



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

## CONTINUING CONNECTED TRANSACTIONS

Prior to the Listing, the Company entered into the agreements with AVIC II in respect of provision of goods and/or services on a continuing basis. Besides these transactions with the AVIC II Group, the Group has also been conducting, on a recurring basis, transactions with its joint venture partners (which are connected persons of the Company as they hold at least 10% interest in the subsidiaries of the Company), and non-wholly owned subsidiaries of the Company (which are connected persons of the Company because AVIC II or its associates has not less than 10% interest in them).

Upon Listing, the aforesaid transactions constitute continuing connected transactions of the Company under the Listing Rules. The Company has been conducting these continuing connected transactions subject to caps set for the three financial years ending 31 December 2005.

As the caps and/or some of the agreements relating to these continuing connected transactions will expire on 31 December 2005, the Company has on 26 August 2005 entered into various supplemental agreements for the purpose of extending the term of some of the existing agreements in relation to these continuing connected transactions to 31 December 2008. Moreover, the Group has also entered into certain new agreements with its joint venture partners (which are connected persons of the Company as they hold at least 10% interest in the subsidiaries of the Company) in respect of provision of goods and/or services on a continuing basis. As the transactions contemplated under the supplemental agreements and new agreements will constitute continuing connected transactions of the Company under Chapter 14A of the Listing Rules, these continuing connected transactions together with the proposed annual caps will be subject to approval by the Independent Shareholders at the EGM.

AVIC II, Mitsubishi, Suzuki, Agusta S.p.A. and their respective associate(s), if any, will abstain from voting on the ordinary resolutions to be proposed to consider these continuing connected transactions and the proposed annual caps, which will be taken by way of poll at the EGM as required under the Listing Rules.

The Independent Board Committee has been established to advise the Independent Shareholders in respect of these continuing connected transactions and the proposed annual caps. An independent financial adviser will issue a letter of advice to the Independent Board Committee and the Independent Shareholders in respect of these continuing connected transactions and the proposed annual caps. A circular containing further information in relation to these continuing connected transactions as required under the Listing Rules (including a letter from the Independent Board Committee and its recommendations to the Independent Shareholders, and an opinion letter from the independent financial adviser) will be issued by the Company and despatched to the Shareholders as soon as practicable.

### Background

Shares of the Company are listed on the Stock Exchange since October 2003. As part of the reorganization carried out for the purpose of facilitating listing of the Company's shares, AVIC II, together with three other promoters, established the Company by injecting most of the assets and equity interests relating to the development and manufacturing of aviation products, vehicles and vehicles engines into the Company. AVIC II retained interest in enterprises which are primarily engaged in the production of military aviation products, aviation and vehicle parts and components and other general machinery and equipment; one export and import enterprise specializing in trading of aviation products and related business namely CATIC; four research and design institutes; and 23 general trading, consultants, advertisement and financial service enterprises, as well as non-profit-making social and community service entities, education entities and overseas establishments. The enterprises which have not been injected into the Group are principally engaged in businesses which are not part of the core business of the Group. In addition, the Group also purchases certain raw materials, parts and components from independent suppliers through the AVIC II Group so as to benefit from increased negotiation power for bulk orders. As a result, there are certain continuing transactions between the Group and the AVIC II Group subsequent to the reorganization. As AVIC II is the controlling shareholder of the Company, these transactions constitute continuing connected transactions of the Company under the Listing Rules.

Besides those continuing connected transactions with the AVIC II Group, the Group has also been conducting, on a recurring basis, transactions with its joint venture partners (which are connected persons of the Company as they hold at least 10% interest in the subsidiaries of the Company), and non-wholly owned subsidiaries of the Company (which are connected persons of the Company because AVIC II or its associates has not less than 10% interest in them). The Company has been conducting these continuing connected transactions subject to caps set for the three financial years ending 31 December 2005 (details are set out in the prospectus of the Company dated 21 October 2003). As the caps and/or some of the agreements relating to these continuing connected transactions will expire on 31 December 2005, the Company has entered into various supplemental agreements for the purpose of extending the term of some of the existing agreements in relation to these continuing connected transactions to 31 December 2008. Moreover, the Group has also entered into certain new agreements with its joint venture partners (which are connected persons of the Company as they hold at least 10% interest in the subsidiaries of the Company) in respect of provision of goods and/or services on a continuing basis. Details of these continuing connected transactions are set out below:

#### 1. Mutual Supply Agreement

On 26 August 2005, the Company entered into a supplemental agreement with AVIC II to renew the term of the Mutual Supply Agreement for a further term of three years expiring on 31 December 2008. Save for such extension of the term of the Mutual Supply Agreement and the amendment of the definitions of "associates" of the AVIC II Group and "subsidiaries" of the Company in order to bring these terms in line with the Listing Rules as amended with effect from 31 March 2004, the other terms and conditions of the Mutual Supply Agreement remain unchanged. This supplemental agreement and the proposed annual caps for the three financial years ending 31 December 2008 are subject to approval being obtained from the Independent Shareholders at the EGM.

Pursuant to the Mutual Supply Agreement, the AVIC II Group agrees to provide the following products and services to the Group:

**Products:** supply of parts and components for manufacturing aviation products, supply of raw materials for manufacturing automobile engines, supply of axles, air conditioners and chairs for automobiles, auxiliary parts, procurement of tools and moulds

**Services:** production power supply, provision of import/export agency services, labour services, construction works services, transportation services, trial flying services, information technology and quality control services

**Others:** provision of loan guarantees, leasing of equipment

In respect of the guarantees provided by the AVIC II Group in favor of the Group, on the basis that the Company has not provided any security in respect of such guarantees, such guarantees fall within Rule 14A.65(4) of the Listing Rules and are therefore exempted from reporting, announcement and independent shareholders' approval requirements applicable to continuing connected transactions. The Directors consider such guarantees provided by the AVIC II Group are on normal commercial terms. As at 31 December 2004, the amount of outstanding bank borrowings covered by the guarantees provided by the AVIC II Group in favor of the Group amounted to approximately RMB 946 million (equivalent to approximately HK\$909.6 million). As mentioned in the 2004 annual report of the Company, the Directors have confirmed that all remaining guarantees will be gradually released or withdrawn.

According to the Mutual Supply Agreement, the Group agrees to provide the following products and services to the AVIC II Group:

**Products:** supply of parts and components for manufacturing aeroengines and moulds for the aviation parts and components, parts and components for military aircraft, processing of accessories, sales of aircraft and automobiles, supply of raw materials, supply of automobile engines and moulds for the parts and components of automobiles

**Services:** production power supply, labor services and comprehensive production management services

### Term

Subject to approval being obtained from the Independent Shareholders at the EGM, the Mutual Supply Agreement will be renewed as from 1 January 2006 for a term of three years.

### Pricing

The above products and services shall be provided according to the following pricing policies:

- according to government-prescribed price;
- where there is no government-prescribed price but where there is a government guidance price, then according to the government guidance price;
- where there is neither a government-prescribed price nor a government guidance price, then according to the market price. The market price is defined as the price at which the same type of products or services are provided by independent third parties in their ordinary course of business; or
- where none of the above is applicable, the price is to be agreed between the relevant parties for the provision of the above products or services, which shall be the reasonable cost incurred in providing the same plus not more than 8% profit of such cost (reasonable cost means the cost confirmed by both parties after negotiations and permitted by the financial accounting standards of the PRC).

The profit margin charged by the Group and the AVIC II Group as per the pricing policy (iv) above is determined after arm's length negotiation between the Group and the AVIC II Group. In determining the profit margin charged by the Group for the provision of the above products and services to the AVIC II Group, the Group has taken into account the profit margin required by the Group in conducting such business. In negotiating the profit margin charged by the AVIC II Group for the above mentioned products and services provided by the AVIC II Group, the Group has also taken into account the profit margin of these products and services of the Group after paying such amount of expense to the AVIC II Group and the profit margin required by the AVIC II Group in providing such products and services.

### Historical figures

The total expenditures incurred by the Group for the purchase of products and services from the AVIC II Group for each of the financial years ended 31 December 2003 and 2004 and the six months ended 30 June 2005 were approximately RMB 2,498 million (equivalent to approximately HK\$2,401.9 million), RMB 2,446 million (equivalent to approximately HK\$2,351.9 million) and RMB 1,044 million (equivalent to approximately HK\$1,003.8 million) respectively. The total revenues received by the Group for the provision of products and services to the AVIC II Group for each of the financial years ended 31 December 2003 and 2004 and the six months ended 30 June 2005 amounted to approximately RMB 2,395 million (equivalent to approximately HK\$2,302.9 million), RMB 2,528 million (equivalent to approximately HK\$2,430.8 million) and RMB 1,293 million (equivalent to approximately HK\$1,243.3 million) respectively.

### Annual Caps

The Directors expect that the total expenditures to be incurred by the Group for the purchase of products and services from the AVIC II Group for the three financial years ending 31 December 2008 would not exceed RMB 3,000 million (equivalent to approximately HK\$2,884.6 million), RMB 3,500 million (equivalent to approximately HK\$3,365.4 million) and RMB 4,000 million (equivalent to approximately HK\$3,846.2 million) respectively, while the total revenues to be received by the Group for the provision of products and services to the AVIC II Group for the three financial years ending 31 December 2008 would not exceed RMB5,400 million (equivalent to approximately HK\$5,192.3 million), RMB7,000 million (equivalent to approximately HK\$6,730.8 million) and RMB8,500 million (equivalent to approximately HK\$8,173.1 million) respectively. Accordingly, the Company would like to seek approval from the Independent Shareholders of the aforesaid amounts as the proposed annual caps for the continuing connected transactions to be conducted pursuant to the Mutual Supply Agreement (as amended).

The above proposed annual caps for the total revenues of the Group for the provision of products and services to the AVIC II Group are determined with reference to the projected growth in turnover attributable to these activities in 2006-2008. Historically, turnover attributable to transactions carried out pursuant to the Mutual Supply Agreement mainly came from sales of aviation products to the AVIC II Group for the latter's fulfillment of the government orders or to CATIC for export overseas. The Directors expect that the production and sales of aviation products will increase substantially in the next few years due to the substantial increase in purchase orders as indicated by the AVIC II Group.

The proposed annual caps for the total expenditures to be incurred by the Group for the purchase of products and services from the AVIC II Group are determined with reference to the following factors:

- the expected increase in the Group's sales of aviation products to the AVIC II Group will require an increase in the purchase of aviation parts and components from the AVIC II Group, and hence the transaction volume under the Mutual Supply Agreement will also increase;
- the Group plans to use more imported parts and components for manufacturing aviation products as per clients' specification, such specification from client also occurred in the past. As a result, the expected growth rate for the total expenditures of the Group to be

incurred under the Mutual Supply Agreement would be much lower than that for the total revenues of the Group arising from the provision of products and services to the AVIC II Group pursuant to the Mutual Supply Agreement; and

- the Group expects a growth in sales of vehicles to independent buyers. It is expected that there would be a more than 10% annual growth in the low-end consumer car market in the PRC which is less affected by foreign competition. Such estimation is in line with the market outlook on the low-end consumer car market in the PRC prepared by certain reputable investment banks. Increase in car sales would lead to an increase in purchase of vehicle parts and components from the AVIC II Group.

In determining the above proposed annual caps for the total expenditures and total revenue to be recorded by the Group pursuant to the Mutual Supply Agreement, the Directors have made reference to the historical transaction amounts and consider that these historical transaction amounts and growth rates are not the key assumptions in deriving the above proposed annual caps.

#### 2. Comprehensive Services Agreement

On 26 August 2005, the Company entered into a supplemental agreement with AVIC II to renew the term of the Comprehensive Services Agreement for a further term of three years expiring on 31 December 2008. Save for such extension of the term of the Comprehensive Services Agreement and the amendment of the definitions of "associates" of the AVIC II Group and "subsidiaries" of the Company in order to bring these terms in line with the Listing Rules as amended with effect from 31 March 2004, the other terms and conditions of the Comprehensive Services Agreement remain unchanged. This supplemental agreement and the proposed annual caps for the three financial years ending 31 December 2008 are subject to approval being obtained from the Independent Shareholders at the EGM.

Pursuant to the Comprehensive Services Agreement entered into between the Company and AVIC II, the AVIC II Group agrees to provide certain social welfare and supporting services to the Group including:

- cultural, educational and hygiene services, including staff training, staff publicity services, recreational services and medical services; and
- social welfare services including withholding and payment for social welfare funds and housing provident funds, management services for retired staff, fire safety, security and greenery services, staff housing area management, nursery and children education services and provision of public utilities, transportation and communication services and other supporting services.

### Term

Subject to approval being obtained from the Independent Shareholders at the EGM, the Comprehensive Services Agreement will be renewed as from 1 January 2006 for a term of three years.

### Pricing

The services under the Comprehensive Services Agreement will be provided in accordance with the same pricing basis as set out in the Mutual Supply Agreement, except that if the price is to be agreed between the relevant parties, such price shall be the reasonable cost incurred in providing the relevant services plus not more than 3% of such cost as profit (reasonable cost means the cost confirmed by both parties after negotiations and permitted by the financial accounting standards of the PRC). Such profit margin charged by the AVIC II Group is determined after arm's length negotiation between the Group and the AVIC II Group. In negotiating the profit margin charged by the AVIC II Group for the aforesaid services provided by the AVIC II Group, the Group has also taken into account the overall profit margin of the Group after paying such amount of expense to the AVIC II Group and the profit margin required by the AVIC II Group in providing such services.

### Historical figures

The total expenditures paid by the Group in relation to the social welfare and supporting services provided by the AVIC II Group for each of the financial years ended 31 December 2003 and 2004 and the six months ended 30 June 2005 were approximately RMB 131 million (equivalent to approximately HK\$126.0 million), RMB 150 million (equivalent to approximately HK\$144.2 million) and RMB 49 million (equivalent to approximately HK\$47.1 million) respectively. Payment to the AVIC II Group for the social welfare and supporting services is mostly made in the latter half of the year.

### Annual Caps

Taking into account (i) the expansion of the Group's business in future as a result of the expected economic growth and (ii) the increase in wage caused partly by inflation, the Directors expect that the total expenditures to be incurred by the Group in relation to the social welfare and supporting services sourced from the AVIC II Group for the three financial years ending 31 December 2008 would increase steadily and would not exceed RMB180 million (equivalent to approximately HK\$173.1 million), RMB200 million (equivalent to approximately HK\$192.3 million) and RMB220 million (equivalent to approximately HK\$211.5 million) respectively.

In determining the above proposed annual caps for the total expenditures to be incurred by the Group pursuant to the Comprehensive Services Agreement, the Directors have made reference to the historical transaction amounts and consider that these historical transaction amounts and growth rates are not the key assumptions in deriving the above proposed annual caps.

### Land Use Rights Leasing Agreement and Properties Leasing Agreement

#### Land Use Rights Leasing Agreement

On 2 October 2003, the Company entered into the Land Use Rights Leasing Agreement with AVIC II whereby the AVIC II Group agreed to lease to the Group 48 pieces of lands, with an aggregate area of approximately 2.9 million square meters ("Leased Lands") at an annual rent of approximately RMB37.6 million (equivalent to approximately HK\$36.2 million). Pursuant to the terms of the Land Use Rights Leasing Agreement, the annual rental is to be adjusted every three years and any such revised rent shall not be higher than the prevailing market rent as confirmed by an independent valuer, provided that the rent may be reduced at any time as the parties may agree. In accordance with the Land Use Rights Leasing Agreement, the annual rent is due to be adjusted on 1 January 2006. The Leased Lands are used by the Group as workshops, warehouses, administrative office and ancillary facilities.

#### Term

The Land Use Rights Leasing Agreement has a term of 20 years commencing from 30 April 2003.

#### Historical figures

The annual rentals paid by the Group to the AVIC II Group for the Leased Lands for each of the financial years ended 31 December 2003 and 2004 and the six months ended 30 June 2005 were approximately RMB 37.6 million (equivalent to approximately HK\$36.2 million), RMB 37.6 million (equivalent to approximately HK\$36.2 million) and RMB 18.8 million (equivalent to approximately HK\$18.1 million) respectively.

#### Annual Caps

The annual rentals payable by the Group to the AVIC II Group for the Leased Lands as agreed by the Company and AVIC II for the three financial years ending 31 December 2008 will remain at approximately RMB 37.6 million (equivalent to approximately HK\$36.2 million), which are not higher than the market rent as at 31 July 2005 assessed by Vigers Appraisal & Consulting Limited, the Company's independent property valuer.

#### Properties Leasing Agreement

On 2 October 2003, the Company entered into the Properties Leasing Agreement with AVIC II whereby the AVIC II Group agreed to lease to the Group 54 buildings with an aggregate gross floor area of approximately 110,508 square meters ("Former Rented Properties") at an annual rent of approximately RMB 24 million (equivalent to approximately HK\$23.1 million). Similarly, the Group agreed to lease to the AVIC II Group certain properties with an aggregate gross floor area of approximately 36,835 square meters ("Former Leased Properties") at an annual rent of approximately RMB1.1 million (equivalent to approximately HK\$1.06 million).

Pursuant to the Properties Leasing Agreement, the annual rentals for the Former Rented Properties and the Former Leased Properties are to be adjusted every three years and any such revised rents shall not be higher than the prevailing market rents as confirmed by an independent valuer. The next rental adjustment date pursuant to the Properties Leasing Agreement is 1 January 2006. On 26 August 2005, the Company entered into a supplemental agreement with AVIC II whereby it is agreed that the AVIC II Group will lease certain properties to the Group with an aggregate gross floor area of approximately 111,000 square meters ("Rented Properties") at an annual rental of approximately RMB24 million (equivalent to approximately HK\$23.1 million) and the Group will lease certain properties to the AVIC II Group with an aggregate gross floor area of approximately 36,000 square meters ("Leased Properties") at an annual rental of approximately RMB1.1 million (equivalent to approximately HK\$1.06 million). Save for the above leasing arrangements and the amendment of the definitions of "associates" of the AVIC II Group and "subsidiaries" of the Company in order to bring these terms in line with the Listing Rules as amended with effect from 31 March 2004, the other terms and conditions of the Properties Leasing Agreement remain unchanged. This supplemental agreement and the proposed annual caps for the three financial years ending 31 December 2008 are subject to approval being obtained from the Independent Shareholders at the EGM.

The Rented Properties are used by the Group as workshops, warehouses and ancillary facilities which are built on the Leased Lands. The Leased Properties are used by the AVIC II Group as workshops, warehouses and ancillary facilities.

#### Term

The Properties Leasing Agreement has a term of 10 years commencing from 30 April 2003.

#### Historical figures

The annual rentals for the Former Rented Properties paid by the Group for each of the financial years ended 31 December 2003 and 2004 and the six months ended 30 June 2005 were approximately RMB24 million (equivalent to approximately HK\$23.1 million), RMB24 million (equivalent to approximately HK\$23.1 million) and RMB12 million (equivalent to approximately HK\$11.5 million) respectively, while the annual rentals for the Former Leased Properties received by the Group for each of the financial years ended 31 December 2003 and 2004 and the six months ended 30 June 2005 were approximately RMB1.1 million (equivalent to approximately HK\$1.06 million), RMB1.1 million (equivalent to approximately HK\$1.06 million) and RMB0.55 million (equivalent to approximately HK\$0.53 million) respectively.

#### Annual Caps

The annual rentals for the Rented Properties and the Leased Properties as agreed by the Company and AVIC II for the three financial years ending 31 December 2008 will be approximately RMB 24 million (equivalent to approximately HK\$23.1 million) and approximately RMB 1.1 million (equivalent to approximately HK\$1.06 million) respectively, which are not higher than the market rent as at 31 July 2005 as assessed by Vigers Appraisal & Consulting Limited, the Company's independent property valuer.

#### Reasons for the term of the Land Use Rights Leasing Agreement and the Properties Leasing Agreement being more than three years

The Land Use Rights Leasing Agreement and the Properties Leasing Agreement have an unexpired term longer than three years. The land use rights for the Leased Lands and the Rented Properties were not injected into the Group as part of the reorganization carried out at the time of Listing because such injection by way of investment would require payment of certain fees and taxes by the Group under the applicable PRC law and regulations and State policy. In the circumstances, the Board considers that it is more cost efficient to secure the Group's long-term right to use the Leased Lands and the Rented Properties by entering into the long-term Land Use Rights Leasing Agreement and the Properties Leasing Agreement. Given that the Land Use Rights Leasing Agreement and the Properties Leasing Agreement contain the term that the rentals will be adjusted to not higher than the then prevailing market rents every three years, interests of the Company and the Independent Shareholders would not be prejudiced even though the term of the agreements are longer than three years.

An independent financial adviser will issue a letter of advice explaining, among other things, the long-term nature of this transaction and confirming that it is normal business practice for contracts of this type to be of such duration to the Independent Board Committee and the Independent Shareholders and the same will be contained in the circular to be despatched to the Shareholders as soon as possible.

### 4. Technology Cooperation Agreement

On 26 August 2005, the Company entered into a supplemental agreement with AVIC II to renew the term of the Technology Cooperation Agreement for a further term of three years expiring on 31 December 2008. Save for such extension of the term of the Technology Cooperation Agreement and the amendment of the definitions of "associates" of the AVIC II Group and "subsidiaries" of the Company in order to bring these terms in line with the Listing Rules amended with effect from 31 March 2004, the other terms and conditions of the Technology Cooperation Agreement remain

unchanged. This supplemental agreement and the proposed annual caps for the three financial years ending 31 December 2008 are subject to approval being obtained from the Independent Shareholders at the EGM.

Pursuant to the Technology Cooperation Agreement, the AVIC II Group:

- has transferred or granted exclusive licences to the Group to use certain technologies of the AVIC II Group which is required for the business of the Group in connection with the production of aviation products and automobiles at nil consideration;
- agrees that any improvement made to the transferred technologies shall belong to the Group (whether such improvement is made by the Group or the AVIC II Group). The AVIC II Group may however use such improvement at no consideration with the Group's consent. Any improvement to the licenced technologies shall belong to the parties making the improvement, and the other parties shall be entitled to use such improved technologies free of charge;
- agrees to develop new technologies jointly with the Group. The results of those jointly developed technologies shall be enjoyed by the AVIC II Group and the Group. The AVIC II Group and the Group were entitled to apply for patent registration and software registration jointly, while any improvement made to these new technologies shall be jointly owned by the AVIC II Group and the Group;
- agrees that the Group may appoint the AVIC II Group to develop new technologies for the Group's business and the results of such development shall belong to the Group;
- also agrees that they may also appoint the Group to develop new technologies, in which case the funding of such development shall be provided by the AVIC II Group and the results of such development shall belong to the AVIC II Group except otherwise agreed; and
- agrees with the Group that for any improvement made to the new technologies which one party appointed the other to develop, if such improvement is made by the AVIC II Group, the AVIC II Group shall grant a licence to the Group to use such improvement free of charge. If such improvement is made by the Group, the AVIC II Group may use such improvement free of charge only with the Group's consent and provided that such usage by the AVIC II Group will not constitute competition with the business of the Group.

#### Term

Subject to approval being obtained from the Independent Shareholders at the EGM, the Technology Cooperation Agreement will be renewed as from 1 January 2006 for a term of three years.

#### Pricing

Pursuant to the Technology Cooperation Agreement,

- the Group may develop new technologies jointly with the AVIC II Group. It is expected that in the case of jointly developed project, funding will be contributed in proportion to the two parties' agreed percentage of ownership of the new technologies;
- if the Group appoints the AVIC II Group to develop new technologies for the Group's business, the Group will provide the funding for the development; and
- if the Group is appointed by the AVIC II Group to develop new technologies, the AVIC II Group will provide funding for such development.

#### Historical figures

The amounts spent by the Group on the development of new technologies under the Technology Cooperation Agreement for each of the financial years ended 31 December 2003 and 2004 and the six months ended 30 June 2005 were approximately RMB 33 million (equivalent to approximately HK\$31.7 million), RMB18 million (equivalent to approximately HK\$17.3 million) and RMB5 million (equivalent to approximately HK\$4.8 million) respectively and the amounts received by the Group for developing new technologies for the AVIC II Group pursuant to the Technology Cooperation Agreement for the same years or period were approximately RMB46 million (equivalent to approximately HK\$44.2 million), nil and nil respectively. Because of market development of the aviation products and automobiles, some of the research projects planned to be carried out in 2003 to 2005 had been delayed or cancelled. As a result, the total amounts of expenditures incurred and revenues received by the Group pursuant to the Technology Cooperation Agreement decreased significantly in 2004 and 2005.

#### Annual Caps

The Directors expect that the total expenditures to be spent by the Group on the development of technologies under the Technology Cooperation Agreement for the three financial years ending 31 December 2008 would not exceed RMB33 million (equivalent to approximately HK\$31.7 million), RMB36 million (equivalent to approximately HK\$34.6 million) and RMB40 million (equivalent to approximately HK\$38.5 million) respectively, and the total revenue to be received by the Group for developing new technologies for the AVIC II Group under the Technology Cooperation Agreement for the same years would not exceed RMB22 million (equivalent to approximately HK\$21.2 million), RMB24 million (equivalent to approximately HK\$23.1 million) and RMB27 million (equivalent to approximately HK\$26.0 million) respectively.

The above proposed annual caps for the transactions to be conducted under the Technology Cooperation Agreement are determined after taking into account the planned research projects involving the joint development with the AVIC II Group of the advanced utility helicopters, the modified model of Z-9 series helicopters and the advance jet trainers and the Group's development of some composite materials for the AVIC II Group.

The research projects for the development of the advanced utility helicopters and the advance jet trainers have commenced in 2005, while the rest of the research projects are expected to be launched in 2006. The above proposed annual caps are the current estimation of the aggregate transaction amounts to be incurred for these research projects, the amount of expenditures to be incurred in each projects may deviate from the current estimation depending on the development of these projects.

As the above proposed annual caps are based on the planned research projects to be conducted in the future, the Directors consider that the historical transaction amounts and growth rates are not the key assumptions in deriving the above proposed annual caps.

### 5. Mitsubishi Technology Transfer Agreement & Mitsubishi CKD Agreement

#### Mitsubishi Technology Transfer Agreement

Pursuant to the Mitsubishi Technology Transfer Agreement, Mitsubishi:

- has granted certain licences to Dongan Engine to use the industrial properties rights, patent and technology documents relating to engines, gearboxes and the respective assemblies, parts and components;
- agrees to assist Dongan Engine to establish research and development centre, and provide technical training and technology instructions;
- agrees to provide Dongan Engine with all technology documents pursuant to the Mitsubishi Technology Transfer Agreement;
- agrees to provide technical services in relation to quality control, product technology, production, sales and after-sales services, purchase and management of materials of Dongan Engine; and
- agrees to provide special assistance to Dongan Engine as agreed between Mitsubishi and Dongan Engine.

Since Dongan Engine is a subsidiary of the Company and Mitsubishi is a substantial shareholder of Dongan Engine (i.e. a connected person of the Company as defined under the Listing Rules), the transactions contemplated under the Mitsubishi Technology Transfer Agreement constitute continuing connected transactions of the Company.

#### Term

The Mitsubishi Technology Transfer Agreement has a term of 10 years commencing from 22 October 1999.

#### Pricing

Pursuant to the Mitsubishi Technology Transfer Agreement, Dongan Engine will pay Mitsubishi royalty fee charged in respect of each engine and gearbox produced by Dongan Engine using Mitsubishi's technology. The amount of royalty fee is agreed between Dongan Engine and Mitsubishi after arm's length negotiation. In negotiating the royalty fee with Mitsubishi, the Directors have taken into account:

- the overall operation and development of the vehicle engines and gearboxes business of the Group;
- the fact that the royalty fees are charged in proportion to the production of engines and gearboxes produced by Dongan Engine using Mitsubishi's technology; and
- that the expected gross profit margins of the engines and gearboxes to be produced by Dongan Engine using Mitsubishi's technology during commercial production will not be lower than that of other engines and gearboxes produced by the Group even after taking into account the royalty fees payable to Mitsubishi.

Having considered all the above factors, the Directors consider that the royalty fees charged by Mitsubishi are fair and reasonable to the Company and the Shareholders as a whole.

#### Historical figures

The amounts of royalty fees paid by the Group for the engines and gearboxes using Mitsubishi's technology for each of the financial years ended 31 December 2003 and 2004 and the six months ended 30 June 2005 were approximately RMB 5 million (equivalent to approximately HK\$4.8 million), RMB 4 million (equivalent to approximately HK\$3.8 million) and RMB 3 million (equivalent to approximately HK\$2.9 million) respectively.

#### Annual Caps

The Directors estimate that the total expenditures to be incurred by the Group under Mitsubishi Technology Transfer Agreement for the three financial years ending 31 December 2008 would not exceed RMB 8 million (equivalent to approximately HK\$7.7 million), RMB 14 million (equivalent to approximately HK\$13.5 million) and RMB17 million (equivalent to approximately HK\$16.3 million) respectively. Accordingly, the Company would like to seek approval from the Independent Shareholders of the aforesaid amounts as the proposed annual caps for this type of continuing connected transactions for the three financial years ending 31 December 2008. The basis in respect of the proposed annual caps for this type of continuing connected transactions has been summarized under the paragraph headed "Annual Caps" under the Mitsubishi CKD Agreement below.

#### Mitsubishi CKD Agreement

Pursuant to the Mitsubishi CKD Agreement, Dongan Engine agrees to purchase CKD spare parts and components from Mitsubishi.

#### Term

The Mitsubishi CKD Agreement took effect from 22 October 1999 and would remain effective until the expiry of the joint venture contract of Dongan Engine. However, it is expected that no transaction will be conducted under the Mitsubishi CKD Agreement after the expiry of the Mitsubishi Technology Transfer Agreement since both are required for producing the types of engines and gearboxes that are being manufactured by Dongan Engine. Accordingly, the Mitsubishi CKD Agreement effectively has a term of 10 years commencing from 22 October 1999 which coincides with the Mitsubishi Technology Transfer Agreement.

#### Pricing

Pursuant to the Mitsubishi CKD Agreement, the prices payable for the CKD spare parts and components are fixed for a term of four and a half years commencing from the placement of the first order by the Company on 23 November 2000. The prices were fixed after arm's length negotiation between Dongan Engine and Mitsubishi based on market price. Dongan Engine would continue to purchase these parts and components from Mitsubishi at the same prices for the period ending 31 December 2007.

#### Historical figures

The total expenditures paid by the Group for the purchase of the CKD spare parts and components from Mitsubishi, being the subject matter of the Mitsubishi CKD Agreement, for each of the financial years ended 31 December 2003 and 2004 and the six months ended 30 June 2005 were approximately RMB 486 million (equivalent to approximately HK\$467.3 million), RMB 204 million (equivalent to approximately HK\$196.2 million) and RMB 11 million (equivalent to approximately HK\$10.6 million) respectively. The decrease in purchase of CKD spare parts and components was mainly due to implementation of the localization process which significantly reduced Dongan Engine's demand for imported CKD spare parts and components from Mitsubishi in its production process.

#### Annual Caps

The Directors estimate that the total expenditures to be incurred by the Group under the Mitsubishi CKD Agreement for the two financial years ending 31 December 2007 would not exceed RMB36 million (equivalent to approximately HK\$34.6 million) and RMB86 million (equivalent to approximately HK\$82.7 million) respectively. Accordingly, the Company would like to seek approval from the Independent Shareholders of the aforesaid amounts as the proposed annual caps for this type of continuing connected transactions for the two financial years ending 31 December 2007. The Company would not seek a cap for the Mitsubishi CKD Agreement for the financial year ending 31 December 2008 as the Company expects that localization of parts and components would have been completed by the end of 2007.

The above proposed annual caps for the transactions to be conducted under the Mitsubishi Technology Transfer Agreement and the Mitsubishi CKD Agreement are determined after taking into account:

- the expected more than 10% growth in the low-end consumer car market which is less affected by foreign competition;
- the increased demand from third party buyer. Dongan Engine has been supplying to certain new independent customers since the latter half of 2005. It is expected that the transaction volumes with independent customers would grow in the future;
- the increase in demand for parts and components from Mitsubishi following the expected increase in sales of Dongan Engine's products. It is believed that Dongan Engine's sales will grow with the gradual localization of its products' parts and components which will make Dongan Engine's products increasingly price competitive; and
- the plans to launch the upgraded models of the engines and gearboxes newly developed by Dongan Engine in 2006. The Directors expect that the production of engines and gearboxes by Dongan Engine will increase substantially in 2007 since the upgraded models of the engines and gearboxes will be launched in the market in 2006 and hence the total expenditure to be incurred by the Group under Mitsubishi Technology Transfer Agreement is expected to increase substantially in 2007;
- the expected increase in purchase of CKD spare parts and components from Mitsubishi as a result of the requirement for parts and components for the upgraded models of the engines and gearboxes newly developed by Dongan Engine.

In determining the above proposed annual caps for the transactions to be conducted under the Mitsubishi Technology Transfer Agreement and the Mitsubishi CKD Agreement, the Directors have made reference to the historical transaction amounts and consider that these historical transaction amounts and growth rates are not the key assumptions in deriving the above proposed annual caps.

### Reasons for the term of the Mitsubishi Technology Transfer Agreement and the Mitsubishi CKD Agreement being more than three years

The Mitsubishi Technology Transfer Agreement and the Mitsubishi CKD Agreement have an unexpired term longer than three years. Dongan Engine is a joint venture established between the Group and Mitsubishi. The principal business of Dongan Engine is to manufacture and assemble vehicle engines and gearboxes and related parts and components. To manufacture and assemble the types of vehicle engines and gearboxes that are being produced by Dongan Engine, Dongan Engine has to purchase CKD spare parts and components from Mitsubishi and use the related licences and technology owned by Mitsubishi. The Directors therefore consider that entering into the Mitsubishi Technology Transfer Agreement and the Mitsubishi CKD Agreement for a term exceeding three years will enable Dongan Engine to continue its operation smoothly.

An independent financial adviser issue give a letter of advice explaining, among other things, the long-term nature of this transaction and confirming that it is normal business practice for contracts of this type to be of such duration to the Independent Board Committee and the Independent Shareholders and the same will be contained in the circular to be despatched to the Shareholders as soon as possible.

### 6. Internal CT Agreement

On 26 August 2005, the Company entered into a supplemental agreement with its subsidiaries to renew the term of the Internal CT Agreement for a further term of three years expiring on 31 December 2008. Save for such extension of the term of the Internal CT Agreement, the other terms and conditions of the Internal CT Agreement remain unchanged. This supplemental agreement and the proposed annual caps for the three financial years ending 31 December 2008 are subject to approval being obtained from the Independent Shareholders at the EGM.

The purpose of the Internal CT Agreement is to govern the transactions entered into between the Company (or its wholly owned subsidiaries) and the non-wholly owned subsidiaries of the Company and transactions between the non-wholly-owned subsidiaries of the Company. Dongan Engine and Hafei Auto are two of the parties to the transactions carried out pursuant to the Internal CT Agreement.

Dongan Engine, a subsidiary of the Company, has certain continuing transactions with other subsidiaries of the Company. Since Dongan Group is an associate of AVIC II and a substantial shareholder of Dongan Engine, Dongan Engine is a connected person of the Company as defined under the Listing Rules. As a result, the transactions between Dongan Engine and the other subsidiaries of the Company constitute continuing connected transactions of the Company under the Listing Rules.

Similarly, another non-wholly-owned subsidiary of the Company, Hafei Auto, is currently a connected person of the Company because China Aero (382) Limited (an associate of AVIC II within the meaning of the Listing Rules) holds 25% of the equity interest in Hafei Auto. Therefore, the transactions between Hafei Auto and the other subsidiaries of the Company constitute continuing connected transactions of the Company under the Listing Rules.

In addition, Hafei Industry Company (a wholly-owned subsidiary of the Company) has been giving guarantees in favor of Hafei Auto. For the reasons stated above, such grant of guarantees constitutes continuing connected transactions of the Company under Rule 14A.63 of the Listing Rules.

As disclosed in the announcement and the circular of the Company dated 30 December 2004 and 1 February 2005 respectively in relation to the acquisition of the entire equity interest of Hafei Auto by Dongan Motor (the "Acquisition"), upon completion of the Acquisition, the legal status of Hafei Auto will be cancelled and all the assets, rights and liabilities of Hafei Auto will be assumed by Dongan Motor. As a result, Hafei Auto will cease to be a connected person of the Company following completion of the Acquisition. As at the date of this announcement, the Acquisition is yet to be completed and the transactions conducted between Hafei Auto and members of the Group would continue to constitute continuing connected transactions of the Company.

### Term

Subject to approval being obtained from the Independent Shareholders at the EGM, the Internal CT Agreement will be renewed as from 1 January 2006 for a term of three years.

### Pricing

The transactions that fall under the Internal CT Agreement are carried out in accordance with the same pricing policies as that of the Mutual Supply Agreement.

### Historical figures

The annual expenditure spent by Dongan Engine and Hafei Auto in relation to the products and services purchased from the subsidiaries of the Company for each of the financial years ended 31 December 2003 and 2004 and the six months ended 30 June 2005 were approximately RMB 1,501 million (equivalent to approximately HK\$1,443.3 million), RMB 1,863 million (equivalent to approximately HK\$1,791.3 million) and RMB 1,126 million (equivalent to approximately HK\$1,082.7 million) respectively. The annual revenue received by Dongan Engine and Hafei Auto in relation to the products and services provided to the subsidiaries of the Company for each of the financial years ended 31 December 2003 and 2004 and the six months ended 30 June 2005 were approximately RMB 486 million (equivalent to approximately HK\$467.3 million), RMB 296 million (equivalent to approximately HK\$284.6 million) and RMB 195 million (equivalent to approximately HK\$187.5 million) respectively. The decrease in revenue in 2004 was mainly due to decrease in sales of cars manufactured by Hafei Auto using the engines produced by Dongan Engine, and hence leading to a decrease in purchase of engines by Hafei Auto from Dongan Engine. The purchase of engines by Hafei Auto from Dongan Engine has been picking up in 2005 as reflected by the increase in revenue contributed by transactions conducted pursuant to the Internal CT Agreement with the launch of a new car model by Hafei Auto using the engine manufactured by Dongan Engine.

The amount of outstanding bank borrowings covered by the guarantees provided by Hafei Industry Company in favor of Hafei Auto for each of the financial years ended 31 December 2003 and 2004 and the six months ended 30 June 2005 were approximately RMB 2,516 million (equivalent to approximately HK\$2,419.2 million), RMB 1,784 million (equivalent to approximately HK\$1,715.4 million) and RMB 1,544 million (equivalent to approximately HK\$1,484.6 million) respectively. The current maximum amount of guarantees given by Hafei Industry Company in relation to the debts of Hafei Auto is approximately RMB2,000 million (equivalent to approximately HK\$1,923.1 million).

### Annual Caps

The total expenditures spent by Dongan Engine and Hafei Auto pursuant to the Internal CT Agreement are mainly attributable to the total expenditures spent by Hafei Auto in relation to the purchase of engines from Dongan Motor which is a subsidiary of the Company, while the total revenues received by Dongan Engine and Hafei Auto pursuant to the Internal CT Agreement are mainly attributable to the sales of vehicle engines and gearboxes by Dongan Engine to Hafei Auto.

Based on the expected increase in demand for car engines and the associated parts and components arising from the expected more than 10% growth in the low-end consumer car market in the PRC as mentioned above, the Directors expect that the purchase of engines by Hafei Auto from Dongan Motor and the sales of vehicles engines and gearboxes by Dongan Engine to Hafei Auto will increase accordingly. Based on the above, the Directors expect that the total expenditures to be spent by Dongan Engine and Hafei Auto relating to products and services purchased from other subsidiaries of the Company for the three financial years ending 31 December 2008 would not exceed RMB2,700 million (equivalent to approximately HK\$2,596.2 million), RMB3,200 million (equivalent to approximately HK\$3,076.9 million) and RMB3,800 million (equivalent to approximately HK\$3,653.8 million) respectively; while the total revenues to be received by Dongan Engine and Hafei Auto for the products and services sold to other subsidiaries of the Company for the three financial years ending 31 December 2008 would not exceed RMB500 million (equivalent to approximately HK\$480.8 million), RMB550 million (equivalent to approximately HK\$528.8 million) and RMB600 million

(equivalent to approximately HK\$576.9 million) respectively. However, as the Directors expect that the sales of vehicle engines and gearboxes by Dongan Engine to independent customers will increase in the next few years, the expected percentage increase in the annual revenue to be received by Dongan Engine and Hafei Auto (which is approximately 10%) is lower than the expected percentage increase in the annual expenditure to be spent by Dongan Engine and Hafei Auto (which is approximately 15%).

Based on the current maximum amount of guarantees provided by Hafei Industry Company in favor of Hafei Auto, the Company would like to seek approval from the Independent Shareholders of setting RMB 2,000 million (equivalent to approximately HK\$1,923.1 million) as the proposed annual caps for this type of continuing connected transactions for the three financial years ending 31 December 2008.

In determining the above proposed annual caps for the transactions to be conducted under the Internal CT Agreement, the Directors have made reference to the historical transaction amounts and consider that these historical transaction amounts and growth rates are not the key assumptions in deriving the above proposed annual caps.

### 7. Agusta Agreement

On 2 June 2005, the Group entered into the Agusta Agreement with Agusta S.p.A. Pursuant to the Agusta Agreement, Agusta S.p.A. agrees to supply the parts and components for manufacturing helicopters to Changhe Agusta, a joint venture established between the Group and Agusta S.p.A., and to provide assistance to Changhe Agusta for manufacturing, assembling and sales of the helicopters. Commercial production of the helicopters is expected to start in 2006.

Since Changhe Agusta is a subsidiary of the Company and Agusta S.p.A. is a substantial shareholder of Changhe Agusta (i.e. a connected person of the Company as defined under the Listing Rules), the transactions to be conducted under the Agusta Agreement would constitute continuing connected transactions of the Company. Agusta S.p.A. is an international helicopter manufacturer.

### Term

The Agusta Agreement has a term of 20 years commencing from 2 June 2005.

### Pricing

The prices payable by Changhe Agusta for the helicopter parts and components to be purchased from Agusta S.p.A. for the manufacturing of helicopters pursuant to the Agusta Agreement will be determined after arm's length negotiation between Changhe Agusta and Agusta S.p.A. based on market price.

### Annual Caps

The Directors estimate that the total expenditures to be incurred by the Group for the purchase of helicopter parts and components from Agusta S.p.A. for the three financial years ending 31 December 2008 would not exceed RMB 78 million (equivalent to approximately HK\$75.0 million), RMB 117 million (equivalent to approximately HK\$112.5 million) and RMB 117 million (equivalent to approximately HK\$112.5 million) respectively. Accordingly, the Company would like to seek approval from the Independent Shareholders of the aforesaid amounts as the proposed annual caps for this type of continuing connected transactions for the three financial years ending 31 December 2008. As at the date of this announcement, no transaction has been conducted pursuant to the Agusta Agreement.

The above proposed annual caps for the transactions to be conducted under the Agusta Agreement are determined on the following basis:

- the proposed annual cap for 2006 is determined with reference to the purchase orders as indicated by various government departments; and
- the proposed annual caps for 2007 and 2008 are determined with reference to the management's expectation on the potential demand for these helicopters by various government departments and the Directors' knowledge and outlook on the market.

Since the helicopters produced by Changhe Agusta using the parts and components provided by Agusta S.p.A. are expected to be launched in 2006, the Directors estimate that the demand for these helicopters will increase in 2007 and remain steady in 2008.

### Reasons for the term of the Agusta Agreement being more than three years

The Agusta Agreement has a term of 20 years commencing from 2 June 2005. Changhe Agusta is a joint venture established between the Group and Agusta S.p.A.. The principal business of Changhe Agusta is to manufacture helicopters using parts and components supplied by Agusta S.p.A.. To manufacture and assemble the helicopter, Changhe Agusta has to purchase the helicopter parts and components from Agusta S.p.A.. The Directors therefore consider that entering into the Agusta Agreement for a term exceeding three years is essential for the continuity of the business of Changhe Agusta.

An independent financial adviser will issue a letter of advice explaining, among other things, the long-term nature of this transaction and confirming that it is normal business practice for contracts of this type to be of such duration to the Independent Board Committee and the Independent Shareholders and the same will be contained in the circular to be despatched to the Shareholders as soon as possible.

### 8. Liana Licence Agreement, New Series Automobile Licence Agreement and K Series Engine Licence Agreement

On 24 December 2003, 21 March 2005 and 24 December 2003, Changhe Suzuki and Suzuki entered into three licence agreements, namely the Liana Licence Agreement, the New Series Automobile Licence Agreement and the K Series Engine Licence Agreement.

Pursuant to the Liana Licence Agreement, Suzuki:

- agrees to allow Changhe Suzuki to manufacture, assemble and market the Liana automobiles and their parts and components using Suzuki's technology;
- agrees to grant licences to Changhe Suzuki to use certain trademarks and patents relating to the Liana automobiles and their parts and components;
- agrees to provide assistance to Changhe Suzuki for the manufacturing and assembling of the Liana automobiles; and
- agrees to supply the related parts and components to Changhe Suzuki.

It is expected that the Liana automobiles will be launched in the last quarter of 2005.

Pursuant to the New Series Automobile Licence Agreement, Suzuki:

- agrees to allow Changhe Suzuki to manufacture, assemble and market the new series automobiles and their parts and components using Suzuki's technology;
- agrees to grant licences to Changhe Suzuki to use certain trademarks and patents relating to the new series automobiles and their parts and components;
- agrees to provide assistance to Changhe Suzuki for the manufacturing and assembling of the new series automobiles; and
- agrees to supply the related parts and components to Changhe Suzuki.

It is expected that commercial production of the new series automobile will begin in 2006.

Pursuant to the K Series Engine Licence Agreement, Suzuki:

- agrees to allow Changhe Suzuki to manufacture, assemble and market the K series engines and gearboxes and the related parts and components;
- agrees to grant licences to Changhe Suzuki to use certain trademarks and patents relating to the K series engines and gearboxes and the related parts and components;
- agrees to provide assistance to Changhe Suzuki for the manufacturing and assembling of the K series engines and gearboxes; and

- agrees to supply the related parts and components to Changhe Suzuki.

It is expected that the K series engines and gearboxes will be launched in the last quarter of 2005.

Since Changhe Suzuki is a subsidiary of the Company and Suzuki is a substantial shareholder of Changhe Suzuki, the transactions contemplated under the Liana Licence Agreement, the New Series Automobile Licence Agreement and the K Series Engine Licence Agreement will constitute continuing connected transactions of the Company.

### Term

The Liana Licence Agreement and the K Series Engine Licence Agreement have a term of 8 years commencing from obtaining the relevant PRC authority approval on 18 May 2005. The New Series Automobile Licence Agreement also has a term of 8 years commencing from the effective date of the agreement. As at the date of this announcement, the New Series Automobile Licence Agreement is yet to become effective, pending the necessary approval being obtained from the relevant PRC authority. It is expected that this agreement would become effective in 2006.

### Pricing

Pursuant to the Liana Licence Agreement, the New Series Automobile Licence Agreement and the K Series Engine Licence Agreement, Changhe Suzuki will pay Suzuki royalty fees charged in respect of each Liana automobile, new series automobile and K series engine and gearbox produced by Changhe Suzuki using Suzuki's technology. Such royalty fees are calculated as a percentage of the adjusted sales price. Adjustment includes, among others, deduction of the value added tax and the price of imported parts and components. Pursuant to the K Series Engine Licence Agreement, the aggregate amount of royalty fees charged by Suzuki for the three years' period commencing from the production of the K series engines and gearboxes is subject to a prescribed minimum amount of USD650,000 (equivalent to approximately HK\$5.0 million).

In addition to the royalty fees, Suzuki also charged Changhe Suzuki one-off fees, payable by Changhe Suzuki at different stages of production, for the licences granted by Suzuki under the Liana Licence Agreement, the New Series Automobile Licence Agreement and the K Series Engine Licence Agreement. The one-off fees and the royalty fees are agreed between Changhe Suzuki and Suzuki after arm's length negotiation. In negotiating the one-off fees and the royalty fees with Suzuki, the Directors have taken into account:

- the recent development of the automobiles market in the PRC; the Directors consider that it is in the interests of the Company and the Shareholders as a whole to have an immediate access to the advanced technologies in manufacturing automobiles, vehicle engines and gearboxes possessed by Suzuki, one of the international automobiles manufacturers, through entering into the above mentioned agreements and paying the one-off fees to Suzuki;
- the overall operation and development of the automobiles, vehicle engines and gearboxes businesses of the Group;
- that the licencing of such technologies from Suzuki is more cost and time effective to the Group than developing such technologies by the Group itself;
- the fact that the royalty fees are charged in proportion to the production of the Liana automobiles, the new series automobiles and the K series engines and gearboxes manufactured by Changhe Suzuki using Suzuki's technology; and
- the fact that the expected gross profit margins of the Liana automobiles, the new series automobiles and the K series engines and gearboxes will not be lower than that of other automobiles, engines and gearboxes produced by the Group even after taking into account the royalty fees payable to Suzuki.

Having considered all the above factors, the Directors consider that the one-off fees and the royalty fees charged by Suzuki are fair and reasonable to the Company and the Shareholders as a whole.

It is expected that subject to the approval being obtained from the Independent Shareholders, the Group will pay Suzuki in 2005 an aggregate amount of not more than RMB 45 million (equivalent to approximately HK\$43.3 million) representing a portion of the one-off fees in accordance with the Liana Licence Agreement, the New Series Automobile Licence Agreement and the K Series Engine Licence Agreement.

The prices payable by Changhe Suzuki for the parts and components purchased from Suzuki for the manufacturing of the Liana automobiles, the new series automobiles and the K series engines and gearboxes pursuant to the Liana Licence Agreement, the New Series Automobile Licence Agreement and the K Series Engine Licence Agreement will be determined after arm's length negotiation between Changhe Suzuki and Suzuki based on market price.

It is expected that subject to the approval being obtained from the Independent Shareholders of the Liana Licence Agreement, the New Series Automobile Licence Agreement and the K Series Engine Licence Agreement, the total purchases of parts and components from Suzuki in 2005 pursuant to the aforesaid agreements would amount to not more than 2.5% of the assets, revenue and consideration ratios (as defined in the Listing Rules) pursuant to the agreements. Therefore, these transactions will only be subject to the reporting and announcement requirements under rules 14A.34 of the Listing Rules.

### Annual Caps

Based on the planned production of the Liana automobiles, the new series automobiles and the K series engines and gearboxes, the Directors estimate that the total expenditures to be spent by the Group in relation to the royalty fees and one-off fees and purchases of parts and components under the Liana Licence Agreement, the New Series Automobile Licence Agreement and the K Series Engine Licence Agreement for the three financial years ending 31 December 2008 would not exceed RMB1,105 million (equivalent to approximately HK\$1,062.5 million), RMB2,070 million (equivalent to approximately HK\$1,990.4 million) and RMB2,121 million (equivalent to approximately HK\$2,039.4 million) respectively. Accordingly, the Company would like to seek approval from the Independent Shareholders of the aforesaid amounts as the proposed annual caps for these type of continuing connected transactions for the three financial years ending 31 December 2008.

Taking into account (i) the management's experience in launching new models of vehicles in the market that the demand for those vehicles will increase nearly by 100% during the second year of commercial production, (ii) the expected more than 10% growth in the low-end consumer car market in the PRC as mentioned above and (iii) the Directors' knowledge and outlook on the market, the Directors expect that the demand for the Liana automobiles and the new series automobiles would increase substantially in 2007 and remain relatively steady in the subsequent year.

Based on the expected more than 10% growth in the low-end consumer car market in the PRC as mentioned above and the Director's knowledge and outlook on the market demand for the K series engines and gearboxes, the Directors estimate that the demand for the K series engines and gearboxes would increase moderately during the three financial years ending 31 December 2008.

### Reasons for the term of Liana Licence Agreement, the New Series Automobile Licence Agreement and the K Series Engine Licence Agreement being more than three years

Each of the Liana Licence Agreement, the New Series Automobile Licence Agreement and the K Series Engine Licence Agreement has a term longer than three years. Changhe Suzuki is a joint venture established between the Group and Suzuki. The principal business of Changhe Suzuki is to manufacture and assemble different series automobiles and vehicle engines and gearboxes using Suzuki's technology. The related licences and technology are owned by Suzuki. The Directors therefore consider that entering into the Liana Licence Agreement, the New Series Automobile Licence Agreement and the K Series Engine Licence Agreement for a term exceeding three years is essential for the continuity of the business of Changhe Suzuki.

An independent financial adviser will issue a letter of advice explaining, among others, the long-term nature of this transaction and confirming that

it is normal business practice for contracts of this type to be of such duration to the Independent Board Committee and the Independent Shareholders and the same will be contained in the circular to be despatched to the Shareholders as soon as possible.

## 9. Mitsubishi Joint Development Agreement and Mitsubishi Hafei CKD Agreement

### Mitsubishi Joint Development Agreement

Pursuant to the Mitsubishi Joint Development Agreement, Mitsubishi agrees to assist Hafei Auto (or Dongan Motor after completion of the Acquisition and upon obtaining consent from Mitsubishi) to develop certain automobiles using Mitsubishi's technology. Mitsubishi also agrees to grant licences to Hafei Auto to use the technology, information and patents relating to certain automobiles developed by Mitsubishi.

Since Hafei Auto is a subsidiary of the Company and Mitsubishi is a substantial shareholder of Dongan Engine (i.e. a connected person of the Company as defined under the Listing Rules), the transactions contemplated under the Mitsubishi Joint Development Agreement would constitute continuing connected transactions of the Company.

### Term

The Mitsubishi Joint Development Agreement has a term of 10 years commencing from 8 August 2005.

### Pricing

Pursuant to the Mitsubishi Joint Development Agreement, Hafei Auto will pay Mitsubishi royalty fee charged in respect of each automobile produced by Hafei Auto using Mitsubishi's technology.

In addition to the royalty fees, Mitsubishi also charges Hafei Auto an one-off fee for the licences granted. The one-off fee is payable by Hafei Auto within one year from the effective date of the Mitsubishi Joint Development Agreement.

The one-off fee and the royalty fee payable to Mitsubishi are agreed between Hafei Auto and Mitsubishi after arm's length negotiation. In negotiating the one-off fee and the royalty fee with Mitsubishi, the Directors have taken into account:

- (vi) the recent development of the automobiles market in the PRC; the Directors consider that it is in the interests of the Company and the Shareholders as a whole to have an immediate access to the advanced technologies in manufacturing automobiles possessed by Mitsubishi, one of the international automobiles manufacturers, through entering into the Mitsubishi Joint Development Agreement and paying the one-off fee to Mitsubishi;
- (vii) the overall operation and development of the automobiles business of the Group;
- (viii) that the licencing of such technologies from Mitsubishi is more cost and time effective to the Group than developing such technologies by the Group itself;
- (ix) the fact that the royalty fees are charged in proportion to the production of automobiles produced by Hafei Auto using Mitsubishi's technology; and
- (x) the expected gross profit margin of the automobiles to be produced by Hafei Auto using Mitsubishi's technology during commercial production will not be lower than that of other automobiles produced by the Group even after taking into account the royalty fee charged by Mitsubishi.

Having considered all the above factors, the Directors consider that the one-off fee and the royalty fee charged by Mitsubishi are fair and reasonable to the Company and the Shareholders as a whole.

### Annual Caps

Based on the planned production of automobiles to be manufactured by Hafei Auto using Mitsubishi's technology, the Directors estimate that the total expenditures to be spent by the Group pursuant to the Mitsubishi Joint Development Agreement for the three financial years ending 31 December 2008 would not exceed RMB 41 million (equivalent to approximately HK\$39.4 million), RMB 38 million (equivalent to approximately HK\$36.5 million) and RMB53 million (equivalent to approximately HK\$51.0 million) respectively. Accordingly, the Company would like to seek approval from the Independent Shareholders of the aforesaid amounts as the proposed annual caps for this type of continuing connected transactions for the three financial years ending 31 December 2008.

### Mitsubishi Hafei CKD Agreement

Pursuant to the Mitsubishi Hafei CKD Agreement, Hafei Auto agrees to purchase CKD spare parts and components from Mitsubishi for manufacturing certain automobiles using Mitsubishi's technology.

### Term

The Mitsubishi Hafei CKD Agreement took effect from 8 August 2005. It is expected that no transaction will be carried out under the Mitsubishi Hafei CKD Agreement after expiry of the Mitsubishi Joint Development Agreement since both are required for the subject operation as contemplated under the Mitsubishi Joint Development Agreement. Accordingly, the Mitsubishi Hafei CKD Agreement effectively has a term of 10 years commencing from 8 August 2005 which coincides with the Mitsubishi Joint Development Agreement.

### Pricing

Pursuant to the Mitsubishi Hafei CKD Agreement, the prices payable by Hafei Auto for the CKD spare parts and components will be fixed for a term of 3 years, commencing from the placement of the first order. The Company expects that the price payable for the CKD spare parts and components will be determined after arm's length negotiation between Hafei Auto and Mitsubishi based on market price.

### Annual Caps

Based on the planned production of automobiles manufactured by Hafei Auto using Mitsubishi's technology which will increase the purchase of CKD spare parts and components from Mitsubishi, the Directors estimate that the total expenditures to be incurred by the Group pursuant to the Mitsubishi Hafei CKD Agreement for the three financial years ending 31 December 2008 would not exceed RMB 30 million (equivalent to approximately HK\$28.8 million), RMB 95 million (equivalent to approximately HK\$91.3 million) and RMB 135 million (equivalent to approximately HK\$129.8 million) respectively. Accordingly, the Company would like to seek approval from the Independent Shareholders of the aforesaid amounts as the proposed annual caps for this type of continuing connected transactions for the three financial years ending 31 December 2008.

The above proposed annual caps for the transactions to be conducted under the Mitsubishi Joint Development Agreement and the Mitsubishi Hafei CKD Agreement are based on the planned production of automobiles to be manufactured by Hafei Auto using Mitsubishi's technology which is determined after taking into account:

- (i) the expected more than 10% growth in the low-end consumer car market in the PRC as mentioned above;
- (ii) the expected substantial increase in demand for the automobiles to be manufactured by Hafei Auto using Mitsubishi's Technology during the second year of commercial production and the expected moderate increase of such demand in the subsequent year which is based on the management's past experience in launching new models of vehicles to the market;
- (iii) the plan to launch a new model of vehicles by Hafei Auto using Mitsubishi's technology in 2007; and
- (iv) the expected requirement for CKD spare parts and components for the new model of vehicles to be launched by Hafei Auto using Mitsubishi's technology in 2007.

Based on the above-mentioned factors, the Directors expect that the planned production of the automobiles to be manufactured by Hafei Auto using Mitsubishi's Technology will increase substantially in 2007 and 2008 and accordingly, the total expenditures to be spent by the Group in respect of the royalty fees payable to Mitsubishi and the purchases of CKD spare

parts and components from Mitsubishi under the Mitsubishi Joint Development Agreement and the Mitsubishi Hafei CKD Agreement will increase substantially in 2007 and 2008. The Directors expect that the expected percentage increase in total expenditures to be spent by the Group in 2007 for the purchase of CKD spare parts and components from Mitsubishi will be higher than that of the royalty fees payable to Mitsubishi since the Directors expect that the requirement for CKD spare parts and components for the new model of vehicles to be launched by Hafei Auto using Mitsubishi's technology in 2007 will increase the purchases of CKD spare parts and components from Mitsubishi. However, the Directors also expect that the expected percentage increase in total expenditures to be spent by the Group in 2008 for the purchases of CKD spare parts and components from Mitsubishi will coincide with that of the royalty fees payable to Mitsubishi with the full localization of these CKD spare parts and components in 2008.

### Reasons for the term of Mitsubishi Joint Development Agreement and Mitsubishi Hafei CKD Agreement being more than three years

Each of the Mitsubishi Joint Development Agreement and the Mitsubishi Hafei CKD Agreement has a term longer than three years. Hafei Auto plans to manufacture various series of automobiles using Mitsubishi's technology. To this end, Hafei Auto has entered into the Mitsubishi Joint Development Agreement and the Mitsubishi Hafei CKD Agreement with Mitsubishi. The Directors therefore consider that entering into the Mitsubishi Joint Development Agreement and the Mitsubishi Hafei CKD Agreement for a term exceeding three years is essential for conducting this new project by Hafei Auto.

An independent financial adviser will issue a letter of advice explaining, among other things, the long-term nature of this transaction and confirming that it is normal business practice for contracts of this type to be of such duration to the Independent Board Committee and the Independent Shareholders and the same will be contained in the circular to be despatched to the Shareholders as soon as possible.

### SUMMARY OF THE CONTINUING CONNECTED TRANSACTIONS AND THE PROPOSED ANNUAL CAPS

	Historical figures (in RMB million)			Estimated amount (in RMB million)		
	For the financial year ended 31 December 2003	For the 6 months ended 2005	For the 6 months ended 2006	For the financial year ending 31 December 2006	For the financial year ending 31 December 2007	For the financial year ending 31 December 2008
<b>Agreements</b>						
<b>1 Mutual Supply Agreement</b>						
(a) Annual expenditure of the Group	2,498	2,446	1,044	3,000	3,500	4,000
(b) Annual revenue of the Group	2,395	2,528	1,293	5,400	7,000	8,500
<b>2 Comprehensive Services Agreement</b>						
Annual expenditure of the Group	131	150	49	180	200	220
<b>3 Land Use Rights Leasing Agreement</b>						
Annual expenditure of the Group	38	38	38	38	38	38
<b>Properties Leasing Agreement</b>						
(a) Annual expenditure of the Group	24	24	24	24	24	24
(b) Annual revenue of the Group	1.1	1.1	1.1	1.1	1.1	1.1
<b>4 Technology Cooperation Agreement</b>						
(a) Annual expenditure of the Group	33	18	5	33	36	40
(b) Annual revenue of the Group	46	—	—	22	24	27
<b>5 Mitsubishi Technology Transfer Agreement</b>						
Annual expenditure of the Group	5	4	3	8	14	17
<b>Mitsubishi CKD Agreement</b>						
Annual expenditure of the Group	486	204	11	36	86	0
<b>6 Internal CT Agreement</b>						
(i) Annual expenditure of Dongan Engine and Hafei Auto	1,501	1,863	1,126	2,700	3,200	3,800
(ii) Annual revenue of Dongan Engine and Hafei Auto	486	296	195	500	550	600
(iii) Annual amount of guarantees provided by subsidiary of the Group to Hafei Auto	2,516	1,784	1,544	2,000	2,000	2,000
<b>7 Agusta Agreement</b>						
Annual expenditure of the Group	—	—	—	78	117	117
<b>8 Liana Licence Agreement, New Series Automobile Licence Agreement and K Series Engine Licence Agreement</b>						
Annual expenditure of the Group	—	—	—	1,105	2,070	2,121
<b>9 Mitsubishi Joint Development Agreement</b>						
Annual expenditure of the Group	—	—	—	41	38	53
<b>Mitsubishi Hafei CKD Agreement</b>						
Annual expenditure of the Group	—	—	—	30	95	135

Based on the information described above, the Board is of the view that the above-mentioned continuing connected transactions are on fair and reasonable and normal commercial terms and that they are entered into in the ordinary and usual course of business and in the interests of the Group and the Shareholders as a whole.

In respect of each of these continuing connected transactions, the proposed annual caps represent the maximum aggregate annual value of consideration payable or receivable under the relevant transactions. If any annual cap is exceeded, the Company will be required to re-comply with the applicable continuing connected transactions regulatory requirements under Chapter 14A of the Listing Rules.

### GENERAL

The above-mentioned continuing connected transactions and the proposed annual caps will be subject to approval by the Independent Shareholders at the EGM.

AVIC II, Mitsubishi, Suzuki, Agusta S.p.A. and their respective associate(s), if any, will abstain from voting on the ordinary resolutions to be proposed to consider these continuing connected transactions and the proposed annual caps, which will be taken by way of poll at the EGM as required under the Listing Rules. The Independent Board Committee has been established to advise the Independent Shareholders in respect of these continuing connected transactions and the proposed annual caps. An independent financial adviser will issue a letter of advice to the Independent Board Committee and the Independent Shareholders in respect of these continuing connected transactions and the proposed annual caps. A circular containing further information in relation to these continuing connected transactions as required under the Listing Rules (including a letter from the Independent Board Committee and its recommendations to the Independent Shareholders and an opinion letter from the independent financial adviser) will be issued by the Company and despatched to the Shareholders as soon as practicable.

### DEFINITIONS

In this announcement, unless the context otherwise requires, the following expressions have the following meanings:

"Agusta Agreement"	the Agusta agreement dated 2 June 2005 entered into between Changhe Industry Company and Agusta S.p.A.
"AVIC II"	中國航空工業第二集團公司 (China Aviation Industry Corporation II), the controlling shareholder of the Company
"AVIC II Group"	AVIC II and its subsidiaries and associates (excluding the Group)
"Board" or "Board of Directors"	the board of Directors of the Company
"CATIC"	中國航空技術進出口總公司 (China National Aero-Technology Import and Export Corporation), a state-owned enterprise held as to 50% by AVIC II and 50% by China Aviation Industry Corporation I
"Changhe Agusta"	江西昌河阿古斯特直升機有限公司 (Jiangxi Changhe-Agusta Helicopter Co., Ltd.), a sino-foreign joint venture held as to 60% by Changhe Industry Company and 40% by Agusta S.p.A.

"Changhe Industry Company"	江西昌河航空工業有限公司 (Jiangxi Changhe Aviation Industry Company Limited), a wholly-owned subsidiary of the Company
"Changhe Suzuki"	江西昌河鈴木汽車有限公司 (Jiangxi Changhe Suzuki Automobile Co., Ltd.), a sino-foreign joint venture held as to 41% by Jiangxi Changhe Automobile Co., Ltd which is a subsidiary of the Company, 10% by Changhe Industry Company, 45.4% by Suzuki and 3.6% by OKAYA & Co. Ltd. respectively
"CKD"	completely knocked down, the parts and components for manufacturing of vehicles, vehicle engines and gearboxes which were completely knocked down when imported into the PRC
"Company"	中國航空科技工業股份有限公司 (AviChina Industry & Technology Company Limited), a joint stock limited company established in the PRC with limited liability on 30 April 2003
"Comprehensive Services Agreement"	綜合服務協議 (the comprehensive services agreement) dated 2 October 2003 entered into between the Company and AVIC II
"Directors"	the director(s) of the Company
"Dongan Engine"	哈爾濱東安汽車發動機製造有限公司 (Harbin Dongan Automotive Engine Manufacturing Co., Ltd.), a sino-foreign joint venture held as to 36% by Dongan Motor, 15% by Hafei Industry Company, 19% by Dongan Group, 15.3% by Mitsubishi, 9% by MCIC Holdings Sdn. Bhn. and 5.7% by Mitsubishi Corporation
"Dongan Group"	哈爾濱東安發動機集團有限公司 (Harbin Dongan Engine (Group) Co., Ltd.), a wholly-owned subsidiary of AVIC II
"Dongan Motor"	哈爾濱東安汽車動力股份有限公司 (Harbin Dongan Auto Engine Co., Ltd.), a joint stock limited company whose shares are listed on the Shanghai Stock Exchange with 70.01% of its interest being held by the Company and the rest are held by the public
"EGM" or "Extraordinary General Meeting"	extraordinary general meeting of the Company to be held to approve, inter alia, the continuing connected transactions and the proposed annual caps
"Group"	the Company and its subsidiaries
"Hafei Auto"	哈飛汽車股份有限公司 (Hafei Motor Co., Ltd.), a joint stock limited liability company with foreign investment which is held as to 74.81% by Hafei Industry Company, 25% by China Aero (382) Limited which is ultimately wholly-owned by CATIC, 0.1% by Dongan Group, 0.06% by CATIC and 0.03% by Shenzhen Shenghang Avionics Co., Ltd., which is held as to 34% and 33% respectively by CATIC and Hafei Industry Company
"Hafei Industry Company"	哈爾濱航空工業(集團)有限公司 (Harbin Aviation Industry (Group) Co., Ltd.), a wholly-owned subsidiary of the Company
"Independent Board Committee"	an independent board committee comprising independent non-executive Directors, namely, Dr. The Hon. Li Kwok-Po, David, Mr. Guo Chongqing and Mr. Li Xianzong
"Independent Shareholders"	Shareholders excluding AVIC II, Mitsubishi, Suzuki, Agusta S.p.A. and their respective associate(s), if any
"Internal CT Agreement"	內部關連交易協議 (the internal connected transactions agreement) dated 2 October 2003 entered into between the Company and various subsidiaries of the Company
"K Series Engine Licence Agreement"	K系列特許協議 (the K series engine licence agreement) dated 24 December 2003 entered into between Changhe Suzuki and Suzuki
"Land Use Rights Leasing Agreement"	土地使用權租賃協議 (the land use rights leasing agreement) dated 2 October 2003 entered into between the Company and AVIC II
"Liana Licence Agreement"	Liana 特許協議 (the Liana licence agreement) dated 24 December 2003 entered into between Changhe Suzuki and Suzuki
"Listing"	the listing of the H Shares on the Stock Exchange
"Listing Rules"	the Rules Governing the Listing of Securities on the Stock Exchange (as amended from time to time)
"Mitsubishi"	Mitsubishi Motor Corporation (三菱自動車工業株式會社), a substantial shareholder of Dongan Engine
"Mitsubishi CKD Agreement"	CKD 散件供應協議 (the CKD supply agreement) dated 30 June 1999 entered into between Dongan Engine and Mitsubishi
"Mitsubishi Hafei CKD Agreement"	三菱哈飛汽車車體零件供應合同 (the Mitsubishi Hafei CKD agreement) dated 8 August 2005 entered into between Hafei Auto and Mitsubishi
"Mitsubishi Joint Development Agreement"	三菱聯合開發協議 (the Mitsubishi joint development agreement) dated 8 August 2005 entered into between Hafei Auto and Mitsubishi
"Mitsubishi Technology Transfer Agreement"	三菱技術轉讓協議 (the Mitsubishi technology transfer agreement) dated 30 June 1999 entered into between Dongan Engine and Mitsubishi
"Mutual Supply Agreement"	產品和配套服務互供協議 (the products and ancillary services mutual supply agreement) dated 2 October 2003 entered into between the Company and AVIC II
"New Series Automobile Licence Agreement"	新系列車技術轉讓協議 (the new series automobile licence agreement) dated 21 March 2005 entered into between Changhe Suzuki and Suzuki
"PRC"	the People's Republic of China
"Properties Leasing Agreement"	房屋租賃協議 (the properties leasing agreement) dated 2 October 2003 entered into between the Company and AVIC II
"RMB" or "Renminbi"	Renminbi, the lawful currency of the PRC
"Shares"	Domestic Shares and H Shares
"Shareholders"	the holder(s) of shares of RMB1.00 each in the capital of the Company
"Stock Exchange"	The Stock Exchange of Hong Kong Limited
"Suzuki"	Suzuki Motor Corporation, a joint venture partner of the Company which held as to 45.4% equity interest of Changhe Suzuki
"Technology Cooperation Agreement"	技術合作框架協議 (the technology cooperation framework agreement) dated 2 October 2003 entered into between the Company and AVIC II
"USD"	United States dollars, the lawful currency of the United States of America

*In this announcement, unless otherwise stated, certain amounts denominated in RMB and USD have been converted into HK\$ using an exchange rate of HK\$1.00: RMB1.04 and USD 1: HK\$7.80, for the purpose of illustration only, and does not constitute a representation that any amount has been, could have been, or may otherwise be exchanged or converted at this or any other rate.*

By order of the Board  
**AviChina Industry & Technology Company Limited**  
 Yan Lingxi  
 Company Secretary

30 September 2005

*As at the date of this announcement, the Board comprises of executive Directors of Mr. Zhang Hongbiao, and Mr. Wu Xiangdong, and non-executive Directors of Mr. Liang Zhenhe, Mr. Song Jiangang, Mr. Tan Ruisong, Mr. Wang Bin, Mr. Chen Huaqiu, Mr. Tian Min, Mr. Wang Yong and Mr. Maurice Savart as well as independent non-executive Directors Dr. The Hon. Li Kwok Po, David, Mr. Guo Chongqing and Mr. Li Xianzong.*

\* For identification purposes only.