for heavy-duty trucks in 2014, and this amount is expected to further increase up to RMB20 million in 2016.

The existing production of gear boxes for coaches is expected to increase gradually by approximately 7.7% in 2014 to RMB17 million. It is expected to increase approximately 24% to RMB21 million in 2014 and a further increase of approximately 66% in 2016 to RMB35 million due to the planned growth strategy of the Company.

Accordingly, the Company anticipates that significant sales volumes will be contributed by this vehicle components segment from 2014 and thus, the Company proposed a significant increment of the annual cap amount for the years ending 31 December 2014 to 2016;

(2) According to the China Association of Automobile Manufacturers (中國汽車工業協會), the growth rate of commercial vehicles for the year ended 31 December 2012 dropped by approximately 5.5% and this represent a decrease exceeding 5% two years in a row. Industry consensus view is that the commercial vehicles market in the PRC is at a low point of its business cycle. However, we note that one of the non-wholly owned subsidiary of the Parent Group, SAIC-IVECO Hongyan Commercial Vehicle Ltd.* (上汽依維柯紅岩商用車有限公司), which contributed approximately 40% of the annualized 2013 historical transaction amounts, recorded an annual vehicle sales volume growth of approximately 41% between the years of 2012 and 2013. Sales of vehicle parts and gear boxes to SAIC-IVECO Hongyan Commercial Vehicle Ltd.* grew from approximately RMB34 million in 2012 to an estimated RMBM45 million in 2013 on an annualized basis. These sales are expected to grow further in 2014 to 2016 in the amount of RMB60 million, RMB71 million and RMB92 million, respectively. We have discussed with the management of the Company and have been informed that the significant growth rate, which is contrary to the general market performance, is attributable to the successful range of vehicles produced by SAIC-IVECO Hongyan Commercial Vehicle Ltd.*. We are of the view that in view of such remarkable performance in 2013, the growth rate of SAIC-IVECO Hongyan Commercial Vehicle Ltd.* will be even more significant if the business cycle of commercial vehicles picks up over the next few years, assuming the current downtrend has bottom out. Furthermore, the implementation of the PRC Fourth Emission Standard (an emission standard emulating the Euro 4 emission standard) planned for 1 July 2013 would mean an even further number of commercial vehicles would need to be replaced. As such we are confident that SAIC-IVECO Hongyan Commercial Vehicle Ltd.* can continue and sustain its growth subject to its production capacity limits, which the Company confirms is capable of expanding to cope with the increasing demand.

(3) Chongqing Shengpu Materials Co., Ltd.* (重慶盛普物資有限公司), a wholly-owned subsidiary of the Company, has served as the centralized procurement platform of bulk materials for the Group since 2012. The annualized growth rate between the years of 2012 and 2013 is approximately 113% equivalent to approximately RMB25 million. As stated in the Board Letter, the Group will procure and sell raw materials to the Parent Group through this centralized procurement platform in order to achieve synergy and reduce costs. As this centralized procurement platform is relatively new, the Company expects more members of the Group and the Parent Group will utilize its services in the coming three years. As such, the annual caps of sales due to centralised procurement services is expected to amount to RMB64 million, RMB77 million and RMB93 million for the three years ending 31 December 2016; and

(4) As illustrated in the table above, we notice that the calculated utilization rates were approximately 63.4% and 64.4% for the two years ended 31 December 2012, respectively. However, having considered the factors discussed above, (i) the commencement of new production base of Qijiang Gear Transmission Co., Ltd.* in 2014; (ii) the expected growing demand of vehicles manufactured by SAIC-IVECO Hongyan Commercial Vehicle Ltd.* for the coming three years ending 31 December 2016; (iii) the favourable governmental policy supporting the automobile industry; and (iv) the increase utilization of the centralized procurement platform, we are of the view that the proposed annual cap amounts for the three years ending 31 December 2016 will be utilized to a fuller extent.

Having considered the aforesaid reasons, we concur with the Directors' view that the proposed annual cap amounts under the 2014-2016 Master Sales Agreement for the three years ending 31 December 2016 need to be increased as compared with the annualized 2013 historical transaction amount in order to cope with the expected increase in the Group's business volume, and hence the aforesaid proposed annual cap amounts are fair and reasonable, and in the interests of the Company and the Independent Shareholders as a whole.

***(b) The 2014-2016 Master Supplies Agreement***

The table below sets forth (1) the historical aggregated transaction amounts under the Existing Master Supplies Agreement; (2) the corresponding utilization rates; and (3) and the proposed annual cap amounts under the 2014-2016 Master Supplies Agreement for the three years ending 31 December 2016:

| | Historical transaction amounts | | | | Utilization rates | | | Proposed annual cap amounts | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | For the year ended 31 December | | For the nine months ended 30 September | Existing annual cap for the year ending 31 December | For the year ended 31 December | | | For the year ending 31 December | For the year ending 31 December | For the year ending 31 December |
| | 2011 | 2012 | 2013 | 2013 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
| | *RMB million* | *RMB million* | *RMB million* | *RMB million* | *%* | *%* | *%* | *RMB million* | *RMB million* | *RMB million* |
| The 2014-2016 Master Supplies Agreement | 248.0 | 310.0 | 50.3 | 550.0 | 60.5 | 64.6 | 12.2 *(Note 1)* | 160.0 | 84.0 | 99.0 |

*Note 1:* The estimated utilization rate for the year ending 31 December 2013 is based on the annualized historical transaction amounts for the year ending 31 December 2013.

As stated in the Board Letter, the proposed annual cap amounts for the three years ending 31 December 2016 have been determined with reference to (1) the expected production and estimated sales demand for the products in relation to the vehicle parts and components, general machinery, CNC machine tools and power equipment; (2) the estimated sales and procurement volume of the products for each of the three financial years ending 31 December 2016; (3) the prospect of the PRC economy and the markets relevant to the Group, in particular, the PRC automobile and power equipment segments; (4) the historical amount of supplies transactions for the two financial years ended 31 December 2012; (5) the historical transaction records for the nine months ended 30 September 2013 decreased significantly as compared with those for the year ended 31 December 2012; and (6) the annual cap amount of relevant procurement for 2014 is substantially larger than those for the following two years because of the relatively significant increase in procurement of equipment such as cranes by certain subsidiaries of the Company as a result of their concerted environmental relocation projects in 2014.

In order to determine the fairness and reasonableness of the proposed annual cap amounts, we have considered the following factors:

(1) The significant decrease of historical transaction amounts for the nine months ended 30 September 2013 as compared with those for the year ended 31 December 2012 was mainly attributable to the ceasing of the purchase of electrolytic copper by Chongqing Huahao Smelting Co., Ltd.* (重慶華浩冶煉有限公司), a wholly-owned subsidiary of the Company, from Chongqing Metallurgy & Copper Industry Co., Ltd.* (重慶重冶銅業有限公司), a subsidiary of the Parent Company. This is due to Chongqing Metallurgy & Copper Industry Co., Ltd.* has ceased its production since January 2013. Furthermore, Qijiang Gear Transmission Co., Ltd.* reduced its procurement volume from the subsidiaries of the Parent Group, such as Chongqing Changjiang Bearing Co., Ltd.* (重慶長江軸承股份有限公司), an associate of the Parent Company, due to the adjustment of products structure. For the year ended 2014, the Group has allocated RMB20 million annual cap to acquire the remaining assets and inventory from Chongqing Metallurgy & Copper Industry Co., Ltd.*.

(2) References are made to the Company's 2012 annual report, 2013 interim report, its announcements dated 5 February 2013 and 19 March 2013, the headquarter relocation project of Chongqing Machine Tools (Group) Co., Ltd. and the phase 1 of Machine Tools Group environmental relocation projects (Chongqing Tool Factory Co., Ltd., Chongqing Yinhe Forging & Founding Co., Ltd., Chongqing Shenjian Automotive Drive Part Co., Ltd.) are expected to complete in 2014. Accordingly, the management of the Company has estimated an additional RMB31 million to be used for the procurement of lifting equipment and RMB25 million for fittings and ancillary equipment from the Parent Group due to the aforesaid relocation projects in 2014. Accordingly, we are advised that, taking into account this factor, the corresponding annual cap amount for the year ending 31 December 2014 significantly increased by 138.6% when comparing to the annualized 2013 historical transactions amounts.

The Company expects that the relocation projects will be completed by the end of 2014 and therefore, the procurements of equipment are expected to decrease to less than RMB2 million in 2015 and 2016. Therefore, the proposed annual cap amount for the year of 2015 decreases by 47.5% when comparing to the year of 2014; and

(3) As discussed before, the annual production output of Qijiang Gear Transmission Co., Ltd.* will increase by 200,000 units of gear boxes after the commencement of its new production base. Accordingly, the management of the Company expects the purchasing of raw materials and components for the manufacturing of gear boxes will further increase by approximately 65% for the year of 2016 when comparing to the year of 2015. Furthermore, the estimated transaction amounts between Qijiang Gear Transmission Co., Ltd.* and the Parent Group is expected to contribute approximately 41% and 54% to the total proposed annual cap amounts for the years 2015 and 2016, respectively.

Based on the aforesaid reasons, we concur with the Directors' view that the proposed annual cap amounts under the 2014-2016 Master Supplies Agreement for the three years ending 31 December 2016 are fair and reasonable, and in the interests of the Company and the Independent Shareholders as a whole.

*(c) The 2014-2016 Group Financial Services Framework Agreement*

The table below sets out (1) the existing annual cap amount, the historical transaction amount and the corresponding utilization rate under the Group Financial Services Framework Agreement (as amended by the Group Financial Services Framework Supplemental Agreement); and (2) the proposed annual cap amounts of the deposit services contemplated under the 2014-2016 Group Financial Services Framework Agreement for the three years ending 31 December 2016:

| | For the year ending 31 December 2013 | | | Proposed annual cap amounts | | |
|---|---|---|---|---|---|---|
| | Annual cap amount | Actual amount of the transactions (For the period from 10 April to 30 September 2013) | Utilization rate | for the year ending 31 December 2014 | for the year ending 31 December 2015 | for the year ending 31 December 2016 |
| | *RMB million* | *RMB million* | *%* | *RMB million* | *RMB million* | *RMB million* |
| Maximum daily balance of deposits (including the corresponding accrued interests) to be placed by the Group with the Finance Company | 1,250.0 | 1,230.6 | 98.4 | 1,600.0 | 1,840.0 | 2,116.0 |

As stated in the Board Letter, the proposed annual cap amounts of the deposit services above have been determined with reference to (1) the historical transaction amounts of the deposit services under the Existing Group Financial Services Framework Agreement during the nine months ended 30 September 2013; (2) the expectation of the Group's capital needs for the years ending 31 December 2016; and (3) the financial ability of the Finance Company. Therefore, in assessing the fairness and reasonableness of the proposed annual cap amounts of the deposit services, we have considered the following reasons:

(1) The cash and cash equivalent of the Group

The proposed annual cap amount for the year ending 31 December 2014 has been increased by 30% as compared to the historical maximum daily balance of deposits for 2013, and a further increase of approximately 15.0% annually for the subsequent two years ending 31 December 2016. We notice that the proposed maximum daily balance of deposits (including the corresponding accrued interest) for the three years ending 31 December 2016 represent approximately 81.2%, 93.4% and 107.4% of the Group's cash and cash equivalent for the amount of RMB1,970.9 million as at 30 June 2013, and also represent approximately 24.3%, 27.9% and 32.1% of the Group's cash and cash equivalent together with all accounts receivables as at 30 June 2013. Furthermore, the reported total assets of the Group amounted to approximately RMB13,171.2 million as at 30 June 2013, representing a growth of approximately 8.1% during a six-month period over total assets as at 31 December 2012. In addition, the calculated CAGR of the turnover of the Company between 2010 and 2012 is approximately 14.5%.

As a result, we are of the view that the Group's cash balance and the growth rate of its business would require such amount of annual caps to cater for its deposit needs.

(2) Accounts receivable of the Group

For the year ended 31 December 2012, the Group has accounts receivable of approximately RMB3,950 million on a turnover of approximately RMB10,557 million. This implies that the accounts receivable turnover ratio is approximately 2.67 times. A receivable turnover ratio of 2.67 times would imply that the average days of accounts receivable before collection is approximately 137 days (calculated by dividing 365 by 2.67). Based on the accounts receivable of RMB3,950 million, it would imply the Group collects approximately RMB28.8 million per day or RMB864 million a month. If this amount of cash is collected in a particular month or day where the timing of the payable does not require a cash outflow, the Group would be flushed with cash when accounted together with existing cash and cash equivalents. Therefore, there is a need for the Group to have an annual cap that can accommodate for such sudden increase in cash collected from the accounts receivable of the Group due to timing differences of trading.

(3) Historical cap amount and the maximum daily amount of deposits

We noted that for the period from 10 April 2013 to 30 September 2013, the Group's maximum daily balance of deposits placed with the Finance Company were approximately RMB1,230.6 million, representing approximately 98.5% of the corresponding annual cap amount of RMB1,250.0 million for the year ending 31 December 2013. This indicates that the annual cap amount for the year ending 31 December 2013 is insufficient to cover the deposit needs of the Company.

(4) The business development of the Group

Under the PRC "Twelfth Five-Year Plan", the PRC government is encouraging the development of infrastructure and transportation in the west. The Company is poised perfectly in this sector on ride on the potential growth opportunities as the products of the Group are automotive systems and parts, power generation systems, general machinery, CNC machines and other machineries. In addition, as discussed in the 2013 Company's interim report, the Group will carry out its technological upgrading projects at a faster pace and push ahead with work on joint ventures, and mergers and acquisition projects in an orderly fashion. Accordingly, it is expected that the Group will benefit greatly from the favorable governmental policy support and grow over according to the Group's development strategy plan over the next few years, which in turn would require additional financial related services such as deposits that are ancillary to the smooth running of their existing businesses and further business development.

(5) The business plan of the Finance Company

We have also reviewed the strategy and development plans of the Finance Company. As the operation history of the Finance Company is very short, after discussion with the management of the Company regarding the current condition of the Finance Company, we are advised that the Finance Company is developing according to its established strategy and development plans.

Apart from considering the above reasons, we also discussed with the management of the Company on the basis and assumptions and are given the understanding that the proposed annual cap amounts are closely related to the scale of its operations and operating cash flow in the next three years. Although we have noted that the Group's cashflow has not grown as quickly as its business, in view of the fact that (1) the Company's business volume is expected to grow steadily thus generating stronger cash flow from its operations; (2) the expected growth in the business of the Group and the future treasury requirements; (3) the increase in the proposed annual cap amounts being set at levels that are within the amount of cash available for the Group; and (4) the Group has potential to earn more interest income from the deposit services, we are of the view that the proposed annual cap amounts for the deposit services for the three years ending 31 December 2016 are fair and reasonable so far the Company and the Independent Shareholders are concerned.

### *(d) 2014-2016 Parent Group Financial Services Framework Agreement*

The table below sets out (1) the existing annual cap amounts, the historical transaction amounts and the corresponding utilization rate under the Parent Group Financial Services Framework Agreement (as amended by the Parent Group Financial Services Framework Supplemental Agreement), and (2) the proposed annual cap amounts of the loan services and guarantee services to be contemplated under the 2014-2016 Parent Group Financial Services Framework Agreement for the three years ending 31 December 2016:

| | For the year ending 31 December 2013 | | | Proposed annual cap amounts | | |
|---|---|---|---|---|---|---|
| | Annual cap amount | Actual amount of the transactions (For the period from 10 April to 30 September 2013) | Utilization rate | for the year ending 31 December 2014 | for the year ending 31 December 2015 | for the year ending 31 December 2016 |
| | *RMB million* | *RMB million* | *%* | *RMB million* | *RMB million* | *RMB million* |
| Daily outstanding balance of loans (including the corresponding accrued interests) to be granted by the Finance Company to the Parent Group | 1,170.0 | 950.2 | 81.2 | 1,570.0 | 2,130.0 | 2,500.0 |
| Amount of guarantees (including the corresponding fees) to be provided by the Finance Company to the Parent Group | 618.0 | 102.5 | 16.6 | 618.0 | 618.0 | 618.0 |

As stated in the Board Letter, the proposed annual cap amounts of the loan services and guarantee services above have been determined based on (1) the historical transaction amounts of the loan services and guarantee services during the nine months ended 30 September 2013; (2) the expectation of the capital needs by the Parent Group for the period ending 31 December 2016; and (3) the financial ability of the Finance Company. Therefore, in assessing the fairness and reasonableness of the proposed annual cap amounts of the loan services and guarantee services, we have considered the following reasons:

(1) The borrowings and loans of the Parent Group

The proposed annual caps for the maximum daily balance of loans (including the corresponding accrued interests) for the three years ending 31 December 2016 represent approximately 30.7%, 41.7% and 48.9% of the total borrowings and loans incurred by the Parent Group as at 30 June 2013. Among the total borrowings and loans incurred by the Parent Group, short-term borrowings accounted for approximately 56.4%.

As illustrated in the table above, the utilization rate was approximately 81.2% which indicates that the annual cap amount ending 31 December 2013 has been utilized to a reasonable level. We notice that there is significant increase of the proposed annual cap amount for the loan services ending 31 December 2014 as compared with the historical transaction amount for the nine-month period in 2013, and a further increase of approximately 35.7% and 17.4% for the two years ending 31 December 2015 and 2016, respectively. We have discussed with the management of the Group regarding the development plan of the Parent Group in setting the projected annual growth rates of the turnover of the Parent Group, which will be approximately 25% for the three years ending 31 December 2016. Furthermore, as advised by the Directors, the amount of the total investment plan of the Parent Group for the year ended 31 December 2012 was approximately RMB21 billion and the estimated total investment plan for the years ending 31 December 2015 will further increase approximately 11% annually. In order to support the above investment plan, the Parent Group estimated the capital requirements for the three years ending 31 December 2016, which in turn would require additional financial related services such as loans that are ancillary to the smooth running of the existing businesses and further business development based on the investment plan of the Parent Group.

As the Parent Group could easily place more loans with the Finance Company due to their amount of outstanding borrowings, the increase in proposed annual caps for maximum daily balance of loan could benefit the Finance Company by allowing for more loans thereby generating more income for the Finance Company and the Group.

Although existing loans of the Parent Group far exceeds the proposed annual caps, these existing loans can only be moved to the Finance Company as they mature and/or when the Parent Group can ensure the banking relationship with existing banks can be maintained with the migration of loans to the Finance Company.

(2) The historical amounts of guarantees provided by the Parent Company

The proposed annual cap amounts of the guarantee services for the three years ending 30 December 2016 represent approximately 25.4% of the total guarantees provided by the Parent Group to its subsidiaries as at 30 June 2013. As illustrated in the table above, the utilization rate was approximately 16.6%. Given the Parent Group has existing guarantees of RMB2,432 million as at 30 June 2013, the Parent Group could easily utilize the annual caps amount in full should the Parent Group chose to utilize it.

As discussed with the management of the Company, the usage of guarantee is highly subjected to the acceptance by the counterparty of the guarantee provided by the Finance Company. As the Finance Company has just commenced its operations since April 2013, it has not established itself in the market and only known in the industry as a new guarantee company. As such, the usage of its guarantee facilities has not been high and has not achieved the projected goals set by the Finance Company.

Nevertheless, we are advised that the Finance Company will actively promote itself within the subsidiaries of the Parent Group as well as in the guarantee industry in order to fully utilize the proposed annual cap amounts. Moreover, the Parent Company has promised the Finance Company to actively promote the guarantee services of the Finance Company to the subsidiaries of the Parent Company. Accordingly, we concur with the Directors' view that the proposed annual cap amounts of the guarantee services at equivalent of RMB618 million to be consistent with the historical annual cap amount under the existing Parent Group Financial Services Framework Agreement in order to cope with the abovementioned investment plan of the Parent Group and the increasing reputation of the Finance Company.

As stated in the Board Letter, according to the requirements of the Provisional Measures for Risk Regulation Indicators Assessment of Finance Companies of Enterprise Group (《企業集團財務公司風險監管指標考核暫行辦法》) issued by the CBRC, the ratio of guarantee exposures against the total paid-in capital of the Finance Company shall be not higher than 100%. The total paid-in capital of the Finance Company amounted to RMB600 million. Given the paid-in capital of the Finance Company shall be not higher than 100%, the maximum amount of guarantee (including the corresponding accrued handling fees) to be provided by the Finance Company has therefore been set at RMB618 million. We understand from the Company that the additional RMB18 million over RMB600 million will be the handling fees to be charged by the Finance Company. We have further enquired with the Finance Company and noted that as the RMB18 million will be classified as fees and not guarantee, therefore, it will not conflict with the abovementioned CBRC rules.

(3) The business development of the Parent Group

The Parent Group is principally engaged in automobiles and ancillary automobile business (including special purpose vehicles, compartments and transmission axle), electronic information business and other business. As the growth of these industries is in line with the "Twelfth Five-Year Plan", the Parent Group expects their demand for loan and guarantee services will increase to supplement its working capital for business development.

(4) The business plan of the Finance Company

Please refer to the section headed "2014-2016 Group Financial Services Framework Agreement" above.

Having considered the above reasons, we are of the view that the proposed annual cap amounts for the loan services and guarantee services for the three years ending 31 December 2016 are fair and reasonable so far as the Company and the Independent Shareholders are concerned.

## RECOMMENDATION

Having considered the principal factors and reasons as discussed above, we are of the opinion that the transactions contemplated under the Master Agreements, the Framework Financial Services Agreements and the respective proposed annual cap amounts for the three years ending 31 December 2016 and the terms thereto are on normal commercial terms, fair and reasonable so far as the Independent Shareholders are concerned, and are conducted in the ordinary and usual course of business of the Company and in the interests of the Company and the Independent Shareholders as a whole.

Accordingly, we would recommend that the Independent Shareholders, and the Independent Board Committee to advise the Independent Shareholders, to vote in favor of the ordinary resolutions to be proposed at the upcoming EGM to approve the Master Agreements, the Framework Financial Services Agreements, the transactions contemplated thereunder and the corresponding proposed annual cap amounts.

Yours faithfully,
For and on behalf of
**TC Capital Asia Limited**
**Edward Wu**
*Managing Director*

## 1. FINANCIAL INFORMATION OF THE GROUP

The Company is required to set out in this circular the information for the last three financial years with respect to the Group's profits and losses, financial record and position (set out as a comparative table), and the latest published audited balance sheet together with the notes to the annual accounts for the corresponding financial year.

The audited consolidated financial statements of the Group together with the relevant notes for each of the three years ended 31 December 2010, 2011 and 2012 and the unaudited consolidated financial statements of the Group together with the relevant notes for the six months ended 30 June 2013 have been set out in the annual reports of the Company for the years of 2010, 2011 and 2012 and the interim report of the Company for the six months ended 30 June 2013 dated 31 March 2011 (pages 94-248), 20 March 2012 (pages 92-256), 28 March 2013 (pages 102-256) and 30 August 2013 (pages 16-56) respectively, which have been published on the websites of the Company (http://www.chinacqme.com) and the Stock Exchange (http://www.hkex.com.hk).

## 2. STATEMENT OF INDEBTEDNESS

**Borrowings**

As at the close of business on 12 November 2013, being the Latest Practicable Date for the purpose of this indebtedness statement prior to the printing of this circular, the Group had outstanding borrowings of approximately RMB2,306,046,041.98, comprising (i) bank loans of RMB1,311,368,241.98; and (ii) corporate bonds of RMB994,677,800.00 (the aforesaid figures are unaudited).

**Disclaimer**

Save as aforesaid or as otherwise disclosed herein, and apart from intra-group liabilities and normal trade payables, as at the close of business on 12 November 2013, the Group did not have any outstanding issued or agreed-to-be-issued loan capital, bank overdrafts, loans, or other similar borrowings, liabilities or liabilities under acceptance credit, debentures, mortgages, charges, hire-purchase commitments, guarantees or other material contingent liabilities.

## 3. WORKING CAPITAL

Having taken into account the financial resources available to the Group, including internally generated funds and the available banking facilities, the Directors of the Company are of the opinion that the Group has sufficient working capital for its requirement for at least 12 months from the date of this circular.

## 4. FINANCIAL AND TRADING PROSPECTS

In 2013, the downside risk and uncertainty surrounding the world economy would be mitigated. Without signs of robust recovery, the world economic growth would be sluggish. China's economy has been undergoing structural adjustment period and its moderate growth rate would persist for a relatively long period. In a sign of intense efforts to stabilize economic growth, the government has recently introduced targeted economic stimulus measures, including tax exemptions for micro-enterprises, measures to facilitate trade, reform of investment and financing mechanism for railways, boosting information consumption and accelerating urban infrastructure construction. Overall, the economy would stay stable throughout the year.

To cope with the current market situation, the Group will focus on the following tasks in the fourth quarter of 2013:

### (1) Stepping up quality of economic operation

The Group will make analysis of market conditions and make sound judgments for timely adjustment to business strategy. More efforts would be put into marketing and winning orders. We will also improve product quality, revitalize existing assets, take effective measures and offer specific guidance to subsidiaries. More importance will also be given to safety, environmental protection and occupational health.

### (2) Making prudent investment and pushing ahead with project construction

The Group will monitor its plans under review, carry out with the environmental relocation projects and technological upgrading projects at a faster pace and push ahead with work on joint ventures and M&A projects in an orderly fashion.

### (3) Building up innovation capacity

The Group will increase R&D expenditure and seek favorable policy support. Also, the Group will leverage the technology innovation platform and execute thoroughly the strategy for intellectual property rights.

**(4) Reducing costs and improving profitability vigorously**

The Group will press ahead with a pilot all-round budgeting scheme and will take advantage of futures and currency forward contracts to hedge risk of fluctuation in market prices and exchange rates. The scope and quantity of centralized procurement of commodities will be increased. Concrete measures will be taken to increase revenue and save costs.

**(5) Improving the management and control system**

The Group will strengthen development of the talents team, fully utilizing a talent management and incentive system featuring six mechanisms: "selection, nurturing, appointment, retaining, dismissal and backup". The Group will also step up internal control and risk management, and continue implementing the "5 parallel measures and 3 implementations" (五管齊下三到位) monitoring and examination mechanism.

## 5. EFFECT OF THE 2014-2016 GROUP FINANCIAL SERVICES FRAMEWORK AGREEMENT ON THE EARNINGS, ASSETS AND LIABILITIES OF THE GROUP

In respect of the 2014-2016 Group Financial Services Framework Agreement, (1) the existing capital deposited by the Group with the Finance Company will receive interest at interest rates not lower than the interest rates for deposits of similar nature and under similar terms provided to the Group by other independent commercial banks in the PRC. Such arrangement will enable the Group to increase its interest income more effectively; and (2) the Group is able to obtain loans from the Finance Company at an interest rate not higher than the interest rates for loan of a similar nature and under similar terms charging the Group by other independent commercial banks in the PRC, which could effectively lower its costs of funding.

In respect of the 2014-2016 Group Financial Services Framework Agreement, there has been no, and the Group does not expect there will be any, significant effect on the earnings, assets and liabilities of the Group.

## 6. EFFECT OF THE 2014-2016 PARENT GROUP FINANCIAL SERVICES FRAMEWORK AGREEMENT ON THE EARNINGS, ASSETS AND LIABILITIES OF THE GROUP

In respect of the 2014-2016 Parent Group Financial Services Framework Agreement, (1) the interest rate for loans provided by the Finance Company to the Parent Group will not be lower than the interest rates for loan of a similar nature and under similar terms charging the Parent Group by other independent commercial banks in the PRC. Such arrangement will enable the Group to increase its interest income more effectively; (2) It will help expand the business scale of the Finance Company, thus benefiting the development of the Finance Company, which in turn will facilitate the expansion of the Group's business scale; and (3) the Company will be able to share the profits of the Finance Company, through its direct 51% equity interest in the Finance Company when providing loan and guarantee services to the Parent Group under the 2014-2016 Parent Group Financial Services Framework Agreement.

In respect of the 2014-2016 Parent Group Financial Services Framework Agreement, save as disclosed above, the continuous increase in loans provided by the Finance Company to the Parent Group will increase the assets of the Group; the continuous increase in deposits placed by the Parent Group with the Finance Company will increase the liabilities of the Group. In any case, the amount of loans and deposits of the Finance Company will need to meet the minimum capital adequacy ratio as set out by CBRC.

## 1. RESPONSIBILITY STATEMENT

This circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the 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 this 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 herein or this circular misleading.

## 2. DISCLOSURE OF INTEREST

As at the Latest Practicable Date, none of the Directors, chief executive or Supervisors of the Company had any interests or short positions in the shares, underlying shares or debt securities of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)) (the "SFO") which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provisions of the SFO), or which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers set out in Appendix 10 of the Listing Rules.

## 3. SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSONS' INTERESTS IN SHARES AND UNDERLYING SHARES

As at the Latest Practicable Date, so far as the Directors are aware, the following persons (not being a Director, chief executive or Supervisor of the Company) had interests in the shares of the Company as recorded in the register required to be kept under section 336 of the SFO:

**Domestic shares of RMB1.00 each of the Company**

| Name of substantial shareholders | Number of shares | Nature of Interest | *Notes* | Percentage of total issued domestic shares *(%)* | Percentage of total issued shares *(%)* |
|---|---|---|---|---|---|
| Chongqing Machinery and Electronic Holding (Group) Co., Ltd.* | 1,924,225,189 | Beneficial owner | (1) | 74.46(L) | 52.22 |
| Chongqing Yufu Assets Management (Group) Co. Ltd. | 232,132,514 | Beneficial owner | (1) | 8.98(L) | 6.30 |
| Chongqing Construction Engineering Group Co., Ltd. | 232,132,514 | Beneficial owner | (2) | 8.98(L) | 6.30 |
| China Huarong Asset Management Co., Ltd.* (中國華融資產管理股份有限公司) | 195,962,467 | Beneficial owner | (3) | 7.58(L) | 5.32 |
| State-Owned Assets Supervision and Administration Commission of Chongqing Municipal Government | 2,388,490,217 | Interest in controlled corporation | (1) | 92.42(L) | 64.82 |
| Ministry of Finance of the PRC | 195,962,467 | Interest in controlled corporation | (3) | 7.58(L) | 5.32 |

(L): Long Position

**H shares of RMB1.00 each of the Company**

| Name of shareholders | Number of shares | Capacity | *Notes* | Percentage of total issued H shares *(%)* | Percentage of total issued shares *(%)* |
|---|---|---|---|---|---|
| The Bank of New York Mellon (formerly known as "The Bank of New York") | 87,276,000(L)<br>0(P) | Interest in custodian's Company | (4) | 7.93(L)<br>0(P) | 2.37(L)<br>0(P) |
| The Bank of New York Mellon Corporation | 87,276,000(L)<br>87,276,000(P) | Interest in controlled corporation | (4) | 7.93(L)<br>7.93(P) | 2.37(L)<br>2.37(P) |
| GE Asset Management Incorporated | 75,973,334(L) | Investment Manager | | 6.91(L) | 2.06(L) |

(L): Long position
(P): Lending Pool

*Notes:*

(1) As Chongqing Machinery and Electronic Holding (Group) Co., Ltd. and Chongqing Yufu Assets Management (Group) Co. Ltd. are wholly owned by State-Owned Assets Supervision and Administration Commission of Chongqing Municipal Government, State-Owned Assets Supervision and Administration Commission of Chongqing Municipal Government is deemed to be interested in 1,924,225,189 domestic shares and 232,132,514 domestic shares of the Company held by the two companies.

(2) Chongqing Construction Engineering Group Co., Ltd. is held as to 96.18% by State-Owned Assets Supervision and Administration Commission of Chongqing Municipal Government through its three wholly-owned subsidiaries and as to 3.82% by the Ministry of Finance of the People's Republic of China through China Huarong Asset Management Co., Ltd.* (中國華融資產管理股份有限公司), a wholly-owned subsidiary of the Ministry. Therefore, State-Owned Assets Supervision and Administration Commission of Chongqing Municipal Government and the Ministry of Finance of the People's Republic of China are deemed to be interested in 232,132,514 domestic shares of the Company held by Chongqing Construction Engineering Group Co., Ltd.,

(3) China Huarong Asset Management Co., Ltd.* (中國華融資產管理股份有限公司) is directly held as to 98.06% by the Ministry of Finance of the People's Republic of China and indirectly held as to 1.94% by it through its wholly-owned China Life Insurance (Group) Company, therefore its interest in 195,962,467 domestic shares of the Company was deemed to be the interests of the Ministry of Finance of the People's Republic of China.

(4) The Bank of New York Mellon Corporation holds 100% interest in The Bank of New York Mellon (formerly known as "The Bank of New York"), which holds 87,276,000 H shares of the Company. The interest in 87,276,000 H shares relates to the same block of shares in the Company and includes a lending pool of 87,276,000 H shares of the Company.

Save as disclosed above, the Directors are not aware of any persons holding any interests or short positions in the shares or underlying shares of the Company which were required to be recorded in the register pursuant to section 336 of the SFO as at the Latest Practicable Date.

## 4. DIRECTORS' AND SUPERVISORS' INTERESTS IN ASSETS AND CONTRACTS

As at the Latest Practicable Date, none of the Directors and the Supervisors of the Company had any direct or indirect interest in any assets which have been acquired or disposed of by or leased to the Company or are proposed to be acquired or disposed of by or leased to the Company since 31 December 2012, being the date to which the latest published audited accounts of the Company were made up.

None of the Directors and the Supervisors of the Company was materially interested in any contract or arrangement entered into by the Company subsisting at the Latest Practicable Date and which is significant in relation to the business of the Company.

## 5. SERVICE CONTRACT

None of the Directors has a service contract with the Company which is not determinable by the Company within one year without payment of compensation other than statutory compensation.

## 6. COMPETING INTEREST

As at the Latest Practicable Date, none of the Directors and his associates was interested in any business, which competes or is likely to compete, either directly or indirectly, with that of the Group.

## 7. LITIGATION

As at the Latest Practicable Date, neither the Company nor any other members of the Group was engaged in any litigation or arbitration of material importance and no litigation, arbitration or claim of material importance was known to the Directors to be pending or threatened against any member of the Group.

## 8. MATERIAL ADVERSE CHANGE

As at the Latest Practicable Date, the Directors confirmed that there was no material adverse change in the financial or trading position of the Group since 31 December 2012, the date to which the latest published audited consolidated accounts of the Group were made up.

## 9. EXPERT'S QUALIFICATION AND CONSENT

The qualification of the expert who has provided its advice which is contained in this circular is set out as follows:

| **Name** | **Qualification** |
|---|---|
| TC Capital Asia Limited | Independent Financial Adviser and a licensed corporation to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities under the SFO |

The Independent Financial Adviser has given and has not withdrawn its written consent to the issue of this circular with the inclusion of its letter, report and/or opinions and/or the references to its name in the form and context in which it respectively appears.

As at the Latest Practicable Date, (i) the Independent Financial Adviser did not have any interest, either direct or indirect, in any assets which had been, since 31 December 2012, being the date to which the latest published audited financial statements of the Company were made up, acquired or disposed of by or leased to any member of the Group or are proposed to be acquired or disposed of by or leased to any member of the Group; and (ii) the Independent Financial Adviser did not have any shareholding interests in any member of the Group and it did not have any right, whether legally enforceable or not, to subscribe for or nominate persons to subscribe for securities of any members of the Group.

## 10. MATERIAL CONTRACTS

As at the Latest Practicable Date, save as the Contract on Technological License of High-powered Diesel Engines entered between Chongqing Cummins Engine Co., Ltd. and Cummins on 28 August 2013 (for details please refer to the announcement dated 28 August 2013 published on the website of the Stock Exchange and the Company), no contract (not being a contract entered into in the ordinary course of business) was entered into by members of the Group within the two years immediately preceding the Latest Practicable Date and is, or may be, material.

## 11. MISCELLANEOUS

(i) The registered office and the principal place of business in the PRC of the Company are at No. 60, Middle Section of Huangshan Avenue, New North Zone, Chongqing City, the PRC;

(ii) The principal place of business of the Company in Hong Kong is Suite 2008, 20/F, Jardine House, 1 Connaught Place, Central, Hong Kong;

(iii) The Company's H Share Registrars and transfer office in Hong Kong is Computershare Hong Kong Investor Services Limited, Shops 1712-1716, 17/F, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong;

(iv) The company secretary of the Company is Mr. Wang Xiao Jun, who is a practicing solicitor of the High Court of Hong Kong; and

(v) Unless stated otherwise, in the event of inconsistency, the English language text of this circular shall prevail over the Chinese language text.

## 12. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection at the office of Jun He Law Offices at Suite 2008, 20/F, Jardine House, 1 Connaught Place, Central, Hong Kong during normal business hours on any weekday (except public holidays) from the date of this circular up to and including Monday, 30 December 2013:

(i) the Articles;

(ii) 2014-2016 Group Financial Services Framework Agreement;

(iii) 2014-2016 Parent Group Financial Services Framework Agreement;

(iv) 2014-2016 Master Sales Agreement;

(v) 2014-2016 Master Supplies Agreement;

(vi) 2014-2016 Master Leasing Agreement;

(vii) the letter from the Independent Board Committee to the Independent Shareholders, the text of which is set out in page 26 of this circular;

(viii) the letter from the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders, the text of which is set out in pages 27 to 61 of this circular;

(ix) the written consent from the Independent Financial Advisor;

(x) the annual reports of the Company for the two financial years ended 31 December 2011 and 2012;

(xi) a copy of this circular; and

(xii) Contract on Technological License of High-powered Diesel Engines entered between Chongqing Cummins Engine Co., Ltd. and Cummins on 28 August 2013.

# Chongqing Machinery & Electric Co., Ltd.*
# 重慶機電股份有限公司

*(a joint stock limited company incorporated in the People's Republic of China with limited liability)*

(Stock Code: 02722)

## NOTICE OF THE EXTRAORDINARY GENERAL MEETING

**NOTICE IS HEREBY GIVEN** that the Second EGM of the Company for 2013 will be held at Conference Room 1303, 13/F, Jidian Building, No. 60, Middle Section of Huangshan Avenue, New North Zone, Chongqing City, the PRC at 9:30 a.m. on Monday, 30 December 2013 for the purpose of considering and, if thought fit, passing, the following resolutions:

### ORDINARY RESOLUTIONS:

1. To approve the master sales agreement entered into between the Company and Chongqing Machinery and Electric Holding (Group) Co., Ltd.* on 14 October 2013 ("2014-2016 Master Sales Agreement") and the proposed annual caps for such transactions for the three years ended 31 December 2016; and to authorize the directors of the Company to do all such further acts and things and execute all such further documents and take all such steps that are ancillary to the 2014-2016 Master Sales Agreement and of administrative nature which, in their absolute discretion, to implement and/or give effect to the matters contemplated under this resolution;

2. To approve the master supplies agreement entered into between the Company and Chongqing Machinery and Electric Holding (Group) Co., Ltd.* on 14 October 2013 ("2014-2016 Master Supplies Agreement") and the proposed annual caps for such transactions for the three years ended 31 December 2016; and to authorize the directors of the Company to do all such further acts and things and execute all such further documents and take all such steps that are ancillary to the 2014-2016 Master Supplies Agreement and of administrative nature which, in their absolute discretion, to implement and/or give effect to the matters contemplated under this resolutions;

3. To approve the transactions in respect of the deposit services under the financial services framework agreement entered into between the Company and Chongqing Machinery and Electric Holding (Group) Finance Co., Ltd.* on 14 October 2013 ("2014-2016 Group Financial Services Framework Agreement") and the proposed annual caps for such transactions for the three years ended 31 December 2016; and to authorize the directors of the Company to do all such further acts and things and execute all such further documents and take all such steps that are ancillary to the deposit services under the 2014-2016 Group Financial Services Framework Agreement and of administrative nature which, in their absolute discretion, to implement and/or give effect to the matters contemplated under this resolution;

4. To approve the transactions in respect of the loan services under the financial services framework agreement entered into between Chongqing Machinery and Electric Holding (Group) Finance Co., Ltd.* and Chongqing Machinery and Electronic Holding (Group) Co., Ltd.* on 14 October 2013 ("2014-2016 Parent Group Financial Services Framework Agreement") and the proposed annual caps for such transactions for the three years ended 31 December 2016; and to authorize the directors of the Company to do all such further acts and things and execute all such further documents and take all such steps that are ancillary to the loan services under the 2014-2016 Parent Group Financial Services Framework Agreement and of administrative nature which, in their absolute discretion, to implement and/or give effect to the matters contemplated under this resolution; and

5. To approve the transactions in respect of the guarantee services under the financial services framework agreement entered into between Chongqing Machinery and Electric Holding (Group) Finance Co., Ltd.* and Chongqing Machinery and Electronic Holding (Group) Co., Ltd.* on 14 October 2013 ("2014-2016 Parent Group Financial Services Framework Agreement") and the proposed annual caps for such transactions for the three years ended 31 December 2016; and to authorize the directors of the Company to do all such further acts and things and execute all such further documents and take all such steps that are ancillary to the guarantee services under the 2014-2016 Parent Group Financial Services Framework Agreement and of administrative nature which, in their absolute discretion, to implement and/or give effect to the matters contemplated under this resolution.

By Order of the Board
**Chongqing Machinery & Electric Co., Ltd.***
**Wang Yuxiang**
*Executive Director and Chairman*

15 November 2013

* *For identification purposes only*

*Notes:*

1. A member of the Company ("Member") entitled to attend and vote at the Meeting is entitled to appoint a proxy or proxies to attend and vote in his stead. A proxy need not be a Member. A form of proxy for use at the Meeting is enclosed herewith. In the case of the joint holders of any Share, only the person whose name appears first in the register of members shall be entitled to receive this notice, to attend and exercise all the voting powers attached to such Share at the Meeting, and this notice shall be deemed to be given to all joint holders of such Share.

2. To be valid, the form of proxy together with any power of attorney or other authority (if any) under which it is signed or a notarially certified copy of that power of attorney or authority must be deposited with the Company's H share registrar Computershare Hong Kong Investor Services Limited, at 17M Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, and in case of holders of domestic shares, to the Company's mailing address at No. 60, Middle Section of Huangshan Avenue, New North Zone, Chongqing City, the PRC, not later than 24 hours before the time appointed for holding the Meeting or the time appointed for passing the resolutions or any adjournment thereof. Delivery of the form of proxy shall not preclude a Member from attending and voting in person at the Meeting and, in such event, the instrument appointing a proxy shall be deemed to be revoked.

3. The register of Members in Hong Kong will be closed from 30 November 2013 to 30 December 2013, both days inclusive, during which period no transfer of H shares of the Company will be effected. For the identification of Members who are qualified to attend and vote at the Meeting, all transfer documents accompanied by the relevant share certificates must be lodged with the Company's H share registrar Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17/F, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong not later than 4:30 p.m. on 29 November 2013.

4. Whether or not the holders of H shares of the Company who intend to attend the Meeting shall complete the enclosed reply slip for the Meeting and return it, by hand or by post, to the Company's H share registrar Computershare Hong Kong Investor Services Limited, at 17M Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, or by fax on or before Monday, 9 December 2013.

5. Whether or not the holders of domestic shares of the Company who intend to attend to the Meeting shall complete the enclosed reply slip for the Meeting and return it, by hand or by post, to the Company's mailing address at No. 60, Middle Section of Huangshan Avenue, New North Zone, Chongqing City, the PRC, or by fax on or before Monday, 9 December 2013.

*As at the date of the notice, the executive Directors are Mr. Wang Yuxiang, Mr. Yu Gang, Mr. Ren Yong and Mr. Chen Xianzheng; the non-executive Directors are Mr. Huang Yong, Mr. Wang Jiyu, Mr. Yang Jingpu and Mr. Deng Yong; and the independent non-executive Directors are Mr. Lo Wah Wai, Mr. Ren Xiaochang, Mr. Jin Jingyu and Mr. Yang Zhimin.*