
BUSINESS

OVERVIEW

We principally engage in the design, manufacture and sales of papermaking felts under the brands of **VANOV** and **Gobear**. According to the Frost & Sullivan Report, we were one of the top five papermaking felts manufacturers in the PRC market, among which, we ranked fourth and were the only papermaking felts manufacturer headquartered in the PRC, with an approximate market share of 5.8% in terms of revenue in 2020. Papermaking felts are fabrics used in the papermaking machines for dewatering, pressing, forming and drying of paper in the papermaking process and are consumables with a replacement cycle of approximately 30 to 180 days. We provide comprehensive papermaking felts services to our customers, from conducting on-site visits and advising our customers on the types and specifications of papermaking felts, to sourcing suitable raw materials for our production, conducting quality control, delivering papermaking felts to customers and providing after-sales services.

We have a research and development team which, as believed by our Directors, gives us a competitive edge over our competitors as it ensures quality and standard in our papermaking felts, and supports our commitment towards delivering to our customers high quality products and services which can better fit the specifications of our customers’ papermaking machines. For details of our research and development capabilities, please refer to the paragraph headed “Research and development” in this section. As a result of our research and development capabilities, we apply our proprietary technical know-how in the innovation and development of our products, that allow us to understand our customers’ needs and the precise requirements of our papermaking felts based on our analysis on the data on our customers’ papermaking machines collected during the provision of our services. We developed and launched a trial version of Huanlong Paper Machine Efficiency Operation System* (造紙機運營效率優化服務數字平台系統), which is able to gather and store the data of our customers’ papermaking machines collected during the provision of our services, so that we can analyse the data and customise the product for customers and provide technical advice of improving the efficiency of customers’ papermaking machines. As part of our sales and marketing strategies, upon completion of the development and the launching of the formal version of system, this online platform will allow our selected customers to access our services remotely such as reviewing product development plans, tracking orders and production status, reviewing product examination and technical reports and giving feedback on the efficiency of their papermaking machines. Our Directors believe that such development would provide us with a distinct advantage as compared to our competitors. For more details, please refer to the paragraphs headed “Sales and marketing” and “Research and development” in this section.

Riding on our research and development capabilities and data we stored in the system, in order to increase customer stickiness to our products, we currently also provide complementary papermaking machine efficiency optimisation services from pre-sales technical advice in the use of

BUSINESS

suitable products and/or customisation of our products to after-sales technical advice and evaluation of the effectiveness on our customers’ papermaking machine to our customers, with a view to increase our customers’ operational efficiency. As advised by Frost & Sullivan, papermaking machine efficiency optimisation services are only provided by few competitors in the market, which are mainly leading players such as foreign invested enterprises and our Group.

We are qualified as high and new technology enterprise. As at the Latest Practicable Date, we had 99 patents registered in the PRC. For details of our intellectual property rights, please refer to the paragraph headed “Statutory and General Information — B. Further information about the business — 2. Intellectual property rights” in Appendix V to this document.

Our papermaking felts can be categorised into five types according to the type of papermaking machines that the papermaking felts are applied to: packaging papermaking felts, specialty papermaking felts, printing papermaking felts, household papermaking felts and pulp papermaking felts. For the three years ended 31 December 2020 and the six months ended 30 June 2021, our revenue amounted to approximately RMB159.4 million, RMB167.3 million, RMB182.8 million and RMB76.5 million, respectively. The following table sets forth the breakdown of our revenue by type of papermaking felts during the Track Record Period:

	Year ended 31 December						Six months ended 30 June			
	2018		2019		2020		2020		2021	
	<i>% of total</i>	<i>% of total</i>	<i>% of total</i>	<i>% of total</i>	<i>% of total</i>	<i>% of total</i>	<i>% of total</i>	<i>% of total</i>	<i>% of total</i>	
	<i>RMB'000</i>	<i>revenue</i>	<i>RMB'000</i>	<i>revenue</i>	<i>RMB'000</i>	<i>revenue</i>	<i>RMB'000</i>	<i>revenue</i>	<i>RMB'000</i>	<i>revenue</i>
	(unaudited)									
Packaging papermaking felts . . .	106,027	66.5	114,670	68.6	124,863	68.3	44,017	66.5	52,661	68.8
Specialty papermaking felts	25,755	16.2	26,951	16.1	32,090	17.6	11,496	17.4	12,709	16.6
Printing papermaking felts	14,859	9.3	11,451	6.8	10,732	5.9	4,193	6.3	4,958	6.5
Household papermaking felts	9,975	6.3	10,600	6.3	9,490	5.2	4,225	6.4	4,364	5.7
Pulp papermaking felts	2,740	1.7	3,642	2.2	5,584	3.0	2,274	3.4	1,823	2.4
Total	159,356	100.0	167,314	100.0	182,759	100.0	66,205	100.0	76,515	100.0

During the Track Record Period, based on the operating speed of the applicable papermaking machines, our papermaking felts can mainly be categorised into (i) high-speed papermaking felts; (ii) medium-speed papermaking felts; and (iii) low-speed papermaking felts. According to our Directors, high-speed papermaking felts are generally applied in papermaking machine with operating speed of 700 metres or above per minute for packaging papermaking felts and printing papermaking felts and 600 metres or above per minute for our other products; while low-speed papermaking felts are generally applied in papermaking machine with operating speed of 300 metres or below per minute for packaging papermaking felts and printing papermaking felts and 200 metres or below per minute for our other products. Medium-speed papermaking felts are

BUSINESS

generally applied in papermaking machine with operating speed other than high-speed and low-speed. As advised by Frost & Sullivan, regarding the classification of papermaking felts by speed, there is no standard threshold for the respective category of the speed of papermaking machine due to large variations of paper types by weight and the threshold of the respective speed category may increase along with technological advancement. The categorisation of speed is different based on paper types and papermaking machine. In view of the aforesaid reasons and considering the advancement of papermaking technology with higher speed for certain paper categories such as printing and packaging paper, higher speed papermaking machines have been developed and the range and threshold for speed categories for these paper types could be higher. The development and variation in the product mix of our Group can also be better reflected through the aforesaid categorisation. The following table sets out a breakdown of our revenue, sales volume, average selling price and gross profit of our papermaking felts during the Track Record Period based on the operating speed of the applicable papermaking machine:

	Year ended 31 December														
	2018				2019				2020						
	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit
	RMB '000		(tonnes)	(RMB'000 per tonne)	RMB '000	RMB '000		(tonnes)	(RMB'000 per tonne)	RMB '000	RMB '000		(tonnes)	(RMB'000 per tonne)	RMB '000
High-speed papermaking felts	31,770	20.0	160.8	198	19,709	39,093	23.4	177.9	220	25,772	54,952	30.1	256.5	214	36,208
Medium-speed papermaking felts	90,433	56.7	622.5	145	43,895	92,940	55.5	599.2	155	48,958	91,429	50.0	623.5	147	46,635
Low-speed papermaking felts	37,153	23.3	358.6	104	14,280	35,281	21.1	340.4	104	14,599	36,378	19.9	323.3	113	16,776
Total	159,356	100.0	1,141.9		77,884	167,314	100.0	1,117.5		89,329	182,759	100.0	1,203.3		99,619

	Six months ended 30 June									
	2020					2021				
	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit
	RMB '000		(tonnes)	(RMB'000 per tonne)	RMB '000	RMB '000		(tonnes)	(RMB'000 per tonne)	RMB '000
High-speed papermaking felts	18,338	27.7	82.2	223	11,964	23,709	31.0	113.9	208	15,184
Medium-speed papermaking felts	32,222	48.7	214.8	150	16,043	36,914	48.2	252.5	146	17,832
Low-speed papermaking felts	15,645	23.6	141.0	111	6,847	15,892	20.8	147.9	107	6,061
Total	66,205	100.0	438.0		34,854	76,515	100.0	514.3		39,077

Our customers are primarily paper and paper products manufacturers and trading companies, which can be categorised by geographical region, including: (i) PRC paper and paper products manufacturers and trading companies, from which we derived around 95% to 96% of our revenue during the Track Record Period; and (ii) overseas paper and paper products manufacturers and trading companies, from which we derived around 4% to 5% of our revenue during the Track Record Period. According to the Frost & Sullivan Report, nine out of the top ten papermaking companies in the PRC in 2020 are our Group’s customers.

BUSINESS

Monofilaments and fibre, which are mainly made from nylon, are our major raw materials. Our suppliers, who are mainly based in the PRC, provide us with raw materials, some of which were imported from Germany and Switzerland. For the three years ended 31 December 2020 and the six months ended 30 June 2021, the cost of raw materials amounted to approximately RMB53.1 million, RMB49.1 million, RMB51.5 million and RMB20.6 million, respectively.

COMPETITIVE STRENGTHS

Our Directors believe that our success and potential growth are attributable to the following competitive strengths.

We have research and development capabilities which enable us to enhance our customers' operational efficiency

According to the Frost & Sullivan Report, only a few local papermaking felts manufacturers, including the Group, demonstrated capability of producing high quality papermaking felts for high-speed papermaking machines while majority of other local enterprises generally compete on supplying papermaking felts for medium and low-speed papermaking machines. Our technologies and research and development capabilities are responsive to the new market and product trends. Our Directors believe that our success is mainly attributable to our in-depth knowledge of the papermaking felts manufacturing industry, our ability to identify and understand market trends, and our experience in material and product design development.

According to the Frost & Sullivan Report, the technology in the papermaking felts manufacturing industry has been evolving over the decades. Since there is a strong demand in terms of quality of papermaking felts, the papermaking felts manufacturers are required to respond to the market by developing and adopting different production technology, such as ring weaving, multi-axial weaving and seamless technology for improving the performance and useful life of their products. As the leading domestic papermaking felts manufacturer, our Group demonstrates a better understanding towards the development of papermaking industry in the PRC with a more effective communication with domestic paper manufacturers in respect to the paper machine optimisation and other value-added services offered to customers especially for domestic papermaking enterprises of different size and scale in the PRC.

We have been undertaking research and development activities on technology application, new auxiliary tools design and relevant software applications to maintain our competitiveness. In particular, our Directors believe that the ability of our research and development department to develop advanced manufacturing techniques such as multi-axial weaving and seamless technology has become the hallmark of the papermaking felts manufacturing industry and is critical to our success. In addition, our research and development department has worked closely with domestic

BUSINESS

professors and experts from established tertiary institutions through collaborations. We believe that we can capitalise on the collaboration to further enhance our capabilities, develop new technologies and stay abreast of the latest technological developments. As a result of our research and development capabilities, we apply our proprietary technical know-how in the innovation and development of our products, that allow us to understand our customers’ needs and the precise requirements of our papermaking felts based on our analysis on the data on our customers’ papermaking machines collected during the provision of our services so that we can provide high quality papermaking felts which can better fit the specifications of our customers’ papermaking machines. We developed and launched a trial version of Huanlong Paper Machine Efficiency Operation System* (造紙機運營效率優化服務數字平台系統), which is able to gather and store the data of our customers’ papermaking machines collected during the provision of our services, so that we can analyse the data and customise the product for customers and provide technical advice of improving the efficiency of customers’ papermaking machines. Upon completion of the development and the launching of the formal version of system, this online platform will allow our selected customers to access our services remotely such as reviewing product development plans, tracking orders and production status, reviewing product examination and technical reports and giving feedback on the efficiency of their papermaking machines. Our Directors believe that such development would provide us with a distinct advantage as compared to our competitors.

Riding on our research and development capabilities and data we stored in the system, we also provide papermaking machine efficiency optimisation services from pre-sales technical advice in the use of suitable products and/or customisation of our products to after-sales technical advice and evaluation of the effectiveness on our customers’ papermaking machine to our customers, with a view to increase our customers’ operational efficiency. As advised by Frost & Sullivan, papermaking machine efficiency optimisation services are only provided by few competitors in the market, which are mainly leading players such as foreign invested enterprises and our Group.


Despite the higher research and development capability and better useful life of product offered by other top five papermaking felts manufacturers, our Group is more competitive in customer service, after-sales service and price and the papermaking felts products sold by our Group has a higher cost performance as compared to by other top five papermaking felts manufacturers.

We are qualified as high and new technology enterprise. We place great emphasis on the research and development of new technologies and product innovations, as well as the protection of our intellectual property rights. Our capabilities can be demonstrated in part by the patents we have obtained. As at the Latest Practicable Date, we have obtained 99 patents in the PRC, details of which are set out in the paragraph headed “Statutory and General Information — Further

BUSINESS

information about the business — 2. Intellectual property rights” in Appendix V to this document. We believe that our strong intellectual property portfolio provides us with a competitive advantage in the papermaking felts manufacturing industry.

We have well-established reputation and proven track record in the papermaking felts manufacturing industry in the PRC with a long history of operation and brand recognition

We commenced our papermaking felts manufacturing business in 2007 and since then we have accumulated 14 years of experience in the papermaking felts manufacturing industry in the PRC. According to the Frost & Sullivan Report, we were one of the top five papermaking felts manufacturers in the PRC market, among which, we ranked fourth and were the only papermaking felts manufacturer headquartered in the PRC, with an approximate market share of 5.8% in terms of revenue in 2020. As compared to other top five papermaking felts manufacturers, our Group focuses primarily in the PRC with papermaking felts as the main product. In contrast, some of the other top five papermaking felts manufacturers are conglomerate with global presence, and may focus on sales of other products including, papermaking machine as well as other papermaking consumables. Our focus on the research and development, services and production of papermaking felts, together with our efficiency optimisation services, enables us to provide more refined services to our customers for better customer experience. In addition, our Group offers papermaking felts with different speed range while some of the other leading players mainly offer high speed papermaking felts. Our products are sold under our two brands, namely **VANOV** and . As advised by Frost & Sullivan, our brands are high-end brands and first tier brands amongst the other domestic papermaking felts brands. Our Directors believe that we have well-established reputation in the papermaking felts manufacturing industry with a proven track record in the PRC and we are capable of delivering our products on time and to the satisfaction of our customers.

According to the Frost & Sullivan Report, the sales value of papermaking felts in the PRC has achieved a CAGR of approximately 9.7% from 2016 to 2020 and is expected to increase at a CAGR of approximately 7.6% from 2021 to 2025 due to the expansion in production of high-speed papermaking felts among local papermaking felts manufacturers. By closely following the growing trend in the market, our Directors believe that our responsiveness to the latest technology and high operational efficiency have contributed significantly to our success. With our long history of operation, we believe that we can consistently produce high quality products with short production and delivery cycles.

In addition, our Directors believe that our growing research and development portfolio will continue to integrate us with our customers’ critical research and industrial processes and further differentiate our value proposition from that of our competitors.

BUSINESS

We have established strong business relationships with our key customers and suppliers

Our Directors believe that we have built a good reputation and a good corporate image in the paper and paper products manufacturing industry and we have established strong business relationships with our key customers and suppliers.

We have maintained a wide range of channels leveraging on our products and services, which include building strong relationships with our customers. As at the Latest Practicable Date, we have maintained business relationships with our five largest customers during the Track Record Period for an average of approximately six years. According to the Frost & Sullivan Report, nine out of the top ten papermaking companies in the PRC in 2020 are our Group’s customers.

We believe that our market-leading position and track record in providing quality products which meet certain certification requirements has provided us with a competitive advantage in attracting more well-known paper and paper products manufacturers or their sourcing companies as customers. We communicate and work closely with our customers during the entire production process to ensure that our products are properly designed and manufactured in accordance with their production needs. In order to strengthen our business relationships with our customers, members of our sales and marketing department visit our customers’ production facilities regularly to understand their needs and keep ourselves abreast of the latest development and trends of our customers’ products. As part of our after-sales service, we provide a tailor-made papermaking felts solution whereby, we issue complimentary technical advisory proposals to our customers which analyse the performance of their production machines. Our Directors believe that this service differentiates us from other conventional papermaking felts manufacturers who merely provide papermaking felts to customers.

In addition, we have also established long-term relationships with some of our suppliers of quality raw materials for papermaking felts manufacturing. As at the Latest Practicable Date, we have maintained business relationships with our five largest suppliers during the Track Record Period for an average of approximately ten years. Our Directors believe that such business relationships enable our access to a steady supply of raw materials which are manufactured according to the specifications and timing requested by us and our customers, and such relationships have been built upon a mutual trust and confidence over the years of cooperation between us and our suppliers.

We have a group of experienced and high calibre professional team led by a stable and dedicated management team

Our management team has extensive experience, in-depth knowledge and strong expertise in the papermaking felts manufacturing industry of the PRC. Our chairperson and executive Director, Ms. Shen and our executive Director and chief executive officer, Mr. Zhou, each has over 16 years

BUSINESS

of experience in the papermaking felts manufacturing industry. They have built our Group’s reputation in the papermaking felts manufacturing industry, and facilitated the establishment of long-standing business relationships with our customers and suppliers. Our executive Director, Mr. Xie, has over 18 years of experience in the papermaking felts manufacturing industry with an expertise in research and development in technologies regarding papermaking felts as proven in his contribution as the leading drafter of “China Textile Industry Standard: Batt-on-mesh Papermaking Felts” (中國紡織行業標準：底網造紙毛毯), which has subsequently become the industry standard of the papermaking felts manufacturing industry. Our director of the sales and marketing department, Mr. Gao Qiang, has over 18 years of experience in sales and marketing. Our director of the operation department, Ms. Lin Xiaoyan, has over 12 years of experience in operation and client management. The majority of our senior management has over 10 years of experience in each of their respective fields of expertise. For further details, please refer to the section headed “Directors and Senior Management” in this document.

Our executive Directors and senior management have led and transformed our Group into a well-established papermaking felts manufacturer in the PRC, the only papermaking felts manufacturer headquartered in the PRC among the top five papermaking felts manufacturers in the PRC market, and one of the few local papermaking felts manufacturers which demonstrate capability of producing high quality papermaking felts for high-speed papermaking machine. We believe our management team possesses in-depth knowledge and experience critical to the success in the papermaking felts manufacturing industry and is capable of seizing market opportunities, formulating sound and tailored business strategies, assessing and managing risks and implementing management schemes, so as to maximise our shareholder value.

OUR BUSINESS STRATEGIES

We plan to achieve our business objectives by pursuing the following strategies:

Expanding our production capacity

According to the Frost & Sullivan Report, the total sales volume of papermaking felts in the PRC experienced an overall growth from 2016 to 2020 at a CAGR of approximately 8.1%, and the sales volume of papermaking felts is expected to have a further growth from 2016 onwards and is expected to increase at a CAGR of approximately 6.3% during 2021 to 2025. According to the Frost & Sullivan Report, we were one of the top five papermaking felts manufacturers in the PRC market, among which, we ranked fourth and were the only papermaking felts manufacturer headquartered in the PRC, with an approximate market share of 5.8% in terms of revenue in 2020. The total sales value of papermaking felts in the PRC has also shown an overall increasing trend from approximately RMB2,189.9 million in 2016 to approximately RMB3,166.1 million in 2020, representing a CAGR of approximately 9.7% and is expected to further increase at a CAGR of approximately 7.6% during 2021 to 2025.

BUSINESS

The effective utilisation rate of our Chengdu Production Site was approximately 92.7%, 88.9%, 92.1% and 83.8% for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively, while the effective utilisation rate of our Shanghai Production Site was approximately 99.6%, 103.3%, 97.3% and 83.5% for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively. The actual production volume of our Chengdu Production Site was approximately 547 tonnes, 587 tonnes, 608 tonnes and 276 tonnes for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively, while the actual production volume of our Shanghai Production Site was approximately 498 tonnes, 537 tonnes, 603 tonnes and 259 tonnes for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively.

For details about the production capacities of our existing production facilities during the Track Record Period, please refer to the paragraph headed “Production — Our production capacity and utilisation rate” in this section.

In order to cater for the expected increasing demand in our high-speed papermaking felts, our Directors believe that it is imminent to increase our production capacity for high-speed papermaking felts. Our production capacity expansion plan, which involves the acquisition of production machinery for our Chengdu Production Site and our Shanghai Production Site, is divided into three phases.

We have commenced phase one of our production capacity expansion plan in the fourth quarter of 2020, which involves the acquisition of a set of production machinery including carding machine, cross-forming machine, pre-needling machine, setting machine and other supplemental equipment for our Chengdu Production Site and was financed by internal resources and an other borrowing, in total of which was approximately RMB41.1 million. We have completed phase one of our production capacity expansion plan in September 2021 and commenced operation progressively. RMB41.1 million has been capitalised as the fixed assets in the consolidated statements of financial position. Immediately upon completion of such phase one in September 2021, the annual production capacity of one major production line in our Chengdu Production Site increases by approximately 150 tonnes, which will enable us to have a total annual production capacity of approximately 400 tonnes, comprising approximately 150 tonnes of enlarged annual production capacity and approximately 250 tonnes of existing annual production capacity, to manufacture the papermaking felts used for paper machines of higher speed, and the quality of our products are expected to enhance when the new set of production machinery is in full operation. This set of production machinery together with the production machinery to be acquired under phase three of our production capacity expansion plan as discussed below will enhance the production efficiency and the annual production capacity of the production lines in our Chengdu Production Site.

BUSINESS

Phase two of our production capacity expansion plan, which is expected to complete in one year, has started in the second quarter of 2021 and we plan to expand the annual production capacity by (a) acquiring a set of production machinery as additional production line in our Shanghai Production Site, (b) acquiring supplemental equipment and upgrading certain production lines of our Chengdu Production Site and (c) performing technical transformation on our machinery and production lines of both of our Chengdu Production Site and our Shanghai Production Site by the second quarter of 2022. The total estimated capital expenditure to be incurred in relation to phase two of our production capacity expansion plan is approximately RMB[REDACTED], [REDACTED]% of which will be financed by the [REDACTED], with the remaining to be financed by internal resources. It is expected that following the completion of such phase two, the annual production capacity of our Shanghai Production Site is expected to increase by approximately 300 tonnes for the year ending 31 December 2022 and further increase by approximately 100 tonnes for the year ending 31 December 2023, i.e. an aggregated increase of 400 tonnes enlarged annual production capacity in our Shanghai Production Site upon the full operation and completion of phase two of our production capacity expansion plan. Such additional production capacity is intended mainly for manufacturing the papermaking felts used for paper machines of higher speed. It is expected that there will be no material change to the annual production capacity of our Chengdu Production Site as a result of the upgrade of the production lines in phase two since such upgrade is for the purpose of optimising the production process of warping, winding and weaving. Nevertheless, such upgrade is a necessary preparation for our further expansion plan, which will allow us to increase the annual production capacity of our Chengdu Production Site in our phase three of our production capacity expansion plan as discussed below with the incurring of less capital expenditure. As at the Latest Practicable Date, we have signed certain agreements with machinery and equipment providers for the acquisition of machinery and equipment under phase two of our production capacity expansion plan and capital expenditure of approximately RMB3.7 million under this phase has been incurred so far, and we are still looking for suitable production premises to expand our Shanghai Production Site.

For the particulars of the production machinery and the estimated capital expenditure to be incurred from the purchase the machinery for phase two of our production capacity expansion plan, please see the section headed “Future Plans and [REDACTED]” in this document.

Phase three of our production capacity expansion plan is expected to commence in June 2022 and we plan to further expand the annual production capacity by acquiring a set of production machinery including weaving machine, needling machine and setting machine for one of our production lines in our Chengdu Production site to complement the production machinery invested during phase one of our production capacity expansion plan. The total estimated capital expenditure to be incurred in relation to phase three of our production capacity expansion plan is approximately RMB20.7 million, which will be fully financed by internal resources. It is expected that following the completion of such phase three, together with the production machinery acquired under phase one of our production capacity expansion plan and taking advantage of the production lines upgrade under phase two of our production capacity expansion plan as discussed above, the annual production capacity of our Chengdu Production Site is expected to increase by approximately 200 tonnes for the year ending 31 December 2023 and further increase by

BUSINESS

approximately 200 tonnes for the year ending 31 December 2024, i.e. an aggregated increase of 400 tonnes enlarged annual production capacity in our Chengdu Production Site upon the full operation and completion of phase three of our production capacity expansion plan, mainly for manufacturing the papermaking felts used for paper machines of higher speed.

The following table sets forth the actual annual production capacities and capital expenditure incurred for the year ended 31 December 2020 and the expected annual production capacities and capital expenditure expected to incur for the four years ending 31 December 2024 in respect of our production facilities, assuming our production capacity expansion plan can be completed as scheduled:

		For the year ended 31 December	For the year ending 31 December				
		2020	2021	2022	2023	2024	
Chengdu Production Site	Actual/expected annual production capacity (tonnes) ^(Note 1)	660	710	810	1010	1210	^(Note 2)
	Capital expenditure incurred/expected to incur (RMB'000)	19,056	36,758	10,050	12,290	900	
Shanghai Production Site	Actual/expected annual production capacity (tonnes) ^(Note 1)	620	620	920	1020	1020	
	Capital expenditure incurred/expected to incur (RMB'000)	Nil	45,120	28,370	3,910	Nil	

Notes:

1. The expected increase in the annual production capacity for the four years ending 31 December 2024 are intended for high-speed papermaking felts, which can also be used for medium-speed or low-speed papermaking felts if required.
2. The expected increase in the annual production capacity for the year ending 31 December 2024 in our Chengdu Production Site is due to the expected full operation and completion of phase three of our production capacity expansion plan.

According to the Frost & Sullivan Report, the replacement, adjustment and testing of machine for the production of papermaking felts could generally take several months to a year subject to the time from ordering, manufacturing to shipment of the machine, as well as the time for installation, adjustment and testing process for such machine. Given the time required for

BUSINESS

adjusting and testing the new sets of production machinery following its installation in our three phases of production capacity expansion plan, our Directors estimated that the new sets of machinery will gradually increase our production volume from 2021 to 2024. Our Directors believe that such purchase will allow us to better cope with the expected increase in demand in our high-speed papermaking felts from both existing and new customers.

Further strengthening our research and development capabilities

We believe that our commitment to research and development is essential to enhancing our sales and marketing position, and our ongoing research and development activities, particularly in papermaking machine efficiency optimisation, can help us bolster the quality and performance of our customers’ papermaking machines. We plan to strengthen our research and development capabilities in the area of digitalisation of papermaking machine operation services system to enhance papermaking machine efficiency data services, customised product design and standardised product development. We developed and launched a trial version of Huanlong Paper Machine Efficiency Operation System* (造紙機運營效率優化服務數字平台系統), which is able to gather and store the data of our customers’ papermaking machines collected during the provision of our services, so that we can analyse the data and customise the product for customers and provide technical advice of improving the efficiency of customers’ papermaking machines. As part of our sales and marketing strategies, upon completion of the development and the launching of the formal version of system, this online platform will allow our selected customers to access our services remotely such as reviewing product development plans, tracking orders and production status, reviewing product examination and technical reports and giving feedback on the efficiency of their papermaking machines. We plan to upgrade such online platform to facilitate the collection of information from our customers’ papermaking machines and our production machinery and equipment, support the analysis of the data collected from the machines, build database and promote our customised product services based on our analysis of the data. We will continue to develop our production machinery and equipment based on the information collected using the online platform and allocate more resources to procure staff with relevant expertise to strengthen our information technology facilities. The total estimated capital expenditure to be incurred in relation to upgrade our Huanlong Paper Machine Efficiency Operation System, including developing and upgrading the software platform, investing in the hardwares, hiring professional staff and strengthening our information technology facilities, is approximately RMB[REDACTED], [REDACTED]% of which will be financed by the [REDACTED], with the remaining to be financed by internal resources. For the breakdown of such estimated capital expenditure, please refer to the section headed “Future Plans and [REDACTED]” in this document.

We were accredited as an enterprise technology centre in Sichuan Province in November 2019. We will continue to place strong emphasis on research and development, with an aim to provide continuing support in respect of technical know-how for increasing papermaking machine

BUSINESS

efficiency. We will continue to pursue technological innovation, management innovation and strategic innovation and enhance our level of digitalisation of our comprehensive papermaking felts services. The total estimated capital expenditure to be incurred in relation to upgrading our technology centre, including the investments into the human resources, equipment and facilities, and cooperative research and development projects, is approximately RMB[REDACTED], [REDACTED]% of which will be financed by the [REDACTED], with the remaining to be financed by internal resources. For the breakdown of such estimated capital expenditure, please refer to the section headed “Future Plans and [REDACTED]” in this document.

Pursuing strategic acquisitions

We have demonstrated our ability to execute synergistic acquisitions, such as the acquisition of Shanghai Jinxiong in 2010, that has greatly improved our competitiveness with additional production lines.

To achieve future growth, we may selectively pursue strategic acquisitions that complement our business and strategic priorities, such as for expanding our business horizontally in the industry chain and supply chain, taking into account factors such as the financial and competitive positions of the potential acquisition targets. In particular, we intend to acquire papermaking screens manufacturer(s) with the capacity to produce drying screens (乾網) and three-layer screens (三層網), another consumables required by paper manufacturers during the papermaking process, since generally our paper and paper products manufacturers customers which purchase papermaking felts from us need papermaking screens as well. They are major consumables for pressing, forming and drying in the whole papermaking process. As compared to papermaking felt which is mainly used in pressing section of paper machine, papermaking screens are consumables used for forming section and drying section of a paper machine. According to the Frost & Sullivan Report, the market demand of papermaking screens in the PRC is estimated to be approximately RMB4,000 million to RMB5,300 million in 2020. In terms of production volume, the market size of papermaking screens in the PRC was approximately 2.3 million sq. m.. The market growth of papermaking screens is generally in line with papermaking felts. The top five papermaking felts enterprises (except for our Group) are also engaged in the manufacturing of papermaking screens and it is a market trend for the papermaking felts enterprises to acquire papermaking screens manufacturers to maximise synergies. Acquiring the papermaking screens manufacturer(s) by the papermaking felts providers can provide synergies including (i) provision of all types of dewatering fabric consumables for paper machine at a competitive price, (ii) strengthening business relationship and loyalty of customers, and (iii) achieving scale production and rapid development of papermaking felts providers in terms of business and financial performance.

BUSINESS

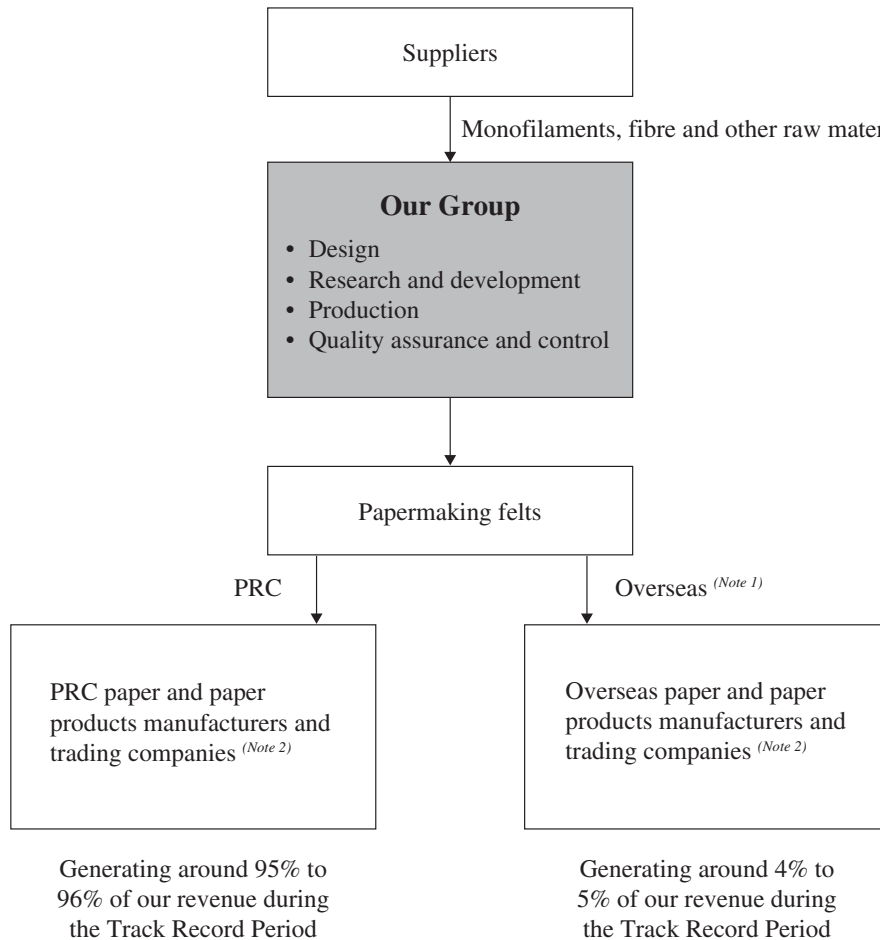
We plan to acquire company(ies) as our subsidiary(ies) by holding more than 50% of its/their equity interest that (i) is/are located in the PRC; (ii) is/are specialised in papermaking screens which has/have sound track record in providing such services with its own production line(s) for drying screens and three-layer screens; (iii) has/have considerable scale of operations with air-conditioned production site of at least 30,000 sq. m. and heavy weaving machines, and sufficient staff with experience in the papermaking industry; (iv) has/have production capacity of at least 400,000 sq. m. for drying screens and at least 30,000 sq. m. for three-layer screens; and (v) has/have research and development capabilities. We plan to incur not more than RMB100 million for such acquisitions, of which we plan to allocate approximately RMB[REDACTED], representing [REDACTED]% of the total [REDACTED], to settle part of the consideration of any strategic acquisitions, with the remaining part being settled by internal resources and/or other external financing. As advised by Frost & Sullivan, there are over 200 papermaking screen manufacturers in the PRC as in 2020 and there are over 30 papermaking screen manufacturers that are feasible potential targets for acquisition by our Group. Through integrating and enhancing the businesses we acquire, we plan to maximise synergies brought by the strategic acquisitions and our Directors believe that we have the requisite knowledge and understanding to pursue strategic acquisitions to enhance our business. As at the Latest Practicable Date, we had not identified any suitable target for such potential acquisition or opportunities.

OUR BUSINESS MODEL

We principally engage in the design, manufacture and sales of papermaking felts under the brands of **VANOV** and **Gobear**. Papermaking felts are fabrics used in the papermaking machine for dewatering, pressing, forming and drying of paper in the papermaking process and are consumables with a replacement cycle of approximately 30 to 180 days. We provide comprehensive papermaking felts services to our customers, from conducting on-site visits and advising our customers on the types and specifications of papermaking felts, to sourcing suitable raw materials of our production, conducting quality control, delivery papermaking felts to customers and providing after-sales services. Our products can be classified into five categories according to the type of papermaking machines that the papermaking felts are applied to: packaging papermaking felts, specialty papermaking felts, printing papermaking felts, household papermaking felts and pulp papermaking felts. We mainly conduct manufacturing process for our products in accordance with the design and technical specifications agreed between our customers and us.

BUSINESS

Our customers mainly include: (i) PRC paper and paper products manufacturers and trading companies, from which we derived around 95% to 96% of our revenue; and (ii) overseas paper and paper products manufacturers and trading companies, from which we derived around 4% to 5% of our revenue. For further details of our customers, please refer to the paragraph headed “Our customers” in this section. The diagram below provides a simplified presentation of our business model:



Notes:

1. Overseas mainly include Singapore, Brazil, Pakistan, Colombia, India and Uzbekistan.
2. To the best knowledge of our Directors, the trading companies will further sell our products to third parties paper and paper products manufacturers overseas.

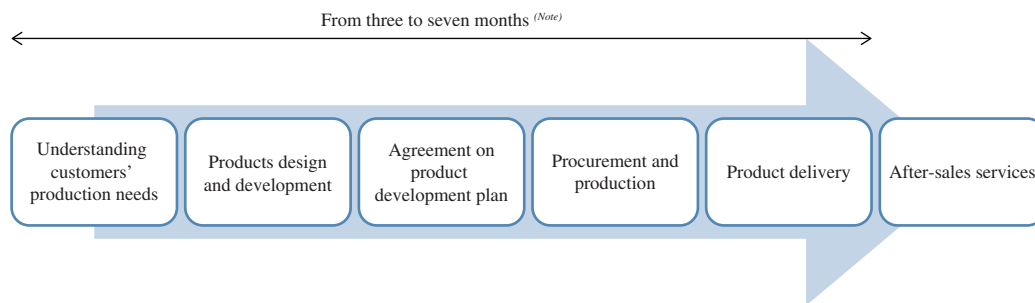
During the Track Record Period, we generally approach our customers directly, and to a much lesser extent, we engaged several independent service providers to provide services in relation to our customers’ matters such as receiving purchase orders, handling export tax rebate applications,

BUSINESS

promoting our brands and identifying potential customers. The total amount of agency service fees incurred for the three years ended 31 December 2020 and the six months ended 30 June 2021 were approximately RMB3.3 million, RMB4.9 million, RMB7.2 million and RMB1.9 million, respectively.

New customers

The following diagram illustrates our operation flow when we are engaged by our new customers:



Note: The time span from the receipt of a product request from our customers to the provision of after-sales services to our customers ranges from three to seven months. The actual duration for us to process a product request may vary from case to case depending on the type, quantity, customer’s special requirement, complexity of the design of the papermaking felts, our production capacity and delivery location and schedule.

Understanding production needs of our new customers

Our new customers generally approach us with their requests for our products with product requirements. In other cases, members of our sales and marketing department will directly approach potential customers to pursue business opportunities.

We normally request our potential customers to provide the information about their production process and product catalogue to us. After that, we will conduct technical reviews on their production machinery. In some cases, we receive our potential customers’ order enquiries and request reports generated from their production machinery in order to understand thoroughly their production needs during their operation and design quality products to cater their specific needs.

For our complementary papermaking machine efficiency optimisation services, particularly for high-speed papermaking felts, we will also collect information from our customers’ papermaking machines, conduct online testing on the machines and analyze the data collected from

BUSINESS

the machines so that we are able to understand our customers’ needs and the precise requirements of our papermaking felts and formulate a product development plan and/or an optimisation plan for our customers.

Product design and development

After conducting technical reviews and analysing our potential customers’ production needs and special requirements, we will formulate a product development plan based on the following proposals:

- (i) offering a selection of products from our existing product portfolio and making adjustments or alterations, where necessary; and/or
- (ii) customising our products.

In a product development plan, we typically include, among other things, source of raw materials, estimated performance of our customised papermaking felts and the adoption of quality standards.

Agreement on product development plan

If our potential customers are satisfied with our customised product development plan, we will generally enter into a sale and purchase agreement with them. The agreement can ensure that our products will be manufactured up to our customers’ standards while integrating and maximising our advanced technological resources. For details of the salient terms of our sale and purchase agreements with our customers, please refer to the paragraph headed “Our customers” in this section.

Procurement and production

We generally procure our raw materials according to a procurement plan prepared by us on a monthly basis. We receive purchase orders from our customers from time to time to indicate, among other things, the quantities they require us to produce. After receipt of purchase orders from our customers, we manufacture our products in accordance with the agreed production development plan. For details of our production process, please refer to the paragraph headed “Production — Our production process” in this section.

BUSINESS

Product delivery

Upon completion of the entire production process, the finished goods will be delivered to the locations specified by our customers through third party logistics service providers. For details of logistics support in relation to transporting finished goods from our production facilities to our customers’ designated locations, please refer to the paragraph headed “Logistics” in this section.

After-sales services

We strive to provide quality and effective after-sales services and technical support to our customers and collect feedback as to the quality of our products for future product enhancement. We conduct testing, analysis and evaluation of the effectiveness of our products after the implementation of the optimisation plan in respect of our complementary papermaking machine efficiency optimisation services, with a view to increase our customers’ operational efficiency.

In the event that a defect is identified, our customers may reject our products or ask for product return under our product return and warranty policy. For details of our product return and warranty policy, please refer to the paragraph headed “Product returns and warranty” in this section.

For certain long-term customers, we pay them on-site visits regularly to conduct review and inspection on the performance of our products on their production machinery. We also offer a complimentary technical advisory proposal to certain long-term customers, in which we inspect their machinery, analyse the performance of their production machines, and evaluate the effectiveness of our products on their machinery with the most up-to-date technology from time to time.

Existing customers

For recurring purchase orders received from our existing customers, adjustment on the product development plan previously agreed by them is generally not required because, as confirmed by our Directors, the same machinery is often used in our customers’ production process for a certain period of time. Therefore, the time span from the receipt of a product request from our existing customers to the delivery of our products to them is normally shorter than that of our new customers. During the Track Record Period, a significant proportion of orders, in terms of revenue, were received from our recurring customers, being those customers who had renewed contracts or had placed orders with us during the previous financial year. For the three years ended 31 December 2020 and the six months ended 30 June 2021, our recurring customers contributed approximately 97.5% 88.4%, 90.5% and 93.4% of our revenue, respectively.

BUSINESS

The table below sets out the sales volumes and average selling prices attributable to new customers and recurring customers during the Track Record Period:

	For the year ended 31 December									For the six months ended 30 June		
	2018			2019			2020			2021		
	Revenue	Average sales selling price		Revenue	Average sales selling price		Revenue	Average sales selling price		Revenue	Average sales selling price	
		volume	per tonne		volume	per tonne		volume	per tonne		volume	per tonne
	(RMB'000)	(tonnes)	(tonne)	(RMB'000)	(tonnes)	(tonne)	(RMB'000)	(tonnes)	(tonne)	(RMB'000)	(tonnes)	(tonne)
Recurring customers	155,370	1,107.3	140	147,969	996.0	149	165,417	1,083.7	153	71,428	477.4	150
New customers	3,986	34.6	115	19,345	121.5	159	17,342	119.6	145	5,087	36.9	138
Total	159,356	1,141.9	140	167,314	1,117.5	150	182,759	1,203.3	152	76,515	514.3	149

The revenue generated from the recurring customers generally increased during the Track Record Period and it was mainly affected by the sale volume to the recurring customers which depends on their needs and demands. The relevant average selling price was increasing due to more and more high-speed papermaking felts were sold during the Track Record Period. For the revenue generated from the new customers, it increased significantly from approximately RMB4.0 million in 2018 to approximately RMB19.3 million in 2019, mainly due to our increasing effort on sourcing new customers. The average selling price with new customers during the Track Record Period fluctuated materially as it was affected by their requests for our products with different product requirements.

OUR PRODUCTS

We principally engage in the design, manufacture and sales of papermaking felts, which are fabrics used in the papermaking machines for dewatering, pressing, forming and drying of paper in the papermaking process. Our products are sold under our two brands, namely **VANOV** and **Gobear**, and can be classified into five categories according to the type of papermaking machines that the papermaking felts are applied to: packaging papermaking felts, specialty papermaking felts, printing papermaking felts, household papermaking felts and pulp papermaking felts.

Our Directors consider that our papermaking felts can be utilised for about 30 to 90 days. Depending on the product development plan prepared by us in accordance with our customers’ production needs, we adopt different techniques in producing customised papermaking felts. For

BUSINESS

the three years ended 31 December 2020 and the six months ended 30 June 2021, our average selling price for our papermaking felts per tonne amounted to approximately RMB140,000, RMB150,000, RMB152,000 and RMB149,000, respectively.

The following table sets out a breakdown of our revenue by product type during the Track Record Period:

	Year ended 31 December						Six months ended 30 June			
	2018		2019		2020		2020		2021	
	RMB'000	% of total revenue	RMB'000	% of total revenue	RMB'000	% of total revenue	RMB'000	% of total revenue	RMB'000	% of total revenue
	(unaudited)									
Packaging papermaking felts . . .	106,027	66.5	114,670	68.6	124,863	68.3	44,017	66.5	52,661	68.8
Specialty papermaking felts . . .	25,755	16.2	26,951	16.1	32,090	17.6	11,496	17.4	12,709	16.6
Printing papermaking felts	14,859	9.3	11,451	6.8	10,732	5.9	4,193	6.3	4,958	6.5
Household papermaking felts . . .	9,975	6.3	10,600	6.3	9,490	5.2	4,225	6.4	4,364	5.7
Pulp papermaking felts	2,740	1.7	3,642	2.2	5,584	3.0	2,274	3.4	1,823	2.4
Total	<u>159,356</u>	<u>100.0</u>	<u>167,314</u>	<u>100.0</u>	<u>182,759</u>	<u>100.0</u>	<u>66,205</u>	<u>100.0</u>	<u>76,515</u>	<u>100.0</u>

The principal functions of papermaking felts include: (i) assisting the formation of paper sheets by pressing and drying the papers; and (ii) conveying paper sheets through various sections of papermaking machines. Therefore, the quality and characteristics of paper produced, and the efficiency of papermaking machines, largely rely on the design and quality of papermaking felts.

During the Track Record Period, based on the operating speed of the applicable papermaking machines, our papermaking felts can mainly be categorised into (i) high-speed papermaking felts; (ii) medium-speed papermaking felts; and (iii) low-speed papermaking felts. According to our Directors, high-speed papermaking felts are generally applied in papermaking machine with operating speed of 700 metres or above per minute for packaging papermaking felts and printing papermaking felts and 600 metres or above per minute for our other products; while low-speed papermaking felts are generally applied in papermaking machine with operating speed of 300 metres or below per minute for packaging papermaking felts and printing papermaking felts and 200 metres or below per minute for our other products. Medium-speed papermaking felts are generally applied in papermaking machine with operating speed other than high-speed and low-speed. As advised by Frost & Sullivan, regarding the classification of papermaking felts by speed, there is no standard threshold for the respective category of the speed of papermaking machine due to large variations of paper types by weight and the threshold of the respective speed category may increase along with technological advancement. The categorisation of speed is different based on paper types and papermaking machine. In view of the aforesaid reasons and considering the advancement of papermaking technology with higher speed for certain paper categories such as printing and packaging paper, higher speed papermaking machines have been

BUSINESS

developed and the range and threshold for speed categories for these paper types could be higher. The development and variation in the product mix of our Group can also be better reflected through the aforesaid categorisation. The following table sets out a breakdown of our revenue, sales volume, average selling price and gross profit of our papermaking felts during the Track Record Period based on the operating speed of the applicable papermaking machine:

	Year ended 31 December														
	2018				2019				2020						
	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit
	RMB '000		(tonnes)	(RMB'000 per tonne)	RMB '000	RMB '000		(tonnes)	(RMB'000 per tonne)	RMB '000	RMB '000		(tonnes)	(RMB'000 per tonne)	RMB '000
High-speed papermaking felts	31,770	20.0	160.8	198	19,709	39,093	23.4	177.9	220	25,772	54,952	30.1	256.5	214	36,208
Medium-speed papermaking felts	90,433	56.7	622.5	145	43,895	92,940	55.5	599.2	155	48,958	91,429	50.0	623.5	147	46,635
Low-speed papermaking felts	37,153	23.3	358.6	104	14,280	35,281	21.1	340.4	104	14,599	36,378	19.9	323.3	113	16,776
Total	159,356	100.0	1,141.9		77,884	167,314	100.0	1,117.5		89,329	182,759	100.0	1,203.3		99,619

	Six months ended 30 June									
	2020					2021				
	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit
	RMB '000		(tonnes)	(RMB'000 per tonne)	RMB '000	RMB '000		(tonnes)	(RMB'000 per tonne)	RMB '000
High-speed papermaking felts	18,338	27.7	82.2	223	11,964	23,709	31.0	113.9	208	15,184
Medium-speed papermaking felts	32,222	48.7	214.8	150	16,043	36,914	48.2	252.5	146	17,832
Low-speed papermaking felts	15,645	23.6	141.0	111	6,847	15,892	20.8	147.9	107	6,061
Total	66,205	100.0	438.0		34,854	76,515	100.0	514.3		39,077

According to our Directors, the features of and the techniques adopted for our products ensure the satisfactory performance of our products on papermaking machines. During our production process, we mainly use two types of weaving techniques, ring weaving and twill weaving. Ring weaving ensures the stability of dewatering performance and the fabric structure and the flatness of the felts, and twill weaving ensures the stability of dewatering performance.

Packaging papermaking felts

Our packaging papermaking felts are manufactured for packaging papermaking machines. The weaving techniques used for manufacturing packaging papermaking felts include ring weaving and twill weaving. Packaging paper mainly includes corrugated medium and linerboard, which is commonly applied to serve protective effect to goods in logistic industry.

BUSINESS

Specialty papermaking felts

Our specialty papermaking felts are applicable to all types of specialty papermaking machines, including specialty papermaking machines that can manufacture papers with superfine surfaces. The weaving technique used for manufacturing specialty papermaking felts is ring weaving. Specialty paper includes paper for industrial, agricultural and medical use.

Printing papermaking felts

Our printing papermaking felts are applicable to printing papermaking machines. The weaving techniques used for manufacturing printing papermaking felts include ring weaving and twill weaving. Printing paper mainly includes newsprint, printing and writing paper and art paper.

Household papermaking felts

Our household papermaking felts are manufactured for the household papermaking machines with models in vacuum cylinder mould and crescent form. Our household papermaking felts are made of thin fibre and with the adoption of ring-weaving technique, the surface of the felts are relatively fine and smooth compared to the other types of papermaking felts. Household paper refers to consumable paper products such as toilet tissue, facial tissue and wet wipes.

Pulp papermaking felts

Our pulp papermaking felts are manufactured for the pulp papermaking machines, of which pulp paper are manufactured and subsequently used as consumables of other types of papermaking machines. The weaving techniques used for manufacturing pulp papermaking felts include twill weaving which enhances the dewatering ability and abrasion resistance.

PRODUCTION

Our production facilities

As at 30 June 2021, we manufactured our products in our production facilities in Chengdu and Shanghai, the PRC, which together housed our major production machines with a total of eight production lines. Our production facility in Chengdu is constructed on a parcel of land owned by our Group, while our production facility in Shanghai is constructed on leased land owned by Independent Third Parties. As at 30 June 2021, all material machinery and equipment applied in our production facilities are owned by us.

BUSINESS

For the three years ended 31 December 2020 and the six months ended 30 June 2021, approximately 52%, 52%, 50% and 52% of our products were manufactured in our Chengdu Production Site, respectively, while approximately 48%, 48%, 50% and 48% of our products were manufactured in our Shanghai Production Site, respectively.

Chengdu Production Site

We established our Chengdu Production Site in 2008. It is situated in Wenjiang District, Chengdu, Sichuan, the PRC.

Our Chengdu Production Site comprises one factory building in operation and ancillary facilities including staff dormitory, staff cafeteria and other buildings with an aggregate gross floor area of approximately 15,748 sq. m. As at the Latest Practicable Date, the Chengdu Production Site has six production lines.

Shanghai Production Site

Our Shanghai Production Site is situated in Fengjing Town, Jinshan District, Shanghai, the PRC. We commenced our production in Shanghai Production Site after the acquisition of Shanghai Jinxiong in 2010.

Our Shanghai Production Site comprises three factory buildings and ancillary facilities including staff dormitory and staff cafeteria with an aggregate site area of approximately 9,006 sq. m. As at the Latest Practicable Date, our Shanghai Production Site has two production lines.

For further details about our properties, please refer to the paragraph headed “Properties” in this section.

BUSINESS

Our production machinery

Major machinery owned by our Group for production use during the Track Record Period are summarised as follows:

Major type of production machinery	Quantity				Principal use	Approximate weighted average remaining useful life ^(note 1)
	As at 31 December			As at 30 June		
	2018	2019	2020	2021		
Fearnought machine (和毛機)	2	2	2	2	Loosening and separating lumps of fibre	nil
Carding machine (梳理機)	4	4	4	4	Brushing and pulling fibre into parallel form	19 months
Cross-forming machine (鋪網機)	4	4	4	4	Folding single layer of fibre batt into thicker layers	19 months
Pre-needling machine (預刺機)	4	4	4	4	Strengthening the fibre in the fibre batt	19 months
Warping machine and winding machine (整經機和卷緯機)	9	9	9	10	Weaving single yarns into warp beams and weft threads	22 months
Weaving machine (織機)	19	20	20	20	Knitting warp beams and weft threads into fabric pieces	33 months
Needling machine (針刺機)	8	8	8	8	Punching and entangling different layers of fabrics into a single layer of felt	21 months
Setting machine (定型機)	4	4	4	4	Eliminating any tension variations in the fabrics and stabilising the shape and structure of the felt	20 months

Note:

- The calculation of the weighted average remaining useful life of our machinery is based on the weighted average of the remaining depreciable period of each unit of machinery determined in accordance with our applicable accounting policies, under which the depreciation is calculated using the straight-line method to allocate their costs to their residual values over their estimated useful lives.

BUSINESS

For details of our production machinery used in each step of our production process, please refer to the paragraph headed “Our production process” in this section.

For the three years ended 31 December 2020 and the six months ended 30 June 2021, we incurred capital expenditures (including additions and transfers from construction in progress) for plant and machinery of approximately RMB9.7 million, RMB5.7 million, RMB1.2 million and RMB2.6 million, respectively. As at 30 June 2021, our Group had prepayment of acquisition of plant and machinery of approximately RMB5.0 million. We adopt a straight-line depreciation policy for our plant and machinery. For details of the relevant accounting policies, please see note 2.6 of the Accountants’ Report set out in Appendix I to this document.

We conduct regular checks on our production machinery, based on which we make replacement and/or repair and maintenance decisions on an ongoing basis. We do not have a pre-determined or regular replacement cycle for our machinery, as replacement decisions are made on a case-by-case basis having regard to various factors, such as, according to our Directors, the feasibility and cost of repairing the worn-out or malfunctioning parts and the cost of replacing the entire machinery with a new one. For the three years ended 31 December 2020 and the six months ended 30 June 2021, our total expenses incurred in relation to the repair and maintenance of machinery were approximately RMB0.7 million, RMB0.7 million, RMB1.0 million and RMB0.5 million, respectively.

Save as disclosed in the paragraph headed “Our production capacity and utilisation rate” in this section, during the Track Record Period, we had not experienced any material disruption in our production due to machinery breakdown.

Our production capacity and utilisation rate

We plan our production based on our sales target of each month. As part of our production plan, we allocate our resources, such as the amount of raw materials and employees based on our estimated maximum capacity.

BUSINESS

The following table sets forth the utilisation of our production facilities during the Track Record Period:

	Year ended 31 December			Six months ended	
				30 June	
	2018	2019	2020	2020	2021
Chengdu Production Site					
— Estimated maximum annual capacity					
(tonnes) ^(Note 1)	590	660	660	330	330
— Approximate actual production volume					
(tonnes) ^(Note 2)	547	587	608	242	276
— Effective utilisation rate (%) ^(Note 3)	92.7	88.9	92.1	73.4	83.8 ^(Note 5)
Shanghai Production Site					
— Estimated maximum annual capacity					
(tonnes) ^(Note 1)	500	520	620	310	310
— Approximate actual production volume					
(tonnes) ^(Note 2)	498	537	603	217	259
— Effective utilisation rate (%) ^(Note 3)	99.6	103.3 ^(Note 4)	97.3	69.9	83.5 ^(Note 5)

Notes:

1. The estimated maximum annual capacity represents the estimated weight of papermaking felts produced by our key production machinery, which mainly include certain types of needling machines, minus the required maintenance days during the year or period. The estimated maximum annual capacity is estimated based on the assumption that our key production facilities operate for 287 days for each calendar year and 24 hours per day taking into account public holidays, subject to rest time of our employees and required maintenance time for each production facilities.
2. The actual production volume represents the weight of papermaking felts produced during the Track Record Period.
3. The effective utilisation rate is calculated by dividing the approximate actual production volume by the estimated maximum annual capacity for the same period.
4. The Shanghai Production Site operated longer than our assumption of the operation time of our relevant key production facilities for the year ended 31 December 2019.
5. Comparing to the effective utilisation rates for the year ended 31 Decemebr 2020, the effective utilisation rates for the six months ended 30 June 2021 is lower due to the fact that our Group’s revenue was subject to seasonal fluctuations as the sales orders during the months of January and September to December are generally higher than those of other months. Comparing to the effective utilisation rates of our Chengdu Production Site and Shanghai Production Site of approximately 73.4% and 69.9% for the six months ended 30 June 2020 respectively, the respective effective utilisation rates increased to approximately 83.8% and 83.5% for the six months ended 30 June 2021 respectively, mainly due to the business operation had been temporarily affected by the outbreak of COVID-19 in the first two months of 2020.

BUSINESS

The following table sets out a breakdown of the actual production volume of our papermaking felts during the Track Record Period based on the operating speed of the applicable papermaking machine:

	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
	<i>(tonnes)</i>	<i>(tonnes)</i>	<i>(tonnes)</i>	<i>(tonnes)</i>	<i>(tonnes)</i>
High-speed papermaking felts . . .	136	184	260	88	121
Medium-speed papermaking felts	587	602	627	225	262
Low-speed papermaking felts . . .	322	338	324	146	152
Total	1,045	1,124	1,211	459	535

Our Directors consider that the utilisation rates of our production facilities are affected by a number of factors such as the number, type and special requirement of our products ordered, status of repair and maintenance of machinery and production schedule and arrangement, taking into account the inventory level of raw materials, work-in-progress and finished goods.

The overall effective utilisation rates of our production facilities were approximately 95.9%, 95.3%, 94.6% and 83.6% for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively.

Our Group replaced a malfunctioning needling machine at our Chengdu Production Site in the year ended 31 December 2018, which resulted in approximately six months of downtime from its breakdown in April 2018 to the eventual installation of the new replacement machine in September 2018. The principal use of such needling machine is punching and entangling different layers of fabrics into a single layer of felt. Our Directors are of the view that such procedures are essential parts of the production of papermaking felts and considered that it is difficult to engage other subcontractors to perform such procedures to continue our production as the quality of the products manufactured by other subcontractors may vary. The replacement of the machine was completed in September 2018, followed by the adjustment and testing of the machine. As the sales orders of our Group has seasonality effect and such machine was not in the normal production during September to December in 2018, our production had been affected during the same period.

BUSINESS

Various adjustments and tests were conducted on the new replacement machine during the first half of 2019, which limited its production efficiency and production capacity during such period. As such, it took approximately a year from the time of the breakdown of the malfunction needling machine to the completion of its replacement, adjustment and testing. Our Directors consider that the time we spent on replacing, adjusting and testing the needling machine was in line with industry practice. According to the Frost & Sullivan Report, the replacement, adjustment and testing of machine for the production of papermaking felts could generally take several months to a year subject to the time from ordering, manufacturing to shipment of the machine, as well as the time for installation, adjustment and testing process for such machine. The estimated production capacity of the new replacement machine increased following the completion of adjustment and tests during the year ended 31 December 2019. Particularly, the estimated maximum production capacity for such needling machine was 250 tonnes for the year ended 31 December 2019 as compared to 150 tonnes immediately before its replacement. Overall, the estimated maximum annual capacity of our Chengdu Production Site increased from 590 tonnes for the year ended 31 December 2018 to 660 tonnes for the year ended 31 December 2019 which was mainly attributable to the increase in estimated maximum annual production capacity of the new replacement machine. The estimated maximum annual capacity of our Chengdu Production Site has remained the same at 660 tonnes for the years ended 31 December 2019 and 2020.

The estimated maximum annual capacity of our Shanghai Production Site increased from approximately 500 tonnes for the year ended 31 December 2018 to approximately 520 tonnes for the year ended 31 December 2019 and further increased to approximately 620 tonnes for the year ended 31 December 2020 which was mainly attributable to our technological developments in the automatic control system involved in the warping and winding process for controlling the tension, speed, size and length of the warp beams and weft threads, resulting in a shorter processing time involved in the warping and winding process and improvement in our production efficiency.

Since manufacturing high-speed papermaking felts involve more complex techniques, the time required for weaving the warp beams and weft threads into fabric pieces and needle-punching the batt into the base fabrics for manufacturing high-speed papermaking felts is longer than that of medium-speed or low-speed papermaking felts. For illustrative purpose only, the average production time of low-speed papermaking felts, medium-speed papermaking felts and high-speed papermaking felts was estimated to be approximately 48 hours, 86 hours and 122 hours, respectively. The difference in production time was mainly attributable to the fact that generally the processing time involved in the warping and winding process of high-speed papermaking felts is approximately 1.5 to three times of that involved in the production of medium-speed or low-speed papermaking felts. The actual difference in the production time of low-speed, medium-speed and high-speed papermaking felts may vary depending on the type of papermaking felts, complexity of the design and our customers' requirements and quality specifications.

BUSINESS

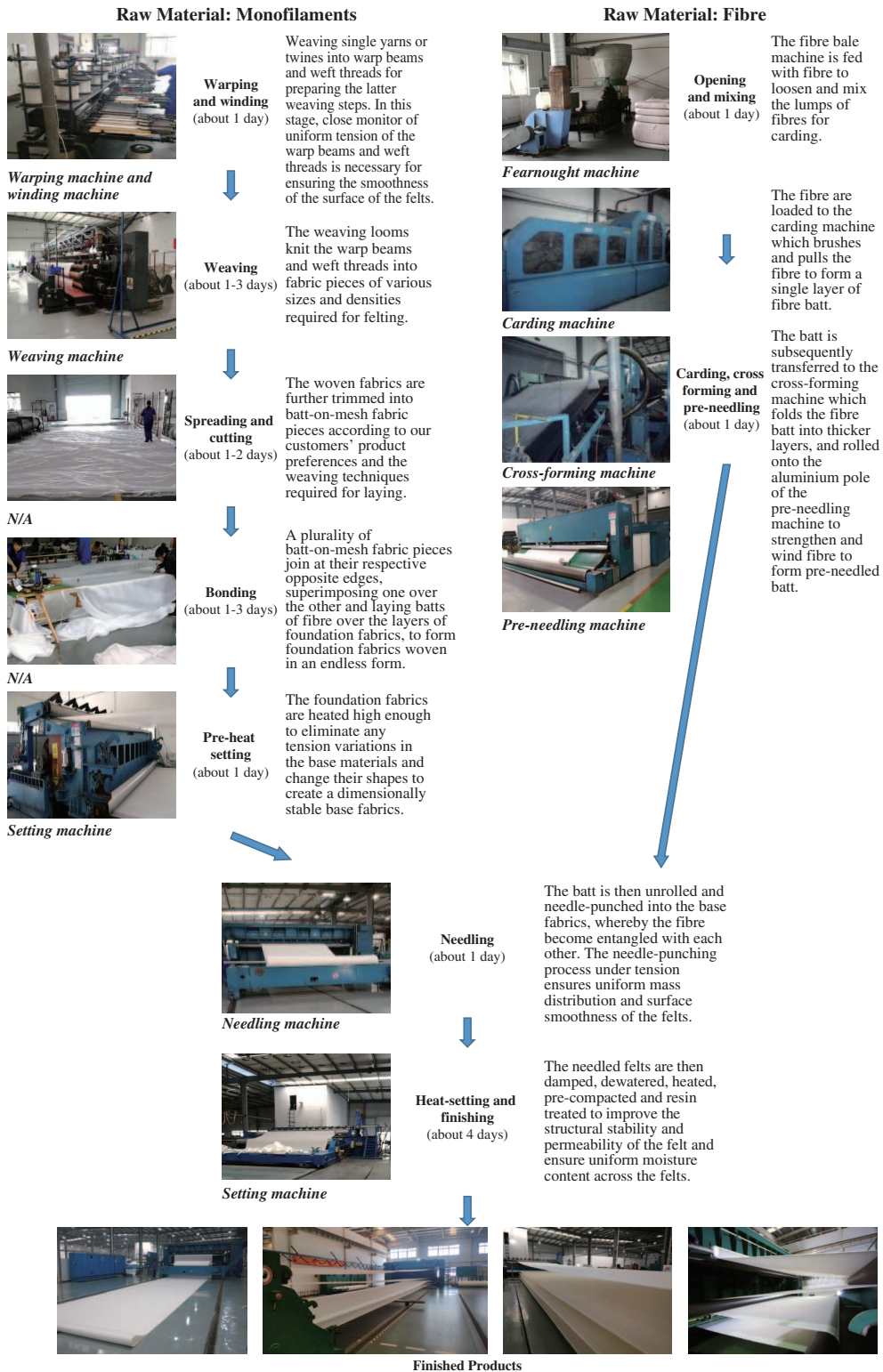
Our total actual production volume of papermaking felts increased from 1,045 tonnes for the year ended 31 December 2018 to 1,124 tonnes for the year ended 31 December 2019 which was mainly attributable to (i) the completion of replacement, adjustment and testing of the malfunctioning needling machine during the year ended 31 December 2019 as explained above, resulting in the increase in actual production volume of our Chengdu Production Site from 547 tonnes for the year ended 31 December 2018 to 587 tonnes for the year ended 31 December 2019; and (ii) the increase in number of days that our Shanghai Production Site had operated during the year ended 31 December 2019 as explained above. Meanwhile, the increase in our Group’s total actual production volume for the year ended 31 December 2019 was limited by our business strategy in allocating more resources on the production of high-speed papermaking felts which involved a longer production time as explained above. The actual production volume of our high-speed papermaking felts increased from 136 tonnes for the year ended 31 December 2018 to 184 tonnes for the year ended 31 December 2019, accounting for 13.1% and 16.4% of our total actual production volume, respectively.

Our total actual production volume slightly increased from 1,124 tonnes for the year ended 31 December 2019 to 1,211 tonnes for the year ended 31 December 2020, which corresponded to (i) the increase in our revenue from approximately RMB167.3 million for the year ended 31 December 2019 to approximately RMB182.8 million for the year ended 31 December 2020; and partially offset by (ii) the extension of our Chinese New Year holidays during early 2020 from 23 January 2020 to 13 February 2020 due to the outbreak of COVID-19 in the PRC; and (iii) our business strategy in allocating more resources on the production of high-speed papermaking felts which involved a longer production time as explained above. The actual production volume of our high-speed papermaking felts increased from 184 tonnes for the year ended 31 December 2019 to 260 tonnes for the year ended 31 December 2020, accounting for 16.4% and 21.5% of our total actual production volume, respectively.

Our total actual production volume increased from 459 tonnes for the six months ended 30 June 2020 to 535 tonnes for the six months ended 30 June 2021, which corresponded to the increase in our revenue from approximately RMB66.2 million for the six months ended 30 June 2020 to approximately RMB76.5 million for the six months ended 30 June 2021. The actual production volume of our high-speed papermaking felts increased from 88 tonnes for the six months ended 30 June 2020 to 122 tonnes for the six months ended 30 June 2021, accounting for 19.2% and 22.8% of our total actual production volume, respectively.

BUSINESS

Our production process



BUSINESS

QUALITY MANAGEMENT

We pride ourselves in the production of high quality and reliable products. In recognition of our quality control management system, we have obtained various quality related certifications, including ISO 9001: 2015 certificate. For details, please refer to the paragraph headed "Certifications and awards" in this section.

We have an established and comprehensive internal quality control practice that allows us to uphold our product quality standards as well as meeting our customers' requirements. Our quality control procedures are implemented throughout the production process from procurement of raw materials to the manufacturing of finished goods.

Quality control team

Our quality control team includes personnel from our production department. As at the Latest Practicable Date, we had 10 quality control personnel, with an average of approximately 18 years of experience in papermaking felts manufacturing industry. Our quality control team is responsible for overseeing our entire operating process, and maintaining and operating our quality control system. Our quality control team also reports regularly in writing any quality issues arising from our production process and any defected products identified by our in-house inspectors or returned by our customers.

Incoming quality control

We generally procure raw materials from suppliers who are included in our list of approved suppliers. The approved suppliers are selected based on a number of factors, including product quality, supply capacity, pricing and way of settlement. After we issue a purchase order to our suppliers and the raw materials are delivered to us, our quality control inspectors will inspect and approve the raw materials before use to make sure that the raw materials used in our production process for our products are of reliable and satisfactory quality.

In-process quality control

Our quality control inspectors monitor our entire production process closely to ensure strict compliance with our standard operating procedures, and in some cases, alongside the quality standard requested by our customers. We conduct quality control checks at each key production stage to maintain the manufacturing performance and avoid production disruption or deviation from our intended procedures. When a technical issue is identified, we will provide technical support and modify our production process and product design to keep up with our high-quality production.

BUSINESS

Outgoing quality control

We perform in-house inspections on sample batches of our finished goods to ensure our products are delivered in a high-quality standard consistently. Our quality control inspectors will identify the causes for any product defects and follow up closely with our quality control team under our production department to confirm any problems with our production process addressed. We have also established a similar system on handling products which do not meet our customers’ quality specifications, where our quality control inspectors will report to our quality control team any quality issues identified from inspecting our returned products. Members of our research and development department regularly conduct analysis on returned products to improve the quality and performance of our products in the future.

During the Track Record Period and up to the Latest Practicable Date, we had not received any material claims or complaints from our customers in relation to the quality of our products.

INVENTORY MANAGEMENT

Our inventory mainly includes raw materials, work-in-progress and finished goods. Our raw material inventories mainly include commonly used raw materials as well as supplemental raw materials such as packaging materials. As at 31 December 2018, 2019 and 2020 and 30 June 2021, our inventories were approximately RMB12.3 million, RMB11.3 million, RMB10.0 million and RMB11.5 million, respectively. For the years ended 31 December 2018, 2019 and 2020 and the six months ended 30 June 2021, our inventory turnover days were approximately 65.9 days, 55.2 days, 46.9 days and 52.1 days, respectively. For more information on our inventory analysis, please refer to the paragraph headed “Financial Information — Discussion of selected statements of financial position items — Inventories” in this document.

We monitor our inventory level in accordance with our inventory control policies and make provisions in accordance with our accounting policy. To effectively monitor our inventory level and minimise obsolete inventory, the following inventory control policies are adopted:

- all purchases of raw materials must be authorised and approved by the head of procurement and the general manager of each business unit;
- all incoming raw materials must be checked and verified against our purchase orders before acceptance;

BUSINESS

- the inventory level of our raw materials, work-in-progress and finished goods is closely monitored through the use of the inventory management system for planning and managing purchasing activities and production schedules, complemented with our daily stock-in and stock-out records;
- we have standard procedure for the acceptance and disposal of returned goods;
- we have standard procedures for the retrieval of inventory; and
- we generally conduct monthly, semi-annually and annual stocktakes.

For the three years ended 31 December 2020 and the six months ended 30 June 2021, provision for inventories amounted to approximately RMB0.1 million, RMB42,000, RMB0.8 million (reversal) and RMB0.2 million were recognised, respectively. We review our inventories at each reporting date and make allowance for impairment of obsolete, slow-moving and impaired items. Our finance and accounting department monitors our inventory level regularly by examining the conditions of our inventories, conducting analysis on the performance of our inventory management and giving advice on whether a provision for impairment should be made.

SALES AND MARKETING

We pride ourselves in the production of high quality and reliable products and provision of technical advisory services and our sales mainly rely on our strong and experienced sales and marketing department. As at the Latest Practicable Date, our sales and marketing department had 21 personnel. Despite our reputation within the papermaking felts manufacturing industry, our sales and marketing department continues to explore new business opportunities, build our brand image and manage existing client relationship through the following marketing activities:

- participating in local and international product exhibitions to showcase our latest product design and research development;
- organising thematic seminars to share and exchange latest development within the industry with our customers;
- sponsoring and participating in activities organised by associations within the industry, such as conferences, seminars and meetings to enhance corporate image and increase our brand awareness across the industry;
- contacting existing customers to collect feedback on the quality of our products;

BUSINESS

- conducting visits to various customers to, as confirmed by our Directors, promote our Group, strengthen our understanding of their needs and discuss, among other things, customers’ business, operational requirements and market trends; and
- cooperating with our customers in delivering our complementary papermaking machine efficiency optimisation services.

We developed and launched a trial version of Huanlong Paper Machine Efficiency Operation System* (造紙機運營效率優化服務數字平台系統), which is able to gather and store the data of our customers’ papermaking machines collected during the provision of our services, so that we can analyse the data and customise the product for customers and provide technical advice of improving the efficiency of customers’ papermaking machines. As part of our sales and marketing strategies, upon completion of the development and the launching of the formal version of system, this online platform will allow our selected customers to access our services remotely such as reviewing product development plans, tracking orders and production status, reviewing product examination and technical reports and giving feedback on the efficiency of their papermaking machines.

Our Directors are of the view that this system allows us to better understand our customers’ production needs, plan and deploy our resources effectively and respond to their request in a timely manner, which will provide us with a distinct advantage as compared to our competitors.

OUR CUSTOMERS

Our customers are primarily paper and paper products manufacturers and trading companies. The following table sets forth the revenue breakdown by our customer types during the Track Record Period:

	Year ended 31 December						Six months ended 30 June			
	2018		2019		2020		2020		2021	
	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%
							(unaudited)			
Paper and paper products										
manufacturers	138,773	87.1	141,035	84.3	158,782	86.9	55,435	83.8	65,169	85.2
Trading companies	20,583	12.9	26,279	15.7	23,977	13.1	10,770	16.2	11,346	14.8
Total	159,356	100.0	167,314	100.0	182,759	100.0	66,205	100.0	76,515	100.0

BUSINESS

During the Track Record Period, our customers can be categorised by geographical region, including: (i) PRC paper and paper products manufacturers and trading companies, from which we derived around 95% to 96% of our revenue; and (ii) overseas paper and paper products manufacturers and trading companies, from which we derived around 4% to 5% of our revenue.

The following table sets forth the revenue breakdown by geographical region of our customers during the Track Record Period:

	Year ended 31 December						Six months ended 30 June					
	2018		2019		2020		2020		2021		(unaudited)	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%		
PRC												
— North China ^(Note 1)	50,030	31.4	49,980	29.9	63,491	34.8	19,472	29.4	28,042	36.6		
— East China ^(Note 2)	50,532	31.7	56,936	34.0	60,159	32.9	22,724	34.3	22,112	28.9		
— South China ^(Note 3)	36,670	23.0	37,404	22.4	31,513	17.2	12,290	18.6	13,355	17.5		
— West China ^(Note 4)	10,529	6.6	11,123	6.7	11,496	6.3	4,608	7.0	6,334	8.3		
— North-East China ^(Note 5)	4,378	2.8	2,212	1.3	5,539	3.0	2,402	3.6	1,873	2.4		
— North-West China ^(Note 6)	1,246	0.8	2,054	1.2	2,973	1.6	1,062	1.6	1,096	1.4		
Sub-total	153,385	96.3	159,709	95.5	175,171	95.8	62,558	94.5	72,812	95.2		
Overseas ^(Note 7)	5,971	3.7	7,605	4.5	7,588	4.2	3,647	5.5	3,703	4.8		
Total	159,356	100.0	167,314	100.0	182,759	100.0	66,205	100.0	76,515	100.0		

Notes:

1. North China includes Henan, Hebei, Shandong, Shanxi, Tianjin, Beijing and Inner Mongolia.
2. East China includes Hubei, Anhui, Jiangsu, Zhejiang and Shanghai.
3. South China includes Hunan, Jiangxi, Fujian, Guangxi and Guangdong.
4. West China includes Sichuan, Chongqing, Guizhou and Yunnan.
5. North-East China includes Heilongjiang, Jilin and Liaoning.
6. North-West China includes Shaanxi, Ningxia, Gansu and Xinjiang.
7. Overseas mainly include Singapore, Brazil, Pakistan, Colombia, India and Uzbekistan.

BUSINESS

PRC paper and paper products manufacturers and trading companies

A very substantial part of our revenue was derived from our sales to PRC paper and paper products manufacturers and trading companies.

For the three years ended 31 December 2020 and the six months ended 30 June 2021, our revenue derived from the PRC paper and paper products manufacturers and trading companies amounted to approximately RMB153.4 million, RMB159.7 million, RMB175.2 million and RMB72.8 million, respectively, representing approximately 96.3%, 95.5%, 95.8% and 95.2% of our total revenue for the same periods, respectively.

PRC paper and paper products manufacturers

We generally enter into sale and purchase agreements with the PRC paper and paper products manufacturers. The salient terms of our typical sale and purchase agreement with the PRC paper and paper products manufacturers which is legally binding are summarised as follows:

- *Duration* — We generally enter into the agreement either in the form of purchase order or agreement with a term of one year to three years.
- *Price* — The price is generally determined based on the agreement between the parties as stated in the agreement.
- *Purchase quantity* — A total fixed purchase amount or range is generally set out in the agreement. The actual purchase amount will be subject to the purchase orders separately provided to us by our customers on a monthly basis.
- *Price adjustment* — Generally not specified.
- *Inspection and product return* — Our products shall comply with the agreed quality standards and requirements and shall be inspected by our customers upon receipt of our products. If any product defect or instance of non-compliance with the agreed quality standards and requirements is identified during the inspection, our customers may reject our products or ask for product return under our product return and warranty policy. For details of our product return and warranty policy, please refer to the paragraph headed “Product returns and warranty” in this section.

BUSINESS

- *Renewal and termination* — In certain cases, the agreement should be automatically renewed for a further term of one year, unless either party serves a prior written notice on the other party to terminate or amend the agreement. Termination terms may vary, but generally include the following: (a) termination by our customer in case we fail to perform our obligations under the agreement due to late delivery and/or product defects (except in the cases of force majeure); or (b) termination by us in case our customers fail to pay us in a certain period of time.

PRC trading companies

We also sell our products to PRC trading companies which will further sell our products to third parties paper and paper products manufacturers overseas. Our relationship with our PRC trading company customers is a seller/buyer relationship. We do not set any sales or expansion target or minimum purchase commitment for our PRC trading company customers. Save as the salient terms of our typical sale and purchase agreements set out below, we do not exert any other specific control on our PRC trading company customers. Our Directors consider that selling our products to trading companies is in the interest of our Group as it enables us to expand our market exposure and enlarge our market share in the papermaking felts manufacturing industry. In addition, our Directors are of the view that the trading companies, based on our industry experience, are reliable and reputable with extensive sales networks within the PRC and overseas.

We generally enter into sale and purchase agreements with the PRC trading companies. The salient terms of our typical sale and purchase agreement with the PRC trading companies which is legally binding are summarised as follows:

- *Duration* — We generally enter into the agreement either in the form of purchase order or agreement with a term of one to two years.
- *Price* — The prices are generally determined based on the agreement between the parties as stated in the agreement.
- *Purchase quantity* — The total purchase amount is generally either set out in the agreement or the purchase orders which are separately provided to us from time to time. We do not set any sales or expansion target or minimum purchase commitment for our PRC trading company customers.
- *Credit terms* — While some of our PRC trading company customers are required to settle payment before delivery of our products, we may also grant a credit period of around 30 to 60 days to some of our PRC trading company customers.

BUSINESS

- *Price adjustment* — Generally not specified.
- *Product inspection* — Our products shall comply with the agreed quality standards and requirements and shall be inspected by our customers upon delivery. All title and risks relating to our products were passed to our customers when our products are delivered to our customers.
- *Renewal and termination* — Generally not specified in the agreement which is in the form of purchase order. In certain cases, the agreement can be automatically renewed if neither party requests in writing to amend the terms or to terminate the agreement at least one month before expiration.

Overseas paper and paper products manufacturers and trading companies

To a much lesser extent, we sell our products to overseas paper and paper products manufacturers and trading companies.

For the three years ended 31 December 2020 and the six months ended 30 June 2021, our revenue derived from the overseas paper and paper products manufacturers and trading companies amounted to approximately RMB6.0 million, RMB7.6 million, RMB7.6 million and RMB3.7 million, respectively, representing approximately 3.7%, 4.5%, 4.2% and 4.8% of our total revenue for the same periods, respectively.

Overseas paper and paper products manufacturers

We generally enter into one-off agreements with the overseas paper and paper products manufacturers in the form of purchase order. The salient terms of our typical agreement with the overseas paper and paper products manufacturers which is legally binding are summarised as follows:

- *Duration* — Not applicable.
- *Prices* — The price is generally determined based on the agreement between the parties as stated in each purchase order.
- *Purchase quantity* — The purchase quantity is provided to us as stated in each purchase order.
- *Credit terms* — A certain proportion of the total selling price is generally paid upon the signing of the purchase order, and the remaining shall be settled before shipment.
- *Renewal and termination* — Generally not specified.

BUSINESS

- *Delivery* — Mode and time of delivery are generally stated in each purchase order.

Overseas trading companies

We also sell our products to overseas trading companies which will further sell our products to third parties. We generally enter into one-off agreements with the overseas trading companies in the form of purchase order. Our relationship with our overseas trading company customers is a seller/buyer relationship. We do not set any sales or expansion target or minimum purchase commitment for our overseas trading company customers. Save as the salient terms of our typical sale and purchase agreements set out below, we do not exert any other specific control on the overseas trading company customers. The salient terms of our typical agreement with the overseas trading companies which is legally binding are summarised as follows:

- *Duration* — Not applicable.
- *Prices* — The price is generally determined based on the agreement between the parties as stated in each purchase order.
- *Purchase quantity* — The purchase quantity is provided to us as stated in each purchase order. We do not set any sales or expansion target or minimum purchase commitment for our overseas trading company customers.
- *Credit terms* — Payment will be made after shipment. Credit term is generally not specified in the purchase order and is determined based on mutual agreement on a case-by-case basis.
- *Renewal and termination* — Generally not specified.
- *Delivery* — Mode, time and destination of delivery are generally stated in each purchase order.

Commercial arrangement with our PRC and overseas trading company customers

For the three years ended 31 December 2020 and the six months ended 30 June 2021, our revenue derived from the PRC and overseas trading companies, in aggregate, amounted to approximately RMB20.6 million, RMB26.3 million, RMB24.0 million and RMB11.3 million, respectively, representing approximately 12.9%, 15.7%, 13.1% and 14.8% of our total revenue for the same periods, respectively. The following paragraphs set forth our relationship with our trading company customers.

BUSINESS

Movement in the number of trading company customers

The table below sets forth the movements in the number of our customers which are trading companies during the Track Record Period:

	For the year ended 31 December			Six months ended 30 June
	2018	2019	2020	2021
Opening balance as at the beginning				
of the relevant year/period	50	56	55	65
Additions	21	19	24	8
Termination/expiration	15	20	14	25
Total number as at the end of				
the relevant year/period	56	55	65	48

Product returns arrangement

We do not allow our customers, including those which are trading companies, to return any products sold to them except due to product defects caused by us. Our Directors confirmed that we have not experienced any material incident of product return from our customers during the Track Record Period and up to the Latest Practicable Date. For details of our product returns policy, please refer to the paragraph headed “Product returns and warranty” in this section.

No geographical exclusivity

We do not impose any geographical exclusivity to our customers, including those who are trading companies. To the best knowledge of our Directors, our trading company customers will sell the products to paper and paper products manufacturers overseas, while most of our direct customers are based in the PRC, and as such, our Directors are of the view that there should be minimal risk of cannibalisation among our trading company customers and our direct customers. During the Track Record Period, our Group responded to requests from our trading company customers for providing complimentary after-sales technical advice to their end-customers. Based on our customer database and information provided by our trading company customers, none of these end-customers had previously made any direct purchase from our Group, or purchased our products from more than one trading company.

Further, we generally supply our products to our trading company customers on an order-by-order basis and we do not accept return or exchange of obsolete products. Our seller/buyer relationship with our trading company customers ensures that our customers would likely make purchase orders with us only when they are certain that an active market from the end

BUSINESS

customer exists. As a result, our business model does not require us to exert any control on our trading company customers, nor is it necessary for us to actively monitor the sales and inventory levels of our trading company customers.

Internal control measures to monitor inventory risks

As with all our other customers, we do not allow our trading company customers to return products sold to them except due to product defects caused by us. For details of our product returns policy, please refer to the paragraph headed “Product returns and warranty” in this section. We believe that the risk of inventory accumulation by our customers is insignificant as (i) we do not retain risk of ownership of our products once our products are sold to our customers and legal title has been passed to them; (ii) our customers do not have a legal right to return products to us except for product defects caused by us; (iii) we are not contractually required to repurchase our products if they remain unsold by the trading companies; (iv) we do not guarantee a minimum resale value of our products; and (v) our five largest trading company customers together contributed no more than 10.0% of our total revenue for each of the financial year during the Track Record Period.

Revenue recognition and trade receivables

Revenue from sales of papermaking felts products is recognised at a point in time when the legal title of the finished good is transferred and our Group has present right to payment and the collection of the consideration is probable. Our Directors confirmed that our revenue recognition policy and our trade receivables in respect of trading company customers are the same as those with our paper and paper products manufacturer customers. For further details, please refer to the paragraphs headed “Financial Information — Critical accounting policies, estimates and judgements — Revenue recognition” and “Financial Information — Discussion of selected statement of financial position items — Trade and other receivables” in this document.

Our largest customers during the Track Record Period

For the three years ended 31 December 2020 and the six months ended 30 June 2021, sales to our five largest customers amounted to approximately RMB25.5 million, RMB25.1 million, RMB27.8 million and RMB12.5 million, respectively, representing approximately 16.0%, 15.0%, 15.2% and 16.4% of our total revenue for the same periods, respectively.

BUSINESS

For the three years ended 31 December 2020 and the six months ended 30 June 2021, sales to our largest customer in each year/period during the Track Record Period amounted to approximately RMB7.1 million, RMB5.8 million, RMB7.2 million and RMB3.2 million, respectively, representing approximately 4.5%, 3.5%, 3.9% and 4.1% of our total revenue for the same periods, respectively.

Our Directors believe that any concentration risk among our customers during the Track Record Period was not significant given that there was no single customer that accounted for more than 5% of our total revenue for the three years ended 31 December 2020 and the six months ended 30 June 2021 and our five largest customers accounted for less than 30% of our total revenue for the corresponding periods.

The following tables set out a breakdown of our revenue from our five largest customers during the Track Record Period and their respective background information:

For the year ended 31 December 2018

No.	Customer	Major products sold by our Group	Credit term and payment method	Business relationship since	Revenue from the customer	Percentage of our total revenue
					<i>RMB'000</i>	<i>%</i>
1.	Customer Group A ^(Note 1)	Packaging and specialty papermaking felts	30–120 days; by bank acceptance bills	2016	7,104	4.5
2.	Customer Group B ^(Note 2)	Packaging papermaking felts	60 days; by bank acceptance bills	2016	6,137	3.8
3.	Customer C ^(Note 3)	Packaging, household, printing and pulp papermaking felts	60–90 days; by bank remittance	2011	4,173	2.6
4.	Customer Group D ^(Note 4)	Packaging, household and printing papermaking felts	Before delivery; by bank remittance	2017	4,122	2.6

BUSINESS

No.	Customer	Major products sold by our Group	Credit term and payment method	Business relationship since	Revenue from the customer	Percentage of our total revenue
					<i>RMB'000</i>	<i>%</i>
5.	Customer E <i>(Note 5)</i>	Packaging papermaking felts	90 days; by bank acceptance bills	2016	3,976	2.5
Total					25,512	16.0

For the year ended 31 December 2019

No.	Customer	Major products sold by our Group	Credit term and payment method	Business relationship since	Revenue from the customer	Percentage of our total revenue
					<i>RMB'000</i>	<i>%</i>
1.	Customer Group F <i>(Note 6)</i>	Packaging papermaking felts	90 days; by bank acceptance bills	2014	5,815	3.5
2.	Customer Group G <i>(Note 7)</i>	Packaging and pulp papermaking felts	120 days; by bank acceptance bills	2018	4,939	3.0
3.	Customer Group B <i>(Note 2)</i>	Packaging papermaking felts	60 days; by bank acceptance bills	2016	4,824	2.9
4.	Customer Group A <i>(Note 1)</i>	Packaging and specialty papermaking felts	30-120 days; by bank acceptance bills	2016	4,745	2.8
5.	Customer Group D <i>(Note 4)</i>	Packaging and household papermaking felts	Before delivery; by bank remittance	2017	4,732	2.8
Total					25,055	15.0

BUSINESS

For the year ended 31 December 2020

No.	Customer	Major products sold by our Group	Credit term and payment method	Business relationship since	Revenue from the customer	Percentage of our total revenue
					<i>RMB'000</i>	<i>%</i>
1.	Customer Group G ^(Note 7)	Packaging and pulp papermaking felts	120 days; by bank acceptance bills	2018	7,172	3.9
2.	Customer H ^(Note 8)	Packaging papermaking felts	120 days; by bank acceptance bills	2011	5,667	3.1
3.	Customer A1 ^(Note 9)	Packaging and specialty papermaking felts	30-120 days; by bank acceptance bills	2016	5,590	3.0
4.	Customer I ^(Note 10)	Packaging papermaking felts	180 days; by bank acceptance bills	2009	5,034	2.8
5.	Customer J ^(Note 11)	Specialty papermaking felt	30 days; by bank acceptance bills	2013	4,342	2.4
	Total				27,805	15.2

BUSINESS

For the six months ended 30 June 2021

No.	Customer	Major products sold by our Group	Credit term and payment method	Business relationship since	Revenue from the customer	Percentage of our total revenue
					<i>RMB'000</i>	<i>%</i>
1.	Customer Group G ^(Note 7)	Packaging and pulp papermaking felts	120 days; by bank acceptance bills	2018	3,156	4.1
2.	Customer K ^(Note 12)	Packaging papermaking felts	120 days; by bank acceptance bills	2020	2,594	3.4
3.	Customer I ^(Note 10)	Packaging papermaking felts	180 days; by bank acceptance bills	2009	2,349	3.1
4.	Customer Group F ^(Note 6)	Packaging papermaking felts	90 days; by bank acceptance bills	2014	2,296	3.0
5.	Customer Group D ^(Note 4)	Packaging and household papermaking felts	30 days; by bank remittance	2017	2,122	2.8
Total					12,517	16.4

Notes:

- Customer Group A comprises two private companies, namely, Customer A1 and Customer A2, both of which were incorporated in Shandong, the PRC in December 2014 and January 2015, respectively, and mainly engaged in the production and sales of paper, paper products and plastic products, and sales of machinery and equipment. Customer A1 was owned by Customer A2 as to 50% from January 2018 to June 2019. From June 2019, Customer A1 was owned by two separate shareholders and Customer A2 no longer owned any shares of Customer A1.

To the best knowledge and latest understanding of our Directors, in May 2021, Customer A1 and Customer A2 became the subsidiaries of a company incorporated in the PRC, which their ultimate controlling shareholders included an individual and the Municipal Finance Bureau (the Municipal State-owned Assets Supervision and Administration Commission) in Shandong who are Independent Third Parties, and the directors of Customer A1 and Customer A2 were individuals who are Independent Third Parties. Based on the public information available and to the best knowledge and latest understanding of our Directors, Customer A1 and Customer A2 had around 450 and 180 employees, respectively. As at the Latest Practicable Date, Customer A1 had a registered capital of RMB150.0 million, and the revenue and net loss of Customer A1 in 2019 amounted to approximately RMB1.4 billion and RMB36.8 million, respectively; and Customer A2 had a registered capital of RMB3.0 million, and the revenue and net profit of Customer A2 in 2019 amounted to approximately RMB120.7 million and RMB2.1 million, respectively.

BUSINESS

- Customer Group B comprise two private companies, namely Customer B1 and Customer B2. Customer B1 was a private company incorporated in Fujian, the PRC in July 2004, and mainly engaged in the production of paper, paper products and packaging products. Customer B2 was incorporated in Zhejiang, the PRC in December 2018, and mainly engaged in the production of raw paper. Customer B1 and Customer B2 were subsidiaries of a company listed on the Shanghai Stock Exchange (“**Listed Customers Group B**”) which is an Independent Third Party with a market capitalisation of approximately RMB15.5 billion as at the Latest Practicable Date.

Based on the public information available, the revenue and net profit of Listed Customers Group B for the six months ended 30 June 2021 amounted to approximately RMB15.2 billion and RMB1.0 billion, respectively.

- Customer C is a private company incorporated in Singapore in March 1973, engaged in the trading of industrial materials including papermaking felts.

To the best knowledge and latest understanding of our Directors, Customer C had around 25 employees. To the best knowledge and latest understanding of our Directors, the ultimate controlling shareholders of Customer C included two individuals who are Independent Third Parties and directors of Customer C. To the best knowledge and latest understanding of our Directors, the directors of Customer C included three individuals who are Independent Third Parties. Based on the public information available and to the best knowledge and latest understanding of our Directors, Customer C had a registered capital of approximately SGD2.5 million as at the Latest Practicable Date.

- Customer Group D comprises two private companies, namely, Customer D1 and Customer D2, both of which were incorporated in Guangxi, the PRC in June 2012 and March 2011, respectively, and mainly engaged in the trading of daily life necessities and other products. Customer D1 and Customer D2 had common shareholders.

To the best knowledge and latest understanding of our Directors, Customer D1 had around 10 employees. To the best knowledge and latest understanding of our Directors, the ultimate controlling shareholders of Customer Group D included two individuals who are Independent Third Parties with around or over 10 years of experience in the papermaking industry, and one of the ultimate controlling shareholders of Customer Group D was also the director of Customer Group D. Based on the public information available and to the best knowledge and latest understanding of our Directors, Customer D1 and Customer D2 had a registered capital of RMB2.0 million and RMB0.5 million as at the Latest Practicable Date, respectively, and the revenue and net loss of Customer D1 in 2019 amounted to approximately RMB27.8 million and RMB0.1 million, respectively, and the revenue and net profit of Customer D2 in 2019 amounted to approximately RMB6.3 million and RMB60,000, respectively.

- Customer E is a private company incorporated in Shandong, the PRC in January 2002, and mainly engaged in the production and sales of pulp, paper and paper products, recycling of waste paper and provision of power generation.

To the best knowledge and latest understanding of our Directors, the ultimate controlling shareholders of Customer E included two individuals who are Independent Third Parties with around or over 18 years of experience in the papermaking industry, and the directors of Customer E included three individuals who are Independent Third Parties. Based on the public information available and to the best knowledge and latest understanding of our Directors, Customer E had a registered capital of RMB100.0 million as at the Latest Practicable Date, and the revenue and net loss of Customer E in 2019 amounted to approximately RMB416.8 million and RMB45.7 million, respectively.

- Customer Group F comprises three private companies, namely, Customer F1, Customer F2 and Customer F3, mainly engaged in the production and sales of paper and paper products and the development of environmental protection technologies, which were subsidiaries of a company listed on the Taiwan Stock Exchange Corporation (“**Listed Customers Group F**”) which is an Independent Third Party with a market capitalisation of approximately HK\$10.2 billion as at the Latest Practicable Date. Customer F1 was incorporated in Zhejiang, the PRC in April

BUSINESS

2007; Customer F2 was incorporated in Jiangsu, the PRC in September 1997; and Customer F3 was incorporated in Hubei, the PRC in December 2014. During the Track Record Period, we sold our products to Customer Group F through a service provider.

Based on the public information available, the revenue and net profit of Listed Customers Group F for the six months ended 30 June 2021 amounted to approximately NTD25.1 billion and NTD1.4 billion, respectively.

7. Customer Group G comprises three private companies, namely Customer G1, Customer G2 and Customer G3, all of which were incorporated in Shandong, the PRC in December 2000, January 2008 and September 2017, respectively, and mainly engaged in the production and sales of paper and paper products and provision of papermaking technology services. Customer G1, Customer G2 and Customer G3 were subsidiaries of a company listed on the Main Board of the Stock Exchange (“**Listed Customers Group G**”) which is an Independent Third Party with a market capitalisation approximately HK\$1.6 billion as at the Latest Practicable Date.

Based on the public information available, the revenue and net profit of Listed Customers Group G for the six months ended 30 June 2021 amounted to approximately RMB3.8 billion and RMB334.7 million, respectively.

8. Customer H is a private company incorporated in Anhui, the PRC in January 2002, and mainly engaged in the production and sales of packaging paper.

To the best knowledge and latest understanding of our Directors, Customer H had around 960 employees. To the best knowledge and latest understanding of our Directors, the ultimate controlling shareholder of Customer H was an individual who is an Independent Third Party and also one of the directors of Customer H, and the directors of Customer H included three individuals who are Independent Third Parties. Based on the public information available and to the best knowledge and latest understanding of our Directors, Customer H had a registered capital of RMB50.0 million as at the Latest Practicable Date, and the revenue and net profit of Customer H in 2019 amounted to approximately RMB1.1 billion and RMB4.7 million, respectively.

9. Customer A1 is a private company incorporated in Shandong, the PRC in December 2014, and mainly engaged in the production and sales of paper, paper products and plastic products, and sales of machinery and equipment.

To the best knowledge and latest understanding of our Directors, Customer A1 had around 450 employees. To the best knowledge and latest understanding of our Directors, the ultimate controlling shareholder of Customer A1 included an individual and the Municipal Finance Bureau (the Municipal State-owned Assets Supervision and Administration Commission) in Shandong who are Independent Third Parties, and the director of Customer A1 was an individual who is an Independent Third Party. Based on the public information available and to the best knowledge and latest understanding of our Directors, Customer A1 had a registered capital of RMB150.0 million as at the Latest Practicable Date, and the revenue and net loss of Customer A1 in 2019 amounted to approximately RMB1.4 billion and RMB36.8 million, respectively.

10. Customer I is a private company incorporated in Shandong, the PRC in June 1998, and mainly engaged in the production and sales of gypsum plasterboards.

To the best knowledge and latest understanding of our Directors, Customer I had around 1,860 employees. Based on the public information available, Customer I was an associate whose shares were indirectly held by a company listed on the Main Board of the Hong Kong Stock Exchange principally engaged in cement, new materials and engineering services businesses, and whose immediate and ultimate holding company is a state-owned enterprise established in the PRC. To the best knowledge and latest understanding of our Directors, the directors of Customer I included five individuals who are Independent Third Parties. Based on the public information available and to the

BUSINESS

best knowledge and latest understanding of our Directors, Customer I had a registered capital of approximately RMB155.6 million as at the Latest Practicable Date, and the revenue and net loss of Customer I in 2019 amounted to approximately RMB1.7 billion and RMB1.1 billion, respectively.

11. Customer J is a private company incorporated Shandong, the PRC in February 1990, and mainly engaged in the production and sales of specialty paper. Customer J was a subsidiary of a company listed on the Shenzhen Stock Exchange (“**Listed Customer J**”), which is an Independent Third Party with a market capitalisation of approximately RMB3.4 billion as at the Latest Practicable Date.

Based on the public information available, the revenue and net profit of Listed Customer J for the six months ended 30 June 2021 amounted to approximately RMB1.9 billion and RMB153.5 million, respectively.

12. Customer K is a private company incorporated in Guizhou, the PRC in December 2011, and mainly engaged in the production and sales of paper.

To the best knowledge and latest understanding of our Directors, Customer K had around 430 employees. To the best knowledge and latest understanding of our Directors, the ultimate controlling shareholder of Customer K was the Municipal State-owned Assets Supervision and Administration Commission of the State Council in Guizhou, which is an Independent Third Party, and the directors of Customer K included five individuals who are Independent Third Parties. Based on the public information available and to the best knowledge and latest understanding of our Directors, Customer K had a registered capital of RMB46.0 million as at the Latest Practicable Date, and the revenue and net profit of Customer K in 2020 amounted to approximately RMB20.1 million and RMB0.6 million, respectively.

During the Track Record Period, the transaction amounts between our Group and our major customers generally remained stable. However, due to the fragmented nature of our customer base, the five largest customers’ composition of our major customers may be changed as a result of the change of relatively small amount. As such, our Directors are of the view that there were no significant changes in the composition of our major customers during the Track Record Period. Most of our major customers purchased considerable amount in each financial year/period during the Track Record Period and maintained stable relationship with our Group. To the best knowledge of our Directors, the revenue attributable to Customer Group B decreased since 2020 from approximately RMB4.8 million for the year ended 31 December 2019 to approximately RMB1.8 million for the year ended 31 December 2020 which was mainly due to the changes in their purchase decision of procuring more from their other suppliers and reducing our proportion. The revenue attributable to Customer E decreased in 2019 which, to the best knowledge of our Directors, was mainly due to that this customer ceased the business with us since early 2019 due to their commercial decision.

Our Directors have confirmed that all of our five largest customers during the Track Record Period are Independent Third Parties and none of our Directors, their respective close associates and our Shareholders who own more than 5% of the issued share capital of our Company had any interest in any of the above five largest customers of our Group during the Track Record Period. Save for the ordinary course of business dealings with our top five customers, to the best knowledge of our Directors, there were no past or present relationships or dealings (including

BUSINESS

family, business, employment, trust, fund flow, financing or otherwise) between each of our top five customers, their respective shareholders, directors or senior management, or any of their respective associates on one hand and our Group, Shareholders, Directors or senior management or their respective associates on the other hand during the Track Record Period and up to the Latest Practicable Date.

During the Track Record Period, we commenced certain actions against our customers in relation to the collection of payments from them. Save as the aforesaid, we had no material disputes or claims with our customers which would have had a material impact on our business, financial condition or results of operations during the Track Record Period.

Our Directors confirm that, during the Track Record Period, we did not have any major customers who were also our suppliers.

Credit policy and settlement

While some of our customers are required to settle payment before delivery of our products, we generally grant to our customers a credit period of around 30 to 180 days based on various factors including their years of business relationship with us, their historical payment records and the life span of products they purchase from us. Majority of our customers were granted high-end of the credit period (i.e. 90 days to 180 days) during the Track Record Period. In our standard procedure, we will issue invoices to our customers for payment collection. If we encounter difficulties in collecting payment, we will contact the customer by different means, and if we fail to reach the customer via such arrangement, we will follow our standard collection procedure and commence a series of actions such as initiating legal proceedings before analysing whether to recognise any outstanding amount as bad debt on our accounts.

If a customer fails to pay us punctually, we may also reassess their creditability and adjust credit limits accordingly. We have implemented a system to manage our customers' credit rating, credit limit and credit term. Our sales and marketing department conducts regular visits to our customers to stay updated about their operation conditions and assess their repayment ability. An assessment is made subsequently by our management team and finance and accounting department as to whether or not a provision for trade receivable should be made. For certain customers, we may request for payment of a deposit and settlement of the remaining balance on a cash-on-delivery basis.

Our Directors are of the view that any late payments from individual customers would not adversely affect our financial performance as our Directors believe that any concentration risk among our five largest customers was not significant given their respective contributions to our total revenue.

BUSINESS

Our customers generally settle their payment in Renminbi and by way of bank remittance and/or bank acceptance bills. Our Directors confirm that during the Track Record Period, other than the amounts written off as disclosed in the section headed “Financial Information” in this document, we had not experienced any major defaults in payments or bad debts from our customers which may materially affect our financial condition and operating results.

Business activities in Countries subject to International Sanctions

During the Track Record Period, we sold papermaking felts to (i) customers located in Egypt and Russia (excluding Crimea); and (ii) a customer located in the PRC, with the ultimate end destination or end customers being located in Iran, according to the best knowledge of our Directors. The revenue generated from such transactions related to the Countries subject to International Sanctions was approximately RMB29,000, RMB213,000, RMB571,000 and RMB217,000, representing approximately 0.02%, 0.13%, 0.31% and 0.28% of our total revenue for the years ended 31December 2018, 2019 and 2020, and the six months ended 30 June, 2021, respectively.

Whilst Egypt was subject to targeted sanctions during the Track Record Period, Iran is subject to a comprehensive sanctions program administered by OFAC. Russia is not a Sanctioned Country within the meaning of HKEX GL101-19 issued by the Stock Exchange in March 2019. Russia has been subject to a variety of additional sanctions measures since its actions and claims of sovereignty in Crimea were deemed to be illegal by many Western governments and governmental organisations, including additional sanctions measures adopted by the United States in 2018-2021 period. Further, the region of Crimea, which is part of Russia/Ukraine, is subject to comprehensive international sanctions (the rest of Russia and Ukraine are not subject to such sanctions), and while we have not conducted any business transactions in Crimea during the Track Record Period, the end customers of certain transactions were located in Russia (excluding Crimea). For further details, please refer to the paragraph headed “Regulatory Overview — X. Sanctions laws and regulations” in this document.

As at the Latest Practicable Date, our Group has ceased all transactions with customers located in Egypt, Iran and Russia.

As advised by our International Sanctions Legal Advisers, for the reasons set out below, we did not engage in Primary Sanctioned Activity or Secondary Sanctionable Activity that violated any relevant sanctions regulations as a result of our direct and indirect sales to Iran, Egypt and Russia (excluding Crimea) during the Track Record Period:

- our Company is not incorporated or located in the United States (i.e., it does not have U.S. subsidiaries or U.S. offices, and does not have U.S. person employees) and because it does not otherwise have a nexus with the Relevant Jurisdiction (i.e., it did not conduct

BUSINESS

the transactions involving Iran in U.S. dollars nor did such transactions involve products subject to U.S. law), our Company has not engaged in Primary Sanctioned Activity that could result in any material sanction risk;

- sales of papermaking felts are not among the types of activities targeted by U.S. secondary sanctions, and our transactions did not involve parties designated as Specially Designated Nationals and Blocked Persons ("SDNs"). Therefore, our activities during the Track Record Period involving Iran and Russia (excluding Crimea), which did not involve SDNs or types of activities targeted by U.S. secondary sanctions, mean that we did not engage in Secondary Sanctionable Activity and it does not appear likely that our activities would result in the imposition of sanctions;
- our Company has not been designated as a Sanctioned Target, nor are we located, incorporated, organised or resident in a Sanctioned Country; and
- our Company is not a Sanctioned Trader because we did not derive any revenue during the Track Record Period from business activities with Sanctioned Country entities or persons, or with Sanctioned Targets.

In addition, as advised by our International Sanctions Legal Advisers, we did not engage in any Primary Sanctioned Activity or Secondary Sanctionable Activity for the purpose of the guidance letter HKEX-GL101-19 given that our Directors confirm that as of the date of this document, we had not been designated as a Sanctioned Target or subject to penalties due to any violation of International Sanctions nor have engaged in activity that may result in the imposition of sanctions against us. Further, given the scope of the [REDACTED] and the expected [REDACTED] as set out in this document, our International Sanctions Legal Advisers are of the view that the involvement by parties in the [REDACTED] will not implicate any applicable International Sanctions on such parties, including our Company, our potential investors, Shareholders, the Stock Exchange and the Listing Committee and group companies and accordingly, the sanctions risk exposure to our Company, potential investors and Shareholders, and persons who might, directly or indirectly, be involved in permitting the [REDACTED], trading and clearing of our Shares (including the Stock Exchange, the Listing Committee and related group companies) is very low. As a result, we intend to continue to sell our products to customers in Countries subject to International Sanctions except for Sanctioned Country after [REDACTED] if and when suitable business opportunity arises, subject to our strict adherence to our sanction risk management measures.

BUSINESS

In order to protect the interest of our Group and our Shareholders from economic sanctions risks, we have adopted the following enhanced internal control and risk management measures:

- Know-Your-Client procedures to review the background information (such as identity and nature of business as well as ownership structure) relating to the counterparties to the transaction along with the draft business transaction documentation;
- screening procedures to check the counterparties against the various lists of restricted parties and countries maintained by the U.S., the European Union, the United Nations or Australia, including, without limitation, any government, individual or entity that is the subject of any OFAC-administered sanctions which lists are publicly available, and determine whether the counterparty is, or is owned or controlled by, a person located in Countries subject to International Sanctions or a Sanctioned Person;
- using a compliance clause in contracts with customers, or request a separate certification from customers, confirming that the Group's products will not be exported outside of the country where the product is sold or will not be exported, directly or indirectly, to any Sanctioned Country; and
- enhanced compliance training to ensure awareness of sanctions risks and timely and effective identification and reporting of actual and potential violations.

For details of our sanction risk management measures, please refer to the paragraph headed "Risk management — Sanction risk management" in this section below.

Our Company has further undertaken to the Stock Exchange that we will:

- not directly or indirectly apply the [REDACTED] from the [REDACTED] and any other funds raised through the Stock Exchange to (i) finance or facilitate any Primary Sanctioned Activity and/or Secondary Sanctionable Activity; or (ii) pay any damages for terminating or transferring the relevant contracts that constitute Primary Sanctioned Activity and/or Secondary Sanctionable Activity;
- disclose in our annual and interim reports (i) details of any new and/or existing Primary Sanctioned Activity and/or Secondary Sanctionable Activity; (ii) our efforts in monitoring our business exposure to sanctions risks; and (iii) the current status of, and the anticipated plans for, any new and/or existing Primary Sanctioned Activity and/or Secondary Sanctionable Activity; and
- provide all necessary information to our independent non-executive Directors to ensure they can monitor our compliance with these undertakings.

BUSINESS

SEASONALITY

During the Track Record Period, our revenue was subject to seasonal fluctuations as the sales order during the months of January and September to December are generally higher than that of other months. Our sales for the last quarter for each year during the three years ended 31 December 2020 represented approximately 34%, 42% and 42% of our total sales of the relevant year. Our Directors confirm that this was because our customers, whom are mainly PRC paper and paper products manufacturers and trading companies, generally placed orders prior to the Chinese New Year holidays.

PRICING POLICY

Save for the long-term agreements, we generally determine the price of our products on an order-by-order basis and will set the unit prices of our products with reference to the market trends and price references set out in our pricing policy. We also take reference to the prices offered by our competitors and we may offer price adjustments on a case-by-case basis to enhance our competitiveness. We generally do not offer discounts to our customers under normal circumstances as the final quotations of our products are provided after revisions and negotiations with our customers, taking into consideration of the market trends, product requirements, supply and demand for comparable products and the price of the comparable products in the market. As a result of our pricing policy, our Directors are of the view that we can pass on the increase in costs of raw materials to our customers. Furthermore, our Directors believe that whether or not we can pass the increase in the costs of raw materials to our customers will not have a material impact on our financial condition as the ratio of the costs of raw materials to our total revenue is relatively low, that is, approximately 33.3%, 29.4%, 28.2% and 26.9% for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively.

PRODUCT RETURNS AND WARRANTY

We have implemented procedures to ensure that feedback from customers are handled in a timely and appropriate manner. As a general policy, we accept any product returns due to defects caused by us and bear the costs of such products returned to us after conducting an investigation to ascertain the cause of the defect. Depending on the circumstances of each case, we may replace the defective products or may issue a refund to our customer if the defect is caused by us. Upon receiving a complaint from our customer in relation to a potential product defect, we will conduct an investigation to ascertain the cause of the defect. Our Directors confirm that there was no material product return during the Track Record Period. For the three years ended 31 December 2020 and the six months ended 30 June 2021, warranty provision utilised amounted to approximately RMB2.9 million, RMB2.2 million, RMB3.4 million and RMB1.8 million, respectively.

BUSINESS

OUR SUPPLIERS AND RAW MATERIALS

Monofilaments and fibre which are mainly made from nylon are our major raw materials. Our suppliers, who are mainly based in the PRC, provide us with raw materials, some of which were imported from Germany and Switzerland. For the three years ended 31 December 2020 and the six months ended 30 June 2021, the amount of purchase of raw materials amounted to approximately RMB55.7 million, RMB57.4 million, RMB61.6 million and RMB28.9 million, respectively. The table below sets out the amount of purchase of each of our major raw materials and their respective percentage contributions to the total amount of purchase of raw materials during the Track Record Period:

Raw materials	Year ended 31 December						Six months ended 30 June			
	2018		2019		2020		2020		2021	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%
	(unaudited)									
Monofilaments	20,478	36.7	18,847	32.9	20,128	32.7	7,988	32.4	9,716	33.7
Fibre	28,126	50.5	32,013	55.8	33,166	53.8	14,210	57.6	15,278	52.9
Other raw materials ^(Note)	7,115	12.8	6,511	11.3	8,308	13.5	2,455	10.0	3,874	13.4
Total	<u>55,719</u>	<u>100.0</u>	<u>57,371</u>	<u>100.0</u>	<u>61,602</u>	<u>100.0</u>	<u>24,653</u>	<u>100.0</u>	<u>28,868</u>	<u>100.0</u>

Note: Other raw materials mainly include packaging materials and ancillary materials such as machinery consumables and semi-finished products.

Please refer to the paragraph headed “Financial Information — Key factors affecting our results of operations and financial condition — Fluctuation in our cost of sales” in this document for the sensitivity analysis which illustrates the impact of hypothetical fluctuations in our cost of raw materials on profit before taxation during the Track Record Period.

Our Directors confirm that during the Track Record Period and up to the Latest Practicable Date, we had not encountered any material shortage of, or material difficulties in procuring raw materials or products and we had not experienced any significant delay in the delivery of raw materials or products by our suppliers causing material disruption or delay to our delivery schedules. Our Directors do not foresee that our Group will encounter any material difficulty in the procurement of the raw materials in the future.

We closely monitor the prices of our major raw materials. In response to fluctuations in prices of raw materials, we may negotiate with our customers for a price adjustment before they confirm their purchase orders with us. During the Track Record Period, as confirmed by our Directors, depending on the prices of raw materials, we have established an inventory management policy for our raw materials. We also communicate with our major suppliers from time to time to

BUSINESS

understand the estimated prices of the raw materials in the coming year. We believe that we are able to keep abreast of the latest price trend of our major raw materials, which enables us to make better purchasing decisions.

Our major raw materials are monofilaments and fibre, which made up approximately 87.2%, 88.7%, 86.5% and 86.6% of our total purchase of raw materials for the three years ended 31 December 2020 and the six months ended 30 June 2021.

Selection and evaluation of our suppliers

We maintain a list of approved suppliers that are generally based in the PRC and they are selected based on a number of factors, including product quality, supply capacity, pricing and way of settlement. As confirmed by our Directors, depending on the circumstances, when selecting the approved suppliers, we may request samples of raw materials from suppliers and conduct quality check to ensure that the raw materials supplied are in compliance with our internal quality control standard.

Although we generally source our raw materials from suppliers included in our list of approved suppliers, to avoid reliance on any single supplier, we source each major raw material from more than one supplier. In order to ensure the quality of raw materials, we review our major suppliers' performance periodically by conducting assessment on the quality of their supply of raw materials, their after-sales services, and settlement terms.

We generally enter into procurement agreements with our suppliers and place purchase orders with them from time to time. The salient terms of our typical procurement agreement with the suppliers are summarised as follows:

- *Purchase order* — We shall notify the suppliers of the type, specification, unit price, quantity and date of delivery of the raw materials we need in writing.
- *Price* — Prices will be determined and set out in each purchase order.
- *Inspection and product returns* — Product inspection shall take place within a specified period after delivery of the raw materials to us. We shall be entitled to return to the suppliers the defective raw materials that do not meet the agreed quality standard, and the suppliers shall remedy the same, including product return and replacement.
- *Credit terms and payment method* — The credit period and payment method shall be in accordance with the purchase order.

BUSINESS

- *Termination* — The agreements may be terminated by either party: (a) if the other party fails to perform any of its material obligations under the agreements and fails to remedy such default; or (b) if an insolvency, bankruptcy or similar proceeding is brought by or against the other party.

During the Track Record Period and up to the Latest Practicable Date, we had not adopted any arrangement to hedge any fluctuation in the price of our products and raw materials.

Our largest suppliers during the Track Record Period

For the three years ended 31 December 2020 and the six months ended 30 June 2021, the total purchases from our five largest suppliers amounted to approximately RMB45.1 million, RMB48.0 million, RMB49.8 million and RMB24.0 million, respectively, representing approximately 81.0%, 83.5%, 80.8% and 83.3% of our total purchase of raw materials for the same periods, respectively.

For the three years ended 31 December 2020 and the six months ended 30 June 2021, the total purchases from our largest supplier amounted to approximately RMB24.3 million, RMB29.1 million, RMB30.8 million and RMB14.1 million, respectively, representing approximately 43.6%, 50.7%, 50.0% and 48.9% of our total purchase of raw materials for the same periods, respectively.

Despite such concentration of suppliers, our Directors consider that we are not overly reliant on any single supplier, as there are abundant suppliers providing the same kind of raw materials and we can easily source alternative suppliers in the market.

BUSINESS

The following tables set out a breakdown of the total purchases from our five largest suppliers during the Track Record Period and their respective background information:

For the year ended 31 December 2018

No.	Supplier	Major raw materials purchased by our Group	Credit term and payment method	Business relationship since	The amount of purchase from the supplier	Percentage of our total amount of purchases
					<i>RMB'000</i>	<i>%</i>
1.	Supplier A <i>(Note 1)</i>	Imported nylon fibre	45 days; by bank acceptance bills or bank remittance	2009	24,308	43.6
2.	Supplier B <i>(Note 2)</i>	Nylon monofilaments	30 days; by bank acceptance bills	2010	7,834	14.1
3.	Supplier C <i>(Note 3)</i>	Nylon monofilaments	30-60 days; by bank acceptance bills	2010	5,591	10.0
4.	Supplier D <i>(Note 4)</i>	Nylon monofilaments	30-60 days; by bank acceptance bills	2009	4,162	7.5
5.	Supplier E <i>(Note 5)</i>	Nylon fibre	30 days; by bank acceptance bills	2010	3,243	5.8
Total					45,138	81.0

BUSINESS

For the year ended 31 December 2019

No.	Supplier	Major raw materials purchased by our Group	Credit term and payment method	Business relationship since	The amount of purchase from the supplier	Percentage of our total amount of purchases
					<i>RMB'000</i>	<i>%</i>
1.	Supplier A ^(Note 1)	Imported nylon fibre	45 days; by bank acceptance bills or bank remittance	2009	29,079	50.7
2.	Supplier B ^(Note 2)	Nylon monofilaments	30 days; by bank acceptance bills	2010	7,940	13.8
3.	Supplier D ^(Note 4)	Nylon monofilaments	30-60 days; by bank acceptance bills	2009	5,503	9.6
4.	Supplier C ^(Note 3)	Nylon monofilaments	30-60 days; by bank acceptance bills	2010	3,635	6.3
5.	Supplier F ^(Note 6)	Nylon fibre	30 days; by bank acceptance bills	2019	1,798	3.1
Total					47,955	83.5

BUSINESS

For the year ended 31 December 2020

No.	Supplier	Major raw materials purchased by our Group	Credit term and payment method	Business relationship since	The amount of purchase from the supplier	Percentage of our total amount of purchases
					<i>RMB'000</i>	<i>%</i>
1.	Supplier A ^(Note 1)	Imported nylon fibre	45 days; by bank acceptance bills or bank remittance	2009	30,814	50.0
2.	Supplier B ^(Note 2)	Nylon monofilaments	30 days; by bank acceptance bills	2010	8,593	13.9
3.	Supplier D ^(Note 4)	Nylon monofilaments	30-60 days; by bank acceptance bills	2009	6,237	10.1
4.	Supplier C ^(Note 3)	Nylon monofilaments	30-60 days; by bank acceptance bills	2010	2,168	3.5
5.	Supplier F ^(Note 6)	Nylon fibre	30 days; by bank acceptance bills	2019	2,036	3.3
Total					49,848	80.8

BUSINESS

For the six months ended 30 June 2021

No.	Supplier	Major raw materials purchased by our Group	Credit term and payment method	Business relationship since	The amount of purchase from the supplier <i>RMB'000</i>	Percentage of our total amount of purchases <i>%</i>
1.	Supplier A ^(Note 1)	Imported nylon fibre	45 days; by bank acceptance bills or bank remittance	2009	14,111	48.9
2.	Supplier B ^(Note 2)	Nylon monofilaments	30 days; by bank acceptance bills	2010	4,936	17.1
3.	Supplier D ^(Note 4)	Nylon monofilaments	30-60 days; by bank acceptance bills	2009	3,122	10.8
4.	Supplier F ^(Note 6)	Nylon fibre	30 days; by bank acceptance bills	2019	959	3.3
5.	Supplier G ^(Note 7)	Nylon monofilaments	30-60 days; by bank acceptance bills	2010	921	3.2
Total					24,049	83.3

Notes:

- Supplier A is a private company incorporated in Guangdong, the PRC in April 2003, which mainly engaged in the sales of commodity goods and provision of technical services.

To the best knowledge and latest understanding of our Directors, Supplier A had around 20 employees. To the best knowledge and latest understanding of our Directors, the ultimate controlling shareholders of Supplier A included two individuals who are Independent Third Parties, and one of the ultimate controlling shareholders of Supplier A was also the director of Supplier A. Based on the public information available and to the best knowledge and latest understanding of our Directors, Supplier A had a registered capital of RMB1.0 million as at the Latest Practicable Date, and the revenue and net profit of Supplier A in 2019 amounted to approximately RMB88.4 million and RMB1.1 million, respectively. To the best knowledge and latest understanding of the Directors, Supplier A is a designated trading company of a fibre manufacturer based in Switzerland.

- Supplier B is a private company incorporated in Jiangsu, the PRC in June 2000, which mainly engaged in the production and sales of nylon filaments and plastic products.

To the best knowledge and latest understanding of our Directors, Supplier B had around 50 employees. To the best knowledge and latest understanding of our Directors, the ultimate controlling shareholders of Supplier B included two individuals who are Independent Third Parties, and one of the ultimate controlling shareholders of Supplier B

BUSINESS

was also the director of Supplier B. Based on the public information available and to the best knowledge and latest understanding of our Directors, Supplier B had a registered capital of RMB0.6 million as at the Latest Practicable Date, and the revenue and net profit of Supplier B in 2019 amounted to approximately RMB10.1 million and RMB85,000, respectively.

- Supplier C is a private company incorporated in Henan, the PRC in March 2006, which mainly engaged in the production and sales of plastics and fibre products.

To the best knowledge and latest understanding of our Directors, Supplier C had around 80 employees. To the best knowledge and latest understanding of our Directors, the ultimate controlling shareholder and director of Supplier C was an individual who is an Independent Third Party. Based on the public information available and to the best knowledge and latest understanding of our Directors, Supplier C had a registered capital of RMB10.0 million as at the Latest Practicable Date, and the revenue and net loss of Supplier C in 2019 amounted to approximately RMB17.4 million and RMB0.4 million, respectively.

- Supplier D is a private company incorporated in Jiangsu, the PRC in December 1997, which mainly engaged in the production and sales of fibre and textiles and provision of international trading services.

To the best knowledge and latest understanding of our Directors, Supplier D had around 130 employees. To the best knowledge and latest understanding of our Directors, the ultimate controlling shareholder of Supplier D was a limited company which is an Independent Third Party, and the directors of Supplier D included nine individuals who are Independent Third Parties. Based on the public information available and to the best knowledge and latest understanding of our Directors, Supplier D had a registered capital of USD4.0 million as at the Latest Practicable Date, and the revenue and net profit of Supplier D in 2019 amounted to approximately RMB128.4 million and RMB2.9 million, respectively.

- Supplier E is a private company incorporated in Jiangsu, the PRC in June 1993, which mainly engaged in the production and sales of textiles.

To the best knowledge of our Directors, the ultimate controlling shareholder of Supplier E was an individual who is an Independent Third Party. Based on the public information available and to the best knowledge and latest understanding of our Directors, Supplier E had a registered capital of RMB2.5 million as at the Latest Practicable Date, and the revenue and net loss of Supplier E in 2019 amounted to approximately RMB0.4 million and RMB2.7 million, respectively.

- Supplier F is a private company incorporated in Jiangsu, the PRC in January 2003, which mainly engaged in the production and sales of polyester and nylon fibre.

To the best knowledge and latest understanding of our Directors, Supplier F had around 100 employees. To the best knowledge and latest understanding of our Directors, the ultimate controlling shareholder and director of Supplier F was an individual who is an Independent Third Party. Based on the public information available and to the best knowledge and latest understanding of our Directors, Supplier F had a registered capital of RMB500,000 as at the Latest Practicable Date, and the revenue and net profit of Supplier F in 2019 amounted to approximately RMB35.0 million and RMB1.1 million, respectively.

BUSINESS

7. Supplier G is a private company incorporated in Henan, the PRC in February 2018, which mainly engaged in the production and sales of plastics and fibre products.

To the best knowledge and latest understanding of our Directors, Supplier G had around 50 employees. To the best knowledge and latest understanding of our Directors, the ultimate controlling shareholders of Supplier G was an individual who is an Independent Third Party, and the director of Supplier G was an individual who is an Independent Third Party. Based on the public information available and to the best knowledge and latest understanding of our Directors, Supplier G had a registered capital of RMB10.0 million as at the Latest Practicable Date, and the revenue and net profit of Supplier G in 2020 amounted to approximately RMB3.4 million and RMB30,000, respectively.

Our Directors have confirmed that all of our five largest suppliers during the Track Record Period are Independent Third Parties and none of our Directors, their respective close associates and our Shareholders who own more than 5% of the issued share capital of our Company had any interest in any of the above five largest suppliers of our Group during the Track Record Period. Save for the ordinary course of business dealings with our top five suppliers, to the best knowledge of our Directors, there were no past or present relationships or dealings (including family, business, employment, trust, fund flow, financing or otherwise) between each of our top five suppliers, their respective shareholders, directors or senior management, or any of their respective associates on one hand and our Group, Shareholders, Directors or senior management or their respective associates on the other hand during the Track Record Period and up to the Latest Practicable Date.

During the Track Record Period, we had no disputes or claims with our suppliers which would have a material impact on our business, financial condition or results of operations.

Our Directors confirm that, during the Track Record Period, we did not have any major suppliers who were also our customers.

LOGISTICS

We engage third party logistics service providers to deliver our products to the locations designated by our customers. We settle the logistics fees directly with our third party logistics service providers. To our Directors' belief, our logistics arrangement gives us flexibility over our delivery process and enables us to fulfil urgent orders from our customers. The risk of damage or loss of goods is typically transferred to logistics service providers from the commencement of delivery until the acceptance of the products by our customers, unless otherwise specified in the agreements entered into between our Group and the logistics service providers. Our Directors believe that the operations of third party logistics service providers will ensure sufficient transportation capacity for our future growth.

BUSINESS

RESEARCH AND DEVELOPMENT

We believe our research and development capabilities are the driving force of our long-term competitiveness and our future growth and development. Our market-driven research and development efforts focus on the manufacturing technologies applied to our products with a view to increase our customers’ operational efficiency. As advised by Frost & Sullivan, papermaking machine efficiency optimisation services are only provided by few competitors in the market, which are mainly leading players such as foreign invested enterprises and our Group.

Riding on our research and development capabilities and data we stored in the system, in order to increase customer stickiness to our products, we currently also provide complementary papermaking machine efficiency optimisation services from pre-sales technical advice in the use of suitable products and/or customisation of our products to after-sales technical advice and evaluation of the effectiveness on our customers’ papermaking machine to our customers. We formulate operation efficiency optimisation target for our customers’ papermaking machines through horizontal data comparison based on the data collected from the machines. We are also able to determine the best operating state and operating parameters of our customers’ papermaking machines through longitudinal data comparison by comparing operating efficiency of different papermaking machines based on our experience in providing complementary papermaking machine efficiency optimisation services.

As at the Latest Practicable Date, we have established a dedicated research and development department comprising 15 staff, some of whom had over 10 years of experiences in the production of papermaking felts. In 2012, Sichuan Huanlong was one of the six drafting units, and Mr. Xie, one of our executive Directors who has 18 years of experiences in the papermaking felts manufacturing industry, was a drafter in a group of 10, for the drafting of “China Textile Industry Standard: Batt-on-mesh Papermaking Felts” (中國紡織行業標準：底網造紙毛毯), results of which has subsequently become the industry standard of the papermaking felts manufacturing industry.

Our Directors believe that we are able to select the most appropriate production equipment and processes and apply advanced manufacturing techniques to develop and manufacture products in line with our customers’ specific requirements and practical needs. Our research and development department works closely with other departments such as sales and marketing department and operation department to exchange ideas from time to time to keep abreast of the latest developments in our customers’ business and product requirements. Our research and development department works directly with our customers to develop new products or improve existing ones based on models, prototypes or concepts developed by us.

BUSINESS

As advised by Frost & Sullivan, technology and market know-how serve as key barriers for new market entrants as paper and paper products manufacturers have shown a strong preference of sourcing from papermaking felts manufacturers with distinctive product development capability and technology in design and production of high-speed papermaking felts. Further details, please refer to “Industry Overview — Overview of papermaking felts manufacturing industry in the PRC — Market challenges and constraints” in this document. We have around 14 years of experience in the papermaking felts manufacturing industry and we are committed to continuously innovate in industrial technologies within the papermaking felts manufacturing industry. We are qualified as high and new technology enterprise.

For the three years ended 31 December 2020 and the six months ended 30 June 2021, our research and development expenses amounted to approximately RMB5.4 million, RMB7.3 million, RMB5.7 million and RMB3.0 million, respectively. Our research and development expenditures are primarily used for payment to our external research institutions, our research and development personnel and the procurement of materials used for research.

Our research and development facilitated the successful development and invention which were subsequently registered as patents. As at the Latest Practicable Date, we had registered 99 patents in the PRC. Details of our major patents are set forth below:

Type	Patent number	Patent
Invention patent	ZL200510022040.7	Three-layer seamless bottom net paper press felts* (三層無交織底網造紙壓榨毛毯)
Utility model patent	ZL201220114043.9	Multilayer random seamless papermaking felts* (一種多層任意無交織造紙毛毯)
Utility model patent	ZL201220114041.X	Double-layer blanketless papermaking felts* (一種雙層無毯痕造紙毛毯)
Utility model patent	ZL201420383652.3	Multi-axial press papermaking felts* (用於在紙機上縫合的多軸向壓榨造紙毛毯)
Utility model patent	ZL201420383651.9	Multi-axial base web-looped papermaking felts* (多軸向基網成環的造紙毛毯)
Invention patent	ZL201410330277.0	Base line scribing loop process for seamed papermaking felts* (接縫造紙毛毯的基網劃線成環工藝)

BUSINESS

Type	Patent number	Patent
Invention patent	ZL201410330276.6	High-speed press-slant woven seam papermaking felts and its production process* (高車速高線壓斜織接縫造紙毛毯及其生產工藝)
Invention patent	ZL201610720547.8	Felt tape and its preparation process* (一種氈帶及其製備工藝)
Invention patent	ZL201610714115.6	Composite fibre polyester multi-layer papermaking base structure* (一種複合纖維聚酯多層造紙網結構)
Invention patent	ZL201610714114.1	Composite industrial filter fabric structure with high resistance* (一種具備高抗性的複合工業過濾織物結構)
Invention patent	ZL201610713835.0	Papermaking machine mesh felts and process for producing the papermaking machine mesh felts* (一種造紙機網毯及用於生產該造紙機網毯的工藝)
Invention patent	ZL201910720093.8	Seamless paper press felts manufactured with yarns from yarn creel and its manufacturing method* (一種基於紗架供紗的無交織壓榨毛毯及其製備方法)

As at the Latest Practicable Date, we also had 31 applications of patents in the PRC. Details of which our major patent applications are set out below:

Type	Application number	Patent under application
Invention patent	201711087206.2	Constant tension control method for needling machine used for manufacturing papermaking felts* (一種造紙毛毯針刺機用張力恒定控制方法)
Invention patent	201711108635.3	Hot-pressing forming method for random seamless base papermaking felts* (一種任意無交織基網造紙毛毯熱壓成型方法)

BUSINESS

Type	Application number	Patent under application
Invention patent	201711087191.X	Multi-layer seamless papermaking felts suitable for various papermaking machines* (一種適用於各種紙機的多層無交織造紙毛毯)
Invention patent	201711087209.6	Method for manufacturing multi-axial warping papermaking felts with seamless base* (一種多軸向經編任意無交織基網造紙毛毯製造方法)
Invention patent	201910003674.X	Papermaking felts production method for preventing uneven surface of papermaking felts and the relevant needling machine* (一種可防止毯面不平整的造紙毛毯生產方法及針刺機)
Invention patent	201910003682.4	Automatic high precision papermaking felts needling machine* (一種自動化高精度的造紙毛毯針刺機)
Invention patent	201910003675.4	A new type of high-efficiency anti-breaking papermaking felts needling machine* (一種新型高效防斷針的造紙毛毯針刺機)
Invention patent	201910720094.2	Seamless paper press felts manufactured with warping technique and its manufacturing method* (一種基於整經工藝的無交織壓榨毛毯及其製備方法)
Invention patent	201910571865.6	Method for manufacturing papermaking felts used in high speed vacuum rotary papermaking machines* (一種應用於高速真空圓網造紙機毛毯的製備方法)
Invention patent	201410079137.0	Warp and weft seamless papermaking felts and its manufacturing method* (一種經緯紗無交織造紙毛毯及其製備方法)

BUSINESS

In addition, our efforts in research and development have been recognised by institutions with research and development achievements in which some of our recognised production models have been adopted in our manufacturing process. The following table sets forth our major research and development achievements:

Year	Achievements	Issuing entity
2011	2009-2010 Second Prize of Technology Advancement Award* (2009-2010年度科技進步獎二等獎)	The People’s Government of Wenjiang District, Chengdu City* (成都市溫江區人民政府)
2012	China Textile Industry Standard: Batt-on-mesh Papermaking Felts* (中國紡織行業標準：底網造紙毛毯)	Ministry of Industry and Information Technology of People’s Republic of China* (中國工業和資訊化部)
2013	High-tech Achievement Transformation Project Certification (High-Speed High Pressure-Resistant Bottom Pressing Papermaking Felts Certificate)* (高新技術成果轉化項目證書(高抗壓底網壓榨造紙毛毯))	Shanghai High-tech Achievement Transformation Project Certification Office; Shanghai High-tech Achievement Transformation Service Centre* (上海市高新技術成果轉化專案認定辦公室、上海市高新技術成果轉化服務中心)
2014	Second Prize of Technology Advancement Award of China National Textile and Apparel Council* (中國紡織工業聯合會科學技術進步二等獎)	China National Textile and Apparel Council* (中國紡織工業聯合會)
2014	Top Ten China Industrial Textile Innovative Products / Technologies* (中國產業用紡織品行業十大創新產品／技術)	China Nonwovens & Industrial Textiles Association* (中國產業用紡織品行業協會)
2017	High-tech Achievement Transformation Project Certification (Multi-axial Multi-layer Papermaking Felts Certificate)* (高新技術成果轉化項目證書(多軸向多層造紙毛毯證書))	Shanghai High-tech Achievement Transformation Project Certification Office; Shanghai High-tech Achievement Transformation Service Centre* (上海市高新技術成果轉化專案認定辦公室、上海市高新技術成果轉化服務中心)

BUSINESS

Year	Achievements	Issuing entity
2017	Sichuan Province Technology Advancement Award* (四川省科學技術進步獎證書)	People’s Government of Sichuan Province* (四川省人民政府)
N/A	Nonwovens Technology Advancement and Innovation Unit* (非織造材料技術進步、創新先進企業)	National Nonwovens Construction and Technology Research Centre, National Nonwovens Technology and Information Centre* (國家非織造材料工程技術研究中心、全國非織造科技信息中心)

In addition to in-house research and development capabilities, we have also developed strategic cooperation with universities in the PRC. In 2019 and 2020, we entered into cooperative agreements with universities in the PRC for the research and development on the manufacturing of papermaking felts, in which the results of such may be applied to our production process. Our Directors believe that such collaborations can provide us with the advantages of enhancing our production techniques, improving production efficiency and diversifying our products.

For the three years ended 31 December 2020 and the six months ended 30 June 2021, the amounts incurred for the collaborations with the universities were approximately nil, RMB50,000, RMB50,000 and nil, respectively.

INTELLECTUAL PROPERTY RIGHTS

As at the Latest Practicable Date, we were the registered owner of seven domain names and had 18 trademarks in the PRC, two trademarks in Hong Kong, 99 patents in the PRC and two software copyrights in the PRC. We had also applied for the registration of 31 patents in the PRC as at the Latest Practicable Date.

For details of our intellectual property rights, please refer to the paragraph headed “Statutory and General Information — B. Further information about the business — 2. Intellectual property rights” in Appendix V to this document.

Our Directors confirm that during the Track Record Period and up to the Latest Practicable Date, our Group was not involved in any disputes or litigation relating to the infringement of the intellectual property rights, nor is our Group aware of any such claims either pending or threatened which had a material adverse effect on our business, results of operations, financial conditions and prospect.

BUSINESS

LICENCES, PERMITS AND APPROVALS

Apart from corporate business licences, the following table sets forth the material licences, permits and approvals which are required for our business:

Licences/ Permits/ Approvals	Holder	Issuing entity	Validity period
High and New Technology Enterprise Qualification* (高新技術企業證書)	Sichuan Huanlong	Sichuan Science and Technology Department* (四川省科學技術廳), Sichuan Provincial Department of Finance* (四川省財政廳) and Sichuan Provincial Tax Service, State Taxation Administration* (國家稅務總局四川省稅務局)	From 14 October 2019 to 13 October 2022
Work Safety Standardisation Certificate* (安全生產標準化證書)	Sichuan Huanlong	Emergency Management Bureau of Chengdu Municipality* (成都市應急管理局)	From 15 July 2019 to July 2022
High and New Technology Enterprise Qualification* (高新技術企業證書)	Shanghai Jinxiong	Shanghai Science and Technology Committee* (上海市科學技術委員會), Shanghai Department of Finance* (上海市財政局), Shanghai State Taxation Administration* (上海市國家稅務局) and Shanghai Local Taxation Administration* (上海市地方稅務局)	From 11 November 2020 to 10 November 2023
Work Safety Standardisation Certificate for Small Industry and Trade Enterprises in Shanghai* (上海市工貿小企業安全生產標準化證書)	Shanghai Jinxiong	Shanghai Work Safety Association* (上海市安全生產協會)	Up to December 2022

As advised by our PRC Legal Advisers, during the Track Record Period, we had obtained all material licences, permits and approvals required for our business operation in the PRC.

BUSINESS

CERTIFICATIONS AND AWARDS

Certifications

We have implemented quality control and assurance systems that meet the international and industry standards for our products. In recognition of our quality control efforts, we were certified with a number of ISO certificates during our operating history. A summary of which is set forth in the table below:

Certificates	Nature	Holder	Descriptions	Issuing entity	Validity period
ISO 9001:2015	Quality management system certification	Sichuan Huanlong	The quality management system of our Sichuan Production Site has been assessed and certified as meeting the requirements of ISO 9001:2015 for the production and technical services of papermaking felts	Beijing Zhong Da Hua Yuan Certification Center (北京中大華遠認證中心)	From 12 November 2021 to 15 September 2024
ISO 14001:2015	Environmental management system certification	Sichuan Huanlong	The environmental management system of our Sichuan Production Site has been assessed and certified as meeting the requirements of ISO 14001:2015 for the production and technical services of papermaking felts	Beijing Zhong Da Hua Yuan Certification Center (北京中大華遠認證中心)	From 12 November 2021 to 11 November 2024

BUSINESS

Certificates	Nature	Holder	Descriptions	Issuing entity	Validity period
ISO 45001:2018	Occupation health and safety management system certification	Sichuan Huanlong	The occupational health and safety management system of our Sichuan Production Site has been assessed and certified as meeting the requirements of ISO 45001:2018 for the production and technical services of papermaking felts	Beijing Zhong Da Hua Yuan Certification Center (北京中大華遠認證中心)	From 12 November 2021 to 11 November 2024
ISO 9001:2015	Quality management system certification	Sichuan Huanlong	The management system of our Sichuan Production Site has been assessed and certified as meeting the requirements of ISO 9001:2015 for the production and technical services of papermaking felts	Beijing Zhong Da Hua Yuan Certification Center (北京中大華遠認證中心)	From 12 November 2021 to 15 September 2024
ISO 9001:2015	Quality management system certification	Shanghai Jinxiong	The quality management system of our Shanghai Production Site has been assessed and certified as meeting the requirements of ISO 9001:2015 for the design, development and production of papermaking felts and industrial fabrics	Beijing Zhong Da Hua Yuan Certification Center (北京中大華遠認證中心)	From 8 September 2020 to 7 September 2023

BUSINESS

Certificates	Nature	Holder	Descriptions	Issuing entity	Validity period
ISO 14001:2015	Environmental management system certification	Shanghai Jinxiong	The environmental management system of our Shanghai Production Site has been assessed and certified as meeting the requirements of ISO 14001:2015 for the design, development and production of papermaking felts and industrial fabrics	Beijing Zhong Da Hua Yuan Certification Center (北京中大華遠認證中心)	From 8 September 2020 to 7 September 2023
ISO 45001:2018	Occupational health and safety management system certification	Shanghai Jinxiong	The occupational health and safety management system of our Shanghai Production Site has been assessed and certified as meeting the requirements of ISO 45001:2018 for the design, development and production of papermaking felts and industrial fabrics	Beijing Zhong Da Hua Yuan Certification Center (北京中大華遠認證中心)	From 8 September 2020 to 7 September 2023

During the Track Record Period, we renewed each of the above certifications and did not fail to renew any of them. Our Directors confirm that we do not expect material impediment in renewing any of the above certifications under normal circumstances.

BUSINESS

Awards

Our achievements over the years have been recognised by various awards and accreditations:

Year	Awards/ Recognitions	Awarding institution/ authority
2014	2014 Product Development and Contribution Award* (中國紡織工業聯合會產品開發貢獻獎)	China National Textile and Apparel Council* (中國紡織工業聯合會)
2016	Industry Contribution Award* (中國造紙用紡織品行業貢獻獎)	Papermaking Textile Branch of the China Nonwoven & Industrial Textiles Association* (中國產業用紡織品行業協會)
2016	China Specialty Papers Industry Development Contribution Award* (中國特種紙產業發展貢獻獎)	Specialty Papers Committee of China Technical Association of Paper Industry* (中國造紙學會特種紙專業委員會)
2017	Product Development Contribution Award* (產業開發貢獻獎)	China National Textile And Apparel Council* (中國紡織工業聯合會)
2018	Outstanding Private Enterprise of Wenjiang District* (溫江區優秀民營企業)	The People’s Government of Wenjiang District, Chengdu* (中共成都市溫江區委成都市溫江區人民政府)
2018	Little Giant of Technology Enterprises* (科技小巨人企業)	Shanghai Jinshan District Science and Technology Committee* (上海市金山區科學技術委員會)
2019	Jinshan District Patent Work Demonstration Unit* (金山區專利工作示範單位)	Jinshan District Intellectual Property Office* (金山區知識產權局)

BUSINESS

Year	Awards/ Recognitions	Awarding institution/ authority
2019	Sichuan Provincial Enterprise Technology Centre* (四川省企業技術中心)	Sichuan Provincial Economic and Information Department* (四川省經濟和資訊化廳), Sichuan Provincial Development and Reform Commission* (四川省發展和改革委員會), Sichuan Science and Technology Department* (四川省科學技術廳), Sichuan Provincial Department of Finance* (四川省財政廳), Sichuan Provincial Tax Service, State Taxation Administration* (國家稅務總局四川省稅務局), Sichuan Customs District P.R. China* (中華人民共和國成都海關)
2020	Shanghai Municipal Little Giant of Technology (Training) Enterprise* 上海市科技小巨人(培育)企業	Shanghai Science and Technology Committee* (上海市科學技術委員會), Shanghai Municipal Commission of Economy and Informatisation* (上海市經濟和信息化委員會)
2020	Chengdu Key New Material Enterprise* (成都重點新材料企業)	Chengdu Municipal Bureau of Economic and Information Technology* (成都市經濟和信息化局)

COMPETITION

We are a specialised manufacturer and supplier of papermaking felts to paper and paper products manufacturers and trading companies in the PRC. We face competition from PRC manufacturers as well as overseas manufacturers of similar products for sale to customers in the PRC. According to the Frost & Sullivan Report, (i) the papermaking felts market in the PRC relatively concentrated with the top five players in aggregate accounting for approximately 48.6% of market share in terms of revenue in 2020; (ii) among the top five papermaking felts manufacturers in the PRC market, we were the only papermaking felts manufacturer headquartered in the PRC with an approximate market share of 5.8% in terms of revenue in 2020.

BUSINESS

According to the Frost & Sullivan Report, the principal competitive factors in the papermaking felts manufacturing industry include: (a) product quality, which associates with production efficiency and cost deduction in paper manufacturing process; (b) business relationship with stakeholders, which includes a close business relationship maintained with upstream suppliers, downstream customers and other parties such as research institutions; (c) value-added services, which include pre-sales consulting, customised product design and technical support (including following up of the applicability of papermaking felts in papermaking machines, regular testing of papermaking felts to track the product quality, and assisting customers to enhance the efficiency of papermaking machines); and (d) industry experience and reputation, which indicate proven track record, diversified product portfolio and a professional team of talents that determine the preference of sizeable paper manufacturers.

Furthermore, there are certain major barriers of entry to the papermaking felts manufacturing industry, including: (a) advanced production technology and expertise in developing papermaking felts with enhanced properties, coupled with in-depth experience and know-how in papermaking process; (b) established relationship with customers, as the papermaking felts are often customised based on the type of paper machines and paper products of the customers, paper manufacturers generally show a preference towards established papermaking felts manufacturers as their major suppliers; and (c) ability to acquire and retain technical and management professionals with extensive and comprehensive knowledge and expertise in paper manufacturing, procurement, and research and development of papermaking felts. For details of the competition we face, including the key players in the papermaking felts manufacturing industry in the PRC, please refer to the paragraph headed “Industry Overview — Competitive landscape of papermaking felts manufacturing industry in the PRC” in this document. In addition, our business also faces a number of risks relating to market competition. For further details, please refer to the paragraph headed “Risk Factors — Risks relating to our business and industry” in this document.

BUSINESS

EMPLOYEES

As at the Latest Practicable Date, we employed 316 employees in the PRC. The following table sets forth a breakdown of our employees by department as at the Latest Practicable Date:

Department	Number of employees as at the Latest Practicable Date
Management	4
Finance and accounting	19
Human resources and administration	29
Production	214
Sales and marketing	21
Research and development	15
Operation	10
Supply	3
Project	1
Total	316

Recruitment

We recruit our employees based on their work experience, education background and qualifications. We recruit our employees through internet recruitment and career fair. We aim to hire and retain appropriate and suitable personnel to work for our Group. We assess the available human resources on a continuous basis to determine whether additional personnel are required to cope with our business development.

We have entered into employment contracts with our employees, which set out, among other things, the employee's remuneration, benefits, confidentiality obligations and grounds for termination of the employment. These employment contracts either have no fixed term, or if there is a fixed term, the term is generally up to three years, after which we will evaluate renewals based on performance appraisals.

BUSINESS

We have set up a labour union for our employees in the PRC. Our Directors believe that our employees are among the most valuable assets of our Group and have contributed to the success of our Group. To ensure the successful implementation of our business and growth strategies, we have valued the importance of attracting and retaining experienced and motivated employees at all levels. Our Directors confirm that, during the Track Record Period, we have not experienced any material labour disputes with our employees which had a material impact on our business, financial conditions or result of our operations. Our Directors consider that we have maintained good relationships with our employees.

Remuneration policy and training

The remuneration package offered to our employees generally includes salary, allowances and payment for welfare contributions, including social insurance contributions and housing provident fund contributions. We determine our employees’ remunerations based on each employee’s qualification, relevant experience, position and seniority. We conduct annual review on salary increments, bonuses and promotions based on the performance of each employee.

During the Track Record Period and up to the Latest Practicable Date, save for the instances disclosed in the paragraph headed “Legal proceedings and compliance” in this section, we had made contributions for our employees in the PRC to social security funds (including pension insurance, medical insurance, work-related injury insurance, unemployment insurance and maternity insurance) and housing provident fund. Our total staff cost, including salaries, wages and other benefits, and contributions to defined contribution plans, amounted to approximately RMB25.9 million, RMB24.7 million, RMB26.1 million and RMB15.1 million for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively.

We provide regular on-the-job training to our employees and conduct yearly reviews of their performance. We believe that these initiatives have contributed to stronger work incentive among our employees.

BUSINESS

PROPERTIES

Owned properties

As at the Latest Practicable Date, we owned a parcel of land in Wenjiang District, Chengdu, Sichuan, the PRC with an aggregate site area of approximately 38,391 sq. m. for our Chengdu Production Site, on which buildings with an aggregate gross floor area of approximately 34,613.25 sq. m. were erected. The table below sets forth the information regarding our owned properties as at the Latest Practicable Date:

Type of property	Address	Main usage	Description
Land	No. 519, Section 2, Xinhua Avenue Chengdu Strait Science and Technology Industry Development Park Wenjiang District, Chengdu Sichuan Province, the PRC	Industrial use	A parcel of land with a site area of approximately 38,391 sq. m.
Buildings	No. 519, Section 2, Xinhua Avenue Chengdu Strait Science and Technology Industry Development Park Wenjiang District, Chengdu Sichuan Province, the PRC	Two factory buildings (namely factory building one and factory building two) ^(Note) , one staff dormitory, one staff cafeteria and two power distribution houses	Buildings built on the parcel of land at No. 519, west section of Xinhua Road, Cross-Strait Science and Technology Industrial Development Park, Wenjiang District, Chengdu, Sichuan, the PRC with an aggregate gross floor area of approximately 34,613.25 sq. m.

Note: According to the original construction plan of the Chengdu Production Site, four factory buildings were proposed to be constructed. As at the Latest Practicable Date, two factory buildings were in operation (namely, factory building one and factory building two), of which factory building two was completed construction after the Track Record Period. As at the Latest Practicable Date, Factory building three had been demolished and our Directors confirm that we have no plans to proceed with the construction of factory building four).

In January 2020, Sichuan Huanlong entered into an agreement with a construction contractor to appoint the latter for the construction of factory building two project. Prior to the commencement of the construction of factory building two project in July 2020, Sichuan Huanlong had submitted and obtained approval for the construction design and drawings and was granted the construction project planning permit (建設工程規劃許可證) and the construction project commencement permit (建設工程施工許可證) in relation to the construction of factory building two project, and the construction of factory building two project is covered by the land planning permit (建設用地規劃許可證) in issue. In September 2021, we obtained the construction acceptance report in relation to factory building two project.

BUSINESS

Factory building two project comprises factory building two (with gross floor area of approximately 18,665.64 sq.m.), a power distribution house (with gross floor area of approximately 55.76 sq.m.) and a fire service pump room (which is a structure but not counted as a property). Factory building two may be used for storage of raw materials and finished goods, research and development activities, production process and/or keeping of our machinery and equipment, depending on our operational needs from time to time. After the Track Record Period, the factory building two project have been completed construction and we will apply for the real estate right certificates* (不動產權證書) for it in due course according to the relevant laws. It is estimated that the provisional cost for the development of factory building two project is approximately RMB41.0 million, among which, we have incurred approximately RMB27.5 million as at 30 June 2021. We may use our internal resources and/or bank borrowings as and when further funds are needed for such business expansion.

As at 30 June 2021, we had not obtained the real estate right certificates* (不動產權證書) for the guard room (the “**Guard Room**”) and the factory building three (the “**Factory Building Three**”), and together with the Guard Room, the “**Two Buildings**”). The absence of the real estate right certificates* in relation to the Two Buildings was due to our misunderstanding and lack of sufficient knowledge of the relevant laws and regulations.

As advised by our PRC Legal Advisers, our rights to transfer and mortgage the Two Buildings are restricted due to the fact that the Two Buildings have not obtained the respective real estate right certificates*. As advised by our PRC Legal Advisers, they were not aware of any PRC laws and regulations penalising us for the failure to obtain real estate right certificate*.

Our Directors confirm that: (i) the Guard Room has been demolished in June 2021; and (ii) the demolition work of the Factory Building Three has been completed in August 2021. We will reconstruct Factory Building Three in accordance with relevant laws and regulation. Our Directors take the view that the estimated costs of the aforesaid demolition is minimal.

Our Directors take the view that the failure to obtain the real estate right certificates* of the Two Buildings will not lead to any material issues in relation to land costs. In addition, our Directors confirm that they are not aware of any potential risks in relation to the safety conditions of the Two Buildings.

In view of the above, our Directors are of the view that the operational and financial impact on our Group in relation to the failure to obtain the real estate right certificates* is minimal. As such, our Directors take the view that the adoption of contingency measures will not be necessary.

BUSINESS

Leased properties

As at the Latest Practicable Date, we leased a total of five properties in Fengjing Town, Jinshan District, Shanghai, the PRC with an aggregate gross floor area of approximately 9,006 sq.m. for our Shanghai Production Site. The following table sets forth the particulars of the properties leased by us as at the Latest Practicable Date:

Address	Main usage	Approximate gross floor area	Lease term	Rental rate
Blocks 9-10, No. 78 Shanghai Textile Industry (Jinshan) Park, Jian'an Road, Fengjing Town, Jinshan District, Shanghai, the PRC	Two factory buildings	7,572 sq. m.	From 3 November 2020 to 2 November 2022	RMB1,544,460 per year
Block 3, No. 78, Jian'an Road, Fengjing Town, Jinshan District, Shanghai, the PRC	One factory building	978 sq. m.	From 3 November 2020 to 2 November 2022	RMB177,840 per year
No.70, Jian'an Road, Fengjing Town, Jinshan District, Shanghai, the PRC	Staff dormitory	366 sq. m.	From 1 January 2021 to 31 December 2021	RMB47,304 per year
No. 78-9, Jian'an Road, Fengjing Town, Jinshan District, Shanghai, the PRC	Staff cafeteria	90 sq. m.	From 1 January 2021 to 31 December 2021	RMB11,280 per year

As confirmed by our PRC Legal Advisers, the lease agreements in relation to the above leased properties are legally binding and each respective landlord of the above leased properties has obtained the relevant building ownership certificates.

The above owned and leased properties are used for non-property activities as defined under Rule 5.01(2) of the Listing Rules. Pursuant to Rule 5.01B(2) of the Listing Rules, if the carrying amount (as defined in Rule 5.01(1) of the Listing Rules) of a property interest (as defined in Rule 5.01(3) of the Listing Rules) of an applicant's non-property activities (as defined in Rule 5.01(2) of the Listing Rules) is or is above 15% of its total assets (as defined in Rule 5.01(4) of the Listing Rules), the document shall include the full text of valuation report for such property interest. As the carrying amount of our owned properties, in aggregate, exceeds 15% of our total assets as at 30 June 2021, in order to comply with Rule 5.01B(2) of the Listing Rules, a property valuation report in respect of our owned properties is included in Appendix III to this document.

BUSINESS

According to the property valuation report, our owned properties were valued at RMB66.9 million as at 30 June 2021. Except for the above owned properties, no single property interest that forms part of our non-property activities has a carrying amount of 15% or more of our total assets as at the Latest Practicable Date.

INSURANCE

As at the Latest Practicable Date, our insurance policies include:

- property insurance that covers loss to our major production machinery caused by natural disasters and accidents, including fire, flood, debris, falling objects and water main bursts;
- automobile insurance that covers property damage, medical expenses, personal injury and other third-party liabilities arising from accidents involving our automobiles; and
- environmental liability insurance that covers the environmental protection liability, medical expenses, casualty compensation and cleaning expenses resulting from pollution incidents caused by us.

Our Directors believe that the insurance coverage taken out by us is adequate and consistent with industry norm, having regard to our current operations and the normal commercial practice of the industry.

Certain risks are disclosed in the section headed “Risk Factors” in this document, such as risks in relation to credit risk of our customers, inventory obsolescence, rising labour costs, inability to renew current leases and increase of rental expenses, etc., which are generally not covered by insurance because they are either uninsurable or it is not cost justifiable to insure against such risk. Please refer to the paragraphs headed “Internal control” and “Risk management” in this section for further details.

To minimise our product liability risk, we have stringent quality control measures in order to reduce the incidence of product defects. For details of our quality control measures, please refer to the paragraph headed “Quality management” in this section.

In addition, we are subject to the PRC’s social insurance system and are required to make contributions for our PRC employees. During the Track Record Period, save as disclosed in the paragraph headed “Legal proceedings and compliance — Non-compliances — (2) Non-compliance

BUSINESS

in relation to social insurance contributions” in this section, we contributed to social security insurance for our employees in compliance with the applicable laws, rules and regulations in the PRC in all material respects.

Save as disclosed in the paragraph headed “Legal proceedings and compliance — Non-compliances — (2) Non-compliance in relation to social insurance contributions” in this section, our Directors confirm that we were not subject to any material insurance claims or liabilities arising from our operations during the Track Record Period and we did not make any material insurance claims during the Track Record Period.

HEALTH AND WORKPLACE SAFETY

We are subject to certain PRC occupational health and safety laws and regulations. For details of the applicable occupational health and safety laws and regulations of the PRC, please refer to the paragraph headed “Regulatory Overview — V. PRC laws and regulations in relation to production safety and product quality” in this document.

We are committed to providing a safe and healthy environment for our employees. We provide safety education and training to employees and have in place safety guidelines and operating manuals for our manufacturing process. We also provide our employees with training programmes on work safety in connection with matters such as the operation of equipment with the view to enhance occupational safety and minimising the possibility of work-related accidents and injuries as well as occupational illness. We have established a policy in recording and handling accidents. Upon occurrence of an accident, the employees shall report to the relevant department head and the human resources and administration department within 24 hours to handle the case. The relevant department head shall prepare a report within 72 hours detailing the accident, including date and time of the accident, employees involved, cause, confirmation of responsibility, suggestion on rectification, and submit to the human resources and administration department. The department shall then carry out an investigation, assess the impact of the accident and recommend appropriate measures to improve safety.

According to our PRC Legal Advisers and as confirmed by the competent PRC authorities, we had not been subject to any material penalty imposed by the competent production safety authorities due to non-compliance with the relevant production safety and occupational health laws and regulations during the Track Record Period.

As advised by our PRC Legal Advisers, during the Track Record Period and up to the Latest Practicable Date, we had complied with all the applicable laws and regulations in the PRC relating to health and safety in all material respects.

BUSINESS

Impact of outbreak of COVID-19 on our business

The outbreak of pneumonia-like illness named COVID-19 has been spreading globally. COVID-19 is highly infectious and has resulted in deaths in the PRC and other countries. On 30 January 2020, the World Health Organisation declared the outbreak of COVID-19 as a public health emergency of international concern and subsequently characterised COVID-19 as a pandemic on 11 March 2020. The PRC authorities have taken various measures, such as mandatory quarantine for residents and travelers, lockdown of certain cities and postponement of business units operation following the Chinese New Year holidays until mid of February 2020.

Since late July 2021, the delta variant of COVID-19 has recurred in several provinces across China (the “**Recurrence**”). Our Directors believe that, the Recurrence did not have any material impact on the Group’s business operation and financial performance, mainly because (i) the Recurrence is far less severe in terms of the number of suspected or confirmed cases than the COVID-19 outbreak in early 2020; (ii) the Recurrence was effectively controlled thanks to the quick response of the relevant authorities, and substantially all of the Chinese cities had eased or lifted domestic travel restrictions and resumed normal social activities, work and production as at the Latest Practicable Date; and (iii) the government authorities, our customers and suppliers, and our Company have developed corresponding systems in response to COVID-19 to relieve its potential impact based on past experience.

In light of the aforesaid development, our Directors believe that, based on information as at the Latest Practicable Date, the impact of the COVID-19 outbreak on us was temporary and it would not result in any material disruption to our production and business operations in the long term due to the fact that (i) none of our production facilities are located in the cities or regions affected by lockdowns as at the Latest Practicable Date which would cause material operational disruption; (ii) most of our major customers are not from the cities or regions affected by lockdowns; (iii) our major suppliers are not located in the cities or regions affected by lockdowns, and we have not experienced any material difficulties in making procurement of materials as at the Latest Practicable Date; (iv) as at the Latest Practicable Date, none of our employees had failed to report duty as a result of the COVID-19 outbreak; (v) none of our customers who had placed orders with us before the outbreak of COVID-19 have cancelled their orders and we have been able to perform our contracts with our customers; (vi) based on information as at the Latest Practicable Date, there was no sign of deterioration in the outbreak of COVID-19 in the PRC; and (vii) according to the Frost & Sullivan Report, given that some paper products such as household and specialty papers are considered essential, the impact of COVID-19 outbreak in overseas markets on papermaking felts manufacturers in the PRC is expected to recover in a long term when the outbreak is effectively controlled.

BUSINESS

Notwithstanding our business operation had been temporarily affected by the outbreak of COVID-19 in the first two months of 2020, our Group was able to achieve an overall growth in revenue for the year ended 31 December 2020 as compared to the corresponding period in 2019. Notwithstanding that our gross profit margin decreased slightly in the six months ended 30 June 2021 as compared to the six months ended 30 June 2020, our overall revenue and gross profit increased from approximately RMB66.2 million and RMB34.9 million for the six months ended 30 June 2020 to approximately RMB76.5 million and RMB39.1 million for the six months ended 30 June 2021, respectively. Based on the aforesaid, our executive Directors consider that the outbreak of COVID-19 has not resulted in material adverse impact on our business, financial conditions, results of operations and growth prospects.

Our Directors are closely monitoring the development of outbreak of COVID-19. According to 《Law of the People’s Republic of China on the Prevention and Treatment of Infectious Diseases》 and 《Regulation on the Urgent Handling of Public Health Emergencies》, our Group has established the “Contingency Measures in Response to the Outbreak of COVID-19” 《突發新型冠狀病毒疫情應急預案》 and the “Daily Management Measures” 《日常管理方案》 in order to protect our staff’s health and reduce the risk of infecting coronavirus. The daily precautions included:

- (i) All staff has to conduct daily body temperature check before entering into our Group’s premises.
- (ii) All staff must wear medical mask in our Group’s premises.
- (iii) If any staff has shown symptoms of upper respiratory tract infection/returned from areas severely affected by COVID-19 in the past 14 days/has close contact with the patient of COVID-19, they should conduct home quarantine for 14 days before on duty.
- (iv) The administrative department and production team are responsible for arranging daily disinfection at all our Group’s premises.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE

Our business operation, like other similar business operations in the PRC, is governed by the environmental laws and regulations in the PRC including the Environmental Protection Law of the PRC. For details, please refer to the paragraph headed “Regulatory Overview — VI. PRC laws and regulations in relation to environmental protection” in this document. Our Directors are of the view that our production process does not have a significant adverse effect on the environment, having considered (i) as advised by the relevant authorities in the PRC, business within the heavy pollution industries are not allowed to operate in Chengdu Strait Science and Technology Industry Development Park (where our Chengdu Production Site is situated); (ii) only domestic wastewater

BUSINESS

and domestic waste gas are discharged or emitted during our production process; and (iii) the amount of energy consumed during our production process is insignificant. Our Directors also confirm that our environmental protection measures are adequate to ensure compliance with all the applicable laws and regulations in the PRC. Nevertheless, we consider the protection of the environment to be important.

We are committed to conducting our business operations to comply with all applicable environmental laws and regulations, and endeavour to mitigate any negative effects of our operations on the environment. The management system of our production facilities has been assessed and certified as meeting the requirements of ISO 14001:2015 for the design, development and production of papermaking felts and industrial fabrics.

The Group has several environmental measures in place. As confirmed by our Directors, it is a common practice within the manufacturing industry to engage a company responsible for waste and sewage collection and treatment in accordance with the PRC laws. For this purpose, we engaged an Independent Third Party during the Track Record Period to handle our non-industrial waste and sewage. In addition, we have also engaged an independent consultant to conduct annual inspection on our production sites in relation to wastewater, waste gas and noise level in order to ensure that we meet the relevant discharge or emission standards. Our costs of compliance with the applicable environmental rules and regulations (which comprised of the cost of waste and sewage collection and treatment, discharge of waste residues, inspections and cleanings) were approximately RMB52,000, RMB45,000, RMB41,000 and RMB21,000 for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively. Assuming there are no material changes in the environmental protection laws and regulations in our industry, our Directors expect that we will continue to incur environmental compliance costs annually at a similar level to that incurred for the year ended 31 December 2020 in the future.

We also proactively identify any major environmental and social sustainability risks related to our business, such as environmental and health and safety compliance. We have set up metrics and targets for environmental and health and safety management, to review major environmental and social sustainability risk performance on a regular basis. In respect of water usage and wastewater generation, we evaluate our water usage and wastewater level using the metrics of daily water usage per production site and daily wastewater generated per production site, respectively. We intend to continue to reduce the level of our daily water usage per production site and daily wastewater generated per production site. In respect of waste gas emission, waste gas emitted during our production process is insignificant and cooking oil fumes emitted from our canteen kitchen are treated by a purifier such that the concentration of cooking oil fumes emitted is less than the standard of 2.0 milligram per cubic metre. In respect of noise level, in order to reduce noise generated during our production process, we have adopted comprehensive measures including advanced planning for installation of machinery, sound insulation of buildings and

BUSINESS

factories, and adopting machinery that generates lower level of noise, to keep the noise level at a level not higher than 90 dB(A). In addition, our Group has been promoting low-carbon office practices including the use of online platform and electronic documents for our business process, restrictions in the use of air-conditioner and the use of reusable tableware. We endeavour to review the energy consumption level of our production process regularly and formulate the relevant solutions where needed.

Our PRC Legal Advisers confirms that we are in compliance with all material respect with the applicable environmental laws and regulations in the PRC. During the Track Record Period, as confirmed by the relevant competent government authorities, no administrative sanctions, penalties or punishments have been imposed upon us for the violation of any environmental laws or regulations in the PRC and, so far as our Directors are aware after making all reasonable enquiries, there was no threatened or pending action by any PRC environmental government agencies in respect thereof.

Our Board has the collective and overall responsibility for establishing, adopting and reviewing the environmental, social and governance (“ESG”) vision and target of our Group, identifying the key performance indicators and the relevant measurements and evaluating, determining and addressing our ESG-related risks in accordance with Appendix 27 to the Listing Rules. Our Board will assess, evaluate the ESG risks and review our existing strategy, target and internal controls. Necessary improvement will then be implemented to mitigate the risks.

INTERNAL CONTROL

In preparation for the [REDACTED], we have engaged an internal control consultant to conduct an evaluation of our internal control systems and to review our management of business operations, including our inventory, finance, human resource and IT risks and review and follow up on the effectiveness of our enhanced internal control measures. We have also formulated a policy particularly for granting loans to our employees, including (i) the limit of the loan advanced to each employee depending on the position ranking of that employee; (ii) the reasons of advances which cover expenses for business trips, disbursement, special circumstances such as work injuries and other reasons that comply with our internal rules and regulations; and (iii) the term of advances.

Based on the internal control consultant’s review and recommendations, we have adopted measures and policies to improve its internal control systems and to ensure its compliance with the applicable laws and regulations in the PRC. After the internal control consultant conducted their follow-up review, they have not identified any material deficiencies in our internal control system.

BUSINESS

Based on the above, our Directors are of the view that we have taken reasonable steps to establish an internal control system and procedures to enhance our control on both working and management levels.

RISK MANAGEMENT

In the course of conducting our business, we are exposed to various types of risks, including operational risks, credit risk, market risks and regulatory risks, the details of which have been disclosed in the section headed “Risk Factors” and the paragraph “Financial Information — Key factors affecting our results of operations and financial condition” in this document. Our risk management measures for some of the more particular risks mainly include the following:

- Operational risk management
 - We set up examination and approval procedures for operational issues such as contract signing with our customers and suppliers, employees’ attendance management and repair and maintenance of fixed assets. Our employees are required to report to their respective supervisor within the department or escalate any emergency issues to the head of the department where necessary.
 - Our whistle blowing policy provides a channel for our employees to report and investigate any suspected misconduct, malpractice, irregularity, unlawful or improper incidents.
 - For details of our risk management measures in relation to quality management and inventory management, please refer to the paragraphs headed “Quality management” and “Inventory management” in this section.
- Credit risk management
 - Our sales and marketing department is responsible for collecting receivables from our customers. Our sales representatives conduct regular visits to our customers to examine their operational performance and evaluate their financial capacity to settle payment. The credit periods we grant to our customers range from 30 days to 180 days. In addition, some of our customers are required to settle payment before delivery of our products. We monitor and evaluate overdue payments on a case-by-case basis and consider appropriate follow-up actions such as reissuing invoices, actively communicating with customers and temporarily suspending the supply until repayment. We also have an internal assessment system in place to assess the credit rating of our customers.

BUSINESS

- Market risk management
 - Our internal procurement policy and pricing policy are formulated to ensure prompt reaction to fluctuations in the papermaking felts and paper product markets. For example, our finance and accounting department requests quotations of raw materials from our potential suppliers regularly. In addition, our Directors take part in industry activities and organisations to understand and keep abreast of the market conditions in order to formulate our procurement, pricing and marketing strategies effectively.
- Regulatory risk management
 - For details of our regulatory risk management measures, please refer to the paragraph headed "Corporate governance" in this section.
- Sanction risk management
 - We have adopted enhanced internal control and risk management measures to help us continuously monitor and evaluate our business and take measures to protect the interest of our Group and our Shareholders from economic sanctions risks. The following measures have been implemented as at the Latest Practicable Date:
 - Know-Your-Client procedures to review the background information (such as identity and nature of business as well as ownership structure) relating to the counterparties to the transaction along with the draft business transaction documentation;
 - screening procedures to check the counterparties against the various lists of restricted parties and countries maintained by the U.S., the European Union, the United Nations or Australia, including, without limitation, any government, individual or entity that is the subject of any OFAC-administered sanctions which lists are publicly available, and determine whether the counterparty is, or is owned or controlled by, a person located in Countries subject to International Sanctions or a Sanctioned Person;
 - using a compliance clause in contracts with customers, or request a separate certification from customers, confirming that the Group's products will not be exported outside of the country where the product is sold or will not be exported, directly or indirectly, to any Sanctioned Country; and

BUSINESS

- enhanced compliance training to ensure awareness of sanctions risks and timely and effective identification and reporting of actual and potential violations.

CORPORATE GOVERNANCE

We recognise the value and importance of achieving high corporate governance standards to enhance corporate performance, transparency and accountability, earning the confidence of shareholders and the public. In order to comply with the requirements under the Listing Rules, in particular, the code provisions contained in the corporate governance code and corporate governance report as set out in Appendix 14 (the “Code”) of the Listing Rules, we have adopted the following measures as at the Latest Practicable Date:

- we have established the audit committee, remuneration committee and nomination committee with respective written terms of reference in accordance with the code provisions contained in the Code. Please refer to the section headed “Directors and Senior Management” in this document for further details;
- our Board has adopted the terms of reference with regard to corporate governance and a shareholders’ communication policy in accordance with the code provisions of the Code;
- we have appointed three independent non-executive Directors representing more than one third of the Board and at least one of them has accounting expertise;
- we have established system and manuals in relation to, among others, distribution of annual, interim reports and publication, handling and monitoring of inside information prior to public announcement and other requirements under the Listing Rules;
- our Directors have attended training sessions conducted by our legal advisers as to Hong Kong law on the ongoing obligations and duties of a director of a company whose shares are listed on the Stock Exchange. Our Group will continue to arrange for external training and updates to be provided by its legal advisers on the legal and regulatory requirements applicable to our Group’s business operations to its Directors, senior management and relevant employees;
- we will endeavour to comply with the Corporate Governance Code as set out in Appendix 14 to the Listing Rules. To avoid potential conflicts of interest, we will implement corporate governance measures as set out in the paragraph headed “Relationship with Controlling Shareholders — Corporate governance measures” in this document;

BUSINESS

- we have engaged CMBC International Capital Limited as our compliance adviser pursuant to Rule 3A.19 of the Listing Rules to advise and assist our Board on compliance matters in relation to the Listing Rules and/or other relevant laws and regulations applicable to our Company to ensure that, among other things, we are properly guided and advised as to compliance with the Listing Rules;
- we will consider engaging an independent internal control consultant to have an annual review on the adequacy and effectiveness of our internal control system for the financial year ending 31 December 2021, if necessary, including areas of financial, operational, compliance and risk management; and
- when considered necessary and appropriate, we will seek professional advice and assistance from an independent internal control consultant, external legal advisers and/or other appropriate independent professional advisers with respect to matters relating to our internal controls and legal compliance.

Taking into account the internal control measures implemented by us in connection with the non-compliance incidents disclosed under the paragraph headed “Legal proceedings and compliance” in this section, our ongoing monitoring and supervision with the assistance and advice of external professional advisers where required, and the fact that, as confirmed by our Directors and our PRC Legal Adviser, the non-compliance incidents did not involve fraud or dishonesty, our Directors are of the view that (i) our enhanced internal control measures are adequate and effective; (ii) the suitability of our Directors is compliant with Rules 3.08 and 3.09 of the Listing Rules; and (iii) our Company is suitable for listing under Rule 8.04 of the Listing Rule. Based on the review of the internal control report and other due diligence documents, discussions with our Directors and our Director’s confirmation, nothing has come to the attention of the Sole Sponsor that would cast doubt on the view of our Directors.

LEGAL PROCEEDINGS AND COMPLIANCE

Legal proceedings

Sichuan Huanlong, being the defendant, was involved in a claim in relation to the dispute on the construction of factory building two. In June 2019, the claimant was notified by Sichuan Huanlong that it was selected as the contractor for the construction of factory building two in an open tender. While the parties were in discussion about the terms of the formal construction contract, the claimant had performed certain site preparation works prior to the commencement of the construction of factory building two. Subsequently, no formal contract was entered into by the parties as they could not agree on the contractual terms. Sichuan Huanlong eventually engaged another construction contractor for the construction of factory building two, details of which are set out in the paragraph headed “Properties” above in this section. In June 2020, the claimant lodged a claim against Sichuan Huanlong at Chengdu Wenjiang People’s Court* (成都市溫江區人民法院). The claimant sought compensation for its direct economic loss and notional profit in relation to the tender aforesaid, plus legal costs and interest expenses. Based on the advice of our PRC Legal Advisers, our Directors estimated that the total potential claims payable to the claimant, being the previous constructor, is approximately RMB1.9 million, which included certain site preparation and construction works of approximately RMB0.6 million performed by the

BUSINESS

claimant (in which the amount have been recognised as part of the additions to the property, plant and equipment for the year ended 31 December 2020) and provision of legal claims of approximately RMB1.3 million recognised in profit or loss for the year ended 31 December 2020. The court made the first-instance judgment on 16 July 2021, according to which Sichuan Huanlong was liable to pay the claimant (i) construction fees in sum of approximately RMB0.7 million together with interest; and (ii) damages in sum of approximately RMB1.3 million. As such, a further provision of legal claims of approximately RMB0.3 million recognised in profit or loss for the six months ended 30 June 2021 and approximately RMB2.2 million in aggregate was recorded as provision for legal claim in the statement of financial position of the Group as at 30 June 2021. No party had lodged an appeal to the court and Sichuan Huanlong settled the amount of approximately RMB2.1 million to the claimant according to the aforesaid judgement on 27 August 2021.

Save as the aforesaid claim, during the Track Record Period, we were not involved in any actual or threatened material litigation, arbitration or claim. Besides, save as the aforesaid claim, as at the Latest Practicable Date, none of our Company, any of our subsidiaries or any of our Directors was a party to any material litigation, arbitration or claim that could have a material adverse effect on our financial condition, results of operations or our reputation. To the best of our knowledge, no material litigation, arbitration or administrative proceedings had been threatened against our Company or any of our subsidiaries.

Legal compliance

We are subject to a number of regulatory requirements and guidelines issued by the regulatory authorities in China. Our Directors confirmed that during the Track Record Period and up to the Latest Practicable Date, save for otherwise disclosed in this document, we did not commit any material non-compliance, or experience any systemic non-compliance incident, which taken as a whole, would have a material adverse effect on our business, financial condition and results of operations taken as a whole. As advised by our PRC Legal Advisers, during the Track Record Period and up to the Latest Practicable Date, save as set out below in the paragraph headed “Legal proceedings and compliance — Non-compliances” in this section, we complied with the relevant laws and regulations in all material respects.

BUSINESS

We were involved in certain regulatory non-compliance incidents during the Track Record Period and up to the Latest Practicable Date, the details of which together with a description of the remedial actions are set out below:

Non-compliances

(1) Non-compliance in relation to commencement of construction and delivery of property without obtaining the requisite certificates and permits

Non-compliance incidents	Reason(s) for the non-compliance	Remedial measures and status	Legal consequence and potential financial liabilities
<p>According to the Urban and Rural Planning Law of the PRC (《中華人民共和國城鄉規劃法》), Measures for Construction Permission Management of Construction Projects (《建築工程施工許可管理辦法》), Regulation on Quality Management of Construction Projects (《建設工程質量管理條例》), and other relevant laws and regulations, we are required to obtain construction land planning permit (《建設用地規劃許可證》), construction project planning permit (《建設工程規劃許可證》), and construction project commencement permit (《建設工程施工許可證》) prior to commencement of construction.</p>	<p>The non-compliance was due to our misunderstanding and lack of sufficient knowledge of the relevant laws and regulations.</p>	<p>Upon receipt of advice by our PRC Legal Advisers, Sichuan Huanlong had obtained the Construction Land Planning Permit No. 510115201820160 issued by the Planning Management Bureau of Wenjiang District, Chengdu on 14 May 2018 in respect of the aforementioned parcel of land and Construction Project Planning Permit No. 510115201830558 issued by the Planning Management Bureau of Wenjiang District, Chengdu* (成都市溫江區規劃管理局) on 30 September 2018 in respect of the buildings constructed on the aforementioned parcel of land (except two buildings known as the Factory Building Three and the Guard Room).</p>	<p>We are advised by our PRC Legal Advisers that according to the Urban and Rural Planning Law of the PRC (《中華人民共和國城鄉規劃法》), the relevant authority may order Sichuan Huanlong to demolish the relevant construction within a prescribed time limit, confiscate the relevant property and impose a fine of not more than 10% of the construction cost for our failure to obtain the construction land planning permit and construction project planning permit prior to commencement of construction.</p>
<p>According to the Fire Control Law of the PRC (《中華人民共和國消防法》) and the Rules for the Fire Prevention Oversight and Management of Construction Projects (《建設工程消防監督管理規定》), we are required to complete the fire prevention filing procedure prior to delivery of property.</p> <p>According to the Regulation on Quality Management of Construction Projects and other relevant laws and regulations, we are required to complete the completion acceptance filing before delivery of property.</p>		<p>We have obtained confirmation from the Planning and Natural Resources Bureau of Wenjiang District, Chengdu* (成都市溫江區規劃和自然資源局) on 22 August 2019, 1 July 2020 and 28 January 2021 confirming that no penalty has been imposed on Sichuan Huanlong regarding any breach of the laws and regulations in relation to the failure to obtain construction land planning permit and construction project planning permit on the part of Sichuan Huanlong as at 22 August 2019. Based on an interview with the Planning and Natural Resources Bureau of Wenjiang District, Chengdu, on 23 August 2019, we were informed that no penalty will be imposed on Sichuan Huanlong for our failure to obtain the construction land planning permit and construction project planning permit prior to commencement of construction provided that there are no other illegal construction.</p>	<p>We are advised by our PRC Legal Advisers that according to the Measures for Construction Permission Management of Construction Projects (《建築工程施工許可管理辦法》), Regulation on Quality Management of Construction Projects (《建設工程質量管理條例》), and other relevant laws and regulations, the relevant authority may order us to pay a fine of not more than 1% and less than 2% of the contractual construction cost for our failure to obtain construction project commencement permit prior to commencement of construction.</p>
<p>During the Track Record Period, Sichuan Huanlong has failed to obtain construction land planning permit, construction project planning permit and construction project commencement permit prior to commencement of construction of certain buildings over the parcel of land situated at No. 519, west section of Xinhua Road, Cross-Strait Science and Technology Industrial Development Park, Wenjiang District, Chengdu, Sichuan, the PRC. Sichuan Huanlong has also failed to complete the fire prevention filing procedure and completion acceptance filing before delivery of property for use.</p>			<p>We are advised by our PRC Legal Advisers that according to the Fire Control Law of the PRC (《中華人民共和國消防法》) and the Rules for the Fire Prevention Oversight and Management of Construction Projects (《建設工程消防監督管理規定》), the relevant authority may order us to pay a fine of not more than RMB5,000 for our failure to complete the fire prevention filing procedure prior to delivery of property.</p>

BUSINESS

Non-compliance incidents	Reason(s) for the non-compliance	Remedial measures and status	Legal consequence and potential financial liabilities
	<p>In respect of the property and buildings on the parcel of land referred to in the Real Estate Right Certificate* (Chuan (2020) Wenjiang District (Real Estate) No.0075516) as at 30 December 2020, Ms. Shen and Mr. Zhou, the actual controllers of Sichuan Huanlong, committed in writing that they will fully and unconditionally compensate for any penalties, expenses or economic losses suffered or incurred by Sichuan Huanlong as a result of any non-compliance in relation to planning, construction works, engineering/property or fire control.</p>	<p>Sichuan Huanlong had completed all the fire prevention filing procedures with the fire brigade of Wenjiang District, Chengdu on or before 3 December 2018 in respect of the parcel of land situated at No. 519, west section of Xinhua Road, Cross-Strait Science and Technology Industrial Development Park, Wenjiang District, Chengdu, Sichuan, the PRC (except two buildings known as the Factory Building Three and the Guard Room).</p> <p>We have obtained the construction project commencement permit from the relevant authority on 9 July 2020.</p>	<p>We are advised by our PRC Legal Advisers that according to the Regulation on Quality Management of Construction Projects and other relevant laws and regulations, the relevant authority may order us to make rectification and pay a fine of more than RMB200,000 and less than RMB500,000 for our failure to complete the completion acceptance filing before delivery of property.</p>
	<p>In respect of the property and buildings on the parcel of land referred to in the Real Estate Right Certificate* (Chuan (2020) Wenjiang District (Real Estate) No.0075516) as at 30 December 2020, we will not arrange to obtain the construction project commencement permits and complete the completion acceptance filing, for the reasons that (i) the real estate right certificate* as advised by our PRC Legal Advisers, already represent the legal evidences for titles of the property and buildings based on PRC Property Law; and (ii) based on an interview with Urban and Rural Housing Construction Bureau of Wenjiang District, Chengdu* (成都市溫江區住房和城鄉建設局), on 10 September 2019, we were informed that no penalty will be imposed on Sichuan Huanlong for our failure to obtain the construction project commencement permit prior to commencement of construction of the aforesaid property and buildings and to complete the completion acceptance filing before delivery of the aforesaid property and buildings.</p>	<p>We have obtained confirmation from the Urban and Rural Housing Construction Bureau of Wenjiang District, Chengdu* (成都市溫江區住房和城鄉建設局) on 15 July 2020 and 28 January 2021 confirming that no penalty in respect to violations of housing and urban and rural construction and other related laws and regulations has been imposed upon Sichuan Huanlong, and Sichuan Huanlong was not under investigation or liable for an administrative penalty as at the respective dates.</p> <p>We have obtained confirmation from the fire brigade of Wenjiang District, Chengdu on 22 January 2021 confirming that no administrative penalty has been imposed on Sichuan Huanlong from the fire brigade as at 22 January 2021.</p>	<p>As advised by our PRC Legal Advisers, the Planning and Natural Resources Bureau of Wenjiang District, Chengdu* (成都市溫江區規劃和自然資源局), the Urban and Rural Housing Construction Bureau of Wenjiang District, Chengdu* (成都市溫江區住房和城鄉建設局) and the fire brigade of Wenjiang District, Chengdu are competent to issue the aforesaid confirmations.</p> <p>Our PRC Legal Advisers are of the view that the possibility of having an actual material adverse effect on the existence, operation and production of Sichuan Huanlong due to our failure to (i) obtain construction land planning permit, construction project planning permit and construction project commercial permit within the prescribed period; (ii) complete the fire prevention filing procedure prior to delivery of property; and (iii) complete the completion acceptance filing before delivery of property, is relatively small.</p> <p>Based on the view of our PRC Legal Advisers and the Deed of Indemnity, our Directors confirm that the aforesaid non-compliance incidents would not have material adverse effect on the Group's business operation and financial condition.</p>

BUSINESS

Non-compliance incidents	Reason(s) for the non-compliance	Remedial measures and status	Legal consequence and potential financial liabilities
	<p>In respect of properties we have yet to obtain Real Estate Right Certificate*, namely Factory Building Three and Guard Room, the Directors confirmed that:-</p> <p>(i) Factory Building Three was left idle and the demolition work of Factory Building Three has been completed in August 2021. The Company is in the process of arranging for reconstruction of Factory Building Three according to relevant laws and regulations; and</p> <p>(ii) Guard Room has been demolished in June 2021 according to relevant laws and regulations.</p> <p>Our PRC Legal Advisers are of the view that there are flaws in the reporting and construction procedures of the Factory Building Three and the Guard Room of Sichuan Huanlong. Although relevant laws and regulations provide for penalties as already set out in the column “Legal Consequence and potential financial liabilities” in this Document, our PRC Legal Advisers are of the view that Sichuan Huanlong’s production and operation is less likely to have a significant adverse impact due to the penalty for such non-compliance incident.</p> <p>As mentioned above, Sichuan Huanlong has undertaken to reconstruct the Factory Building Three in accordance with the regulations of the regulatory authorities.</p>		

BUSINESS

(2) Non-compliance in relation to social insurance contributions

Non-compliance incidents	Reason(s) for the non-compliance	Remedial measures and status	Legal consequence and potential financial liabilities
<p>According to the Social Insurance Law of the PRC (中華人民共和國社會保險法) and other relevant regulations, we are required to make social insurance contribution in full for all of our employees.</p> <p>During the three years ended 31 December 2020, Sichuan Huanlong has failed to make full contributions to the social insurance contribution for our employees.</p> <p>The outstanding amounts of the social insurance contribution for the three years ended 31 December 2020 were approximately RMB1.8 million, RMB1.3 million and RMB0.2 million, respectively, totalling RMB3.3 million.</p>	<p>The non-compliance was due to our lack of sufficient knowledge of the relevant laws and regulations that we made social insurance contributions based on a standard which we understood to be acceptable by the local authorities, instead of based on the actual wages of employees.</p>	<p>We have obtained confirmation from Chengdu City Wenjiang District Human Resources and Social Security Bureau* (成都市溫江區人力資源和社會保障局) on 22 July 2019, 13 March 2020, 3 July 2020 and 22 January 2021 confirming that no demand of payment or penalty has been issued against Sichuan Huanlong regarding any breach of the laws and regulations in relation to social insurance contribution.</p> <p>On 21 September 2018, the Ministry of Human Resources and Social Security released an Urgent Notice on Enforcing the Requirement of the General Meeting of the State Council and Stabilization the Levy of Social Insurance Payment (關於貫徹落實國務院會議精神切實做好穩定社保費徵收工作的緊急通知) and required that the policies for both the rate and basis of social insurance contributions shall remain unchanged until the reform on the transfer of the authority for social insurance has been completed. On 16 November 2018, the State Administration of Taxation released the Notice of Certain Measures on Further Supporting and Serving the Development of Private Economy (關於實施進一步支援和服務民營經濟發展若干措施的通知), which provides that the policy for social insurance shall remain stable and the State Administration of Taxation will pursue to lower the social insurance contribution rates with the relevant authorities, and ensure the overall burden of social insurance contribution on enterprises will be lowered.</p> <p>Ms. Shen and Mr. Zhou, the actual controllers of Sichuan Huanlong, committed in writing that they will fully and unconditionally make the social insurance contribution since the establishment of Sichuan Huanlong, when required by Chengdu City Wenjiang District Human Resources and Social Security Bureau* (成都市溫江區人力資源和社會保障局) and/or other regulatory authorities; in addition, Ms. Shen and Mr. Zhou will fully and unconditionally compensate for any other expenses or economic losses incurred by Sichuan Huanlong as it failed to make social insurance contributions for its employees as required.</p> <p>Our Directors undertake to use their best endeavours to comply with applicable laws and regulations. As of 30 June 2019, we had increased the amount of social insurance contribution we made for our employees. As of 22 April 2020, we had made reporting of the social insurance contribution in full for all employees.</p> <p>We have established an internal control team to monitor our on-going compliance with the social insurance contribution regulations and oversee the implementation of any necessary measures to comply with the applicable laws and regulations.</p> <p>We will disclose the process of the aforesaid rectification in our interim/annual reports as appropriate.</p>	<p>We are advised by our PRC Legal Advisers that according to the Social Insurance Law of the PRC (中華人民共和國社會保險法), a daily overdue late fee of 0.05% of the outstanding social insurance contribution may be imposed by the competent authorities from the due date. If Sichuan Huanlong fails to make full payment of the outstanding social insurance contribution and the overdue late fee within the prescribed time limit upon notification(s) or request(s) for payment, a fine in the amount of one to three times of the total outstanding contribution may be imposed.</p> <p>As of the Latest Practicable Date, Sichuan Huanlong has not received any notification(s) or request(s) from the relevant government authorities requesting Sichuan Huanlong to pay the outstanding amounts of social insurance contribution and the overdue late fee within a prescribed period.</p> <p>As advised by our PRC Legal Advisers, Chengdu City Wenjiang District Human Resources and Social Security Bureau* (成都市溫江區人力資源和社會保障局) is competent to issue the aforesaid confirmation. Our PRC Legal Advisers is of the view that the possibility of having an actual material adverse effect on the existence operation and production of Sichuan Huanlong due to our failure to make social insurance contribution in full for all of our employees during the Trade Record Period is relatively small. Based on the view of our PRC Legal Advisers and the Deed of Indemnity, our Directors confirm that such non-compliance incident would not have material adverse effect on the Group's business operation and financial condition.</p>

BUSINESS

(3) Non-compliance in relation to housing provident fund contributions

Non-compliance incidents	Reason(s) for the non-compliance	Remedial measures and status	Legal consequence and potential financial liabilities
<p>According to the Regulation on Administration of Housing Provident Fund (住房公積金管理條例), we are required to (i) register with the housing provident fund management authority within 30 days from the date of its establishment, and complete the housing provident fund account opening procedures for our employees within 20 days from the date of the aforesaid registration; and (ii) make full contribution to the housing provident fund.</p> <p>During the three years ended 31 December 2020, Sichuan Huanlong has failed to (i) register with the housing provident fund management authority within the time limit and complete the housing provident fund account opening procedures for our employees within the time limit; and (ii) make full contribution to the housing provident fund.</p> <p>The outstanding amounts of the housing provident fund contribution for the three years ended 31 December 2020 were approximately RMB0.5 million, RMB0.4 million and RMB0.1 million, respectively, totalling RMB1.0 million.</p>	<p>The non-compliance was due to our lack of sufficient knowledge of the relevant laws and regulations that failed to: (i) register with the housing provident fund management authority within the time limit and complete the housing provident fund account opening procedures for our employees within the time limit; and (ii) make full contribution to the housing provident fund.</p>	<p>Sichuan Huanlong has (i) registered with the housing provident fund management authority in June 2019 and completed the housing provident fund account opening procedures for our employees in June 2019; and (ii) made contribution to the housing provident fund since June 2019.</p> <p>We have obtained confirmation from Chengdu Housing Provident Funds Management Centre* (成都住房公積金管理中心) on 29 January 2021 confirming that Sichuan Huanlong has made contribution to housing provident fund from June 2019 to January 2021. Based on an interview with Chengdu Housing Provident Funds Management Centre* (成都住房公積金管理中心), on 23 August 2019, we were informed that no penalty order has been issued by Chengdu Housing Provident Funds Management Centre* (成都住房公積金管理中心) against Sichuan Huanlong regarding any breach of the laws and regulations in relation to housing provident fund.</p> <p>In addition, in July 2019, certain employees of Sichuan Huanlong provided written confirmations to us, confirming that (i) they understood and acknowledged the amount and the level of payment of the housing provident funds paid by us; and (ii) they would not make any claims in any forms concerning our payment of housing provident funds.</p>	<p>According to the Regulation on Administration of Housing Provident Fund (住房公積金管理條例), the competent authorities have the power to order the employers who failed to make housing provident fund contribution in accordance with the PRC law and regulations to make contribution within a prescribed time limit. If the employers still fail to make the housing provident fund contribution, an application for compulsory enforcement against the employers can be made by employees to the People's Court of the PRC.</p> <p>As of the Latest Practicable Date, Sichuan Huanlong has not received any notification(s) or request(s) from the relevant government authorities requesting Sichuan Huanlong to pay the outstanding housing provident fund contribution within a prescribed period.</p>
<p>Ms. Shen and Mr. Zhou will fully and unconditionally pay for the under-payment of housing provident fund contributions since the establishment of Sichuan Huanlong, when required by Housing Provident Funds Management Centre* (住房公積金管理中心) and/or other regulatory authorities; in addition, Ms. Shen and Mr. Zhou will fully and unconditionally compensate for any other expenses or economic losses incurred by Sichuan Huanlong as it failed to register with the housing provident fund management authority or failed to make contribution to the housing provident fund for its employees as required.</p> <p>Our Directors undertake to use their best endeavours to comply with applicable laws and regulations. As of 30 June 2019, we had increased the amount of housing provident fund contribution we made for our employees. As of 22 April 2020, we had made reporting of the housing provident fund contribution in full for all employees.</p> <p>We have established an internal control team to monitor our on-going compliance with the housing provident fund contribution regulations and oversee the implementation of any necessary measures to comply with the applicable laws and regulations.</p> <p>We will disclose the process of the aforesaid rectification in our interim/annual reports as appropriate.</p>	<p>Ms. Shen and Mr. Zhou, the actual controllers of Sichuan Huanlong, committed in writing that they will fully and unconditionally pay for the under-payment of housing provident fund contributions since the establishment of Sichuan Huanlong, when required by Housing Provident Funds Management Centre* (住房公積金管理中心) and/or other regulatory authorities; in addition, Ms. Shen and Mr. Zhou will fully and unconditionally compensate for any other expenses or economic losses incurred by Sichuan Huanlong as it failed to register with the housing provident fund management authority or failed to make contribution to the housing provident fund for its employees as required.</p> <p>Our Directors undertake to use their best endeavours to comply with applicable laws and regulations. As of 30 June 2019, we had increased the amount of housing provident fund contribution we made for our employees. As of 22 April 2020, we had made reporting of the housing provident fund contribution in full for all employees.</p> <p>We have established an internal control team to monitor our on-going compliance with the housing provident fund contribution regulations and oversee the implementation of any necessary measures to comply with the applicable laws and regulations.</p> <p>We will disclose the process of the aforesaid rectification in our interim/annual reports as appropriate.</p>	<p>As advised by our PRC Legal Advisers, Chengdu Housing Provident Funds Management Centre* (成都住房公積金管理中心) is competent to issue the aforesaid confirmation. Our PRC Legal Advisers is of the view that the possibility of having an actual material adverse effect on the existence operation and production of Sichuan Huanlong due to our failure to make housing provident fund contribution in full for all of our employees during the Trade Record Period is relatively small. Based on the view of our PRC Legal Advisers and the Deed of Indemnity, our Directors confirm that such non-compliance incident would not have material adverse effect on the Group's business operation and financial condition.</p>	<p>As advised by our PRC Legal Advisers, Chengdu Housing Provident Funds Management Centre* (成都住房公積金管理中心) is competent to issue the aforesaid confirmation. Our PRC Legal Advisers is of the view that the possibility of having an actual material adverse effect on the existence operation and production of Sichuan Huanlong due to our failure to make housing provident fund contribution in full for all of our employees during the Trade Record Period is relatively small. Based on the view of our PRC Legal Advisers and the Deed of Indemnity, our Directors confirm that such non-compliance incident would not have material adverse effect on the Group's business operation and financial condition.</p>

BUSINESS

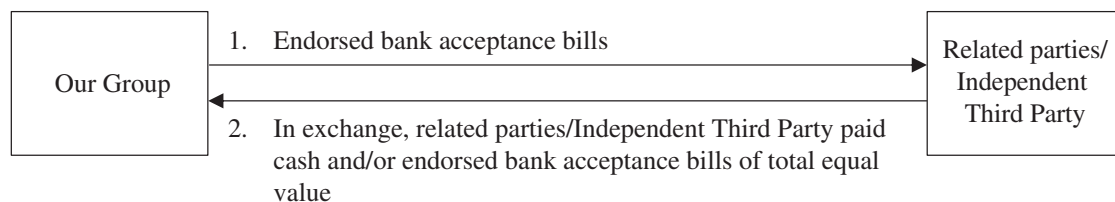
(4) Bills arrangements

During the Track Record Period, we entered into some bills arrangements under the following two scenarios:

Scenario One — Bills-To-Cash/Bills Arrangement

Background

During its ordinary course of business, our Group receives a number of bank acceptance bills with relatively small face value from its customers. During the Track Record Period, our Group had bill transactions with two related parties and an Independent Third Party (who was a former related party) which involved (i) discounting bank acceptance bills for cash for working capital and/or (ii) swapping bank acceptance bills with smaller face value for bank acceptance bills with larger face value (“**Bills-To-Cash/Bills Arrangement**”). The latter arrangement was undertaken because our Company is of the view that the PRC banks are generally more willing to accept bank acceptance bills with larger face value due to administrative convenience as it would involve less administrative work and less time to handle fewer bank acceptance bills with larger face value as compared with a larger number of bank acceptance bills with smaller face value, and because of the administrative convenience to our Company of not having to complete the relevant administrative procedures for larger number of bank acceptance bills with smaller face value. No interest cost or finance cost was paid to the related parties and/or the Independent Third Party under this arrangement. Therefore, the Bills-To-Cash/Bills Arrangement is a financing arrangement (for discounting bank acceptance bills into cash) or a financing facilitating arrangement (for swapping bank acceptance bills with smaller face value to bank acceptance bills with larger face value for more convenient handling by banks when discounting into cash or receiving cash upon maturity of the bank acceptance bills). The following diagram illustrates the processes generally involved:



The tables below set out the total number and corresponding total gross amount of bills endorsed and received by the Group in respect of the Bills-To-Cash/Bills Arrangement for the Track Record Period.

BUSINESS

Bills-To-Cash/Bills Arrangement with related parties

For the Track Record Period, our Group endorsed 147, 94, nil and nil bank acceptance bills, amounting to approximately RMB18.4 million, RMB8.8 million, nil and nil, respectively, to two related parties namely Chengdu Huanlong and Sichuan Huanlong New Material Ltd.* (四川環龍新材料有限公司) under the Bills-To-Cash/Bills Arrangement with related parties.

	For the year ended 31 December						For the six months ended 30 June	
	2018		2019		2020		2021	
	10		2		Nil		Nil	
Number of transactions involved ^(Note 1)								
	<i>Number of bills</i>		<i>Number of bills</i>		<i>Number of bills</i>		<i>Number of bills</i>	
	<i>RMB'000</i>		<i>RMB'000</i>		<i>RMB'000</i>		<i>RMB'000</i>	
Bills transferred out by our Group	147	18,417	94	8,786 <i>(Note2)</i>	Nil	Nil	Nil	Nil
Bills and cash received by our Group in exchange:								
— Bills	Nil	Nil	1	5,000	Nil	Nil	Nil	Nil
— Cash	N/A	18,417	N/A	3,794	N/A	Nil	N/A	Nil
				8,794 <i>(Note2)</i>				
Subtotal.	Nil	18,417	1	8,794 <i>(Note2)</i>	Nil	Nil	Nil	Nil

Notes:

- The number of transactions involved refers to the number of times our Group conducted discounting or swapping of bank acceptance bills with related parties (i.e. multiple number of bills with smaller face value in exchange for one bill with larger face value was treated as one transaction, or multiple number of bills in exchange for a cash payment was treated as one transaction).
- There was an insignificant difference of RMB8,000 due to the following: In order to match the exact amount of face value of a RMB5.0 million bill received by our Group from the related party in exchange for 57 bills from our Group with aggregate face value of RMB4,992,000 in one of the two transactions in the year ended 31 December 2019, cash of RMB8,000 was paid by our Group to the related party. The remaining 37 bills from our Group with aggregate face value of RMB3,794,000 were entirely exchanged for cash from the related party in another transaction in the year ended 31 December 2019.

BUSINESS

Bills-To-Cash/Bills Arrangement with an Independent Third Party

For the Track Record Period, our Group endorsed a total of 20, 47, nil and nil bank acceptance bills, amounting to approximately RMB1.5 million, RMB3.2 million, nil and nil, respectively, under the Bills-To-Cash/Bills Arrangement with an Independent Third Party. Such Independent Third Party was a former related party of our Group from December 2016 to April 2017, respectively.

	For the year ended 31 December						For the six months ended 30 June	
	2018		2019		2020		2021	
Number of transactions involved ^(Note)	2		4		Nil		Nil	
	<i>Number of bills</i>	<i>RMB'000</i>	<i>Number of bills</i>	<i>RMB'000</i>	<i>Number of bills</i>	<i>RMB'000</i>	<i>Number of bills</i>	<i>RMB'000</i>
Bills transferred out by our Group	20	1,500	47	3,175	Nil	Nil	Nil	Nil
Received by our Group:								
— Bills	1	500	7	3,165	Nil	Nil	Nil	Nil
— Cash	N/A	1,000	N/A	10	N/A	Nil	N/A	Nil
Subtotal.	<u>1</u>	<u>1,500</u>	<u>7</u>	<u>3,175</u>	<u>Nil</u>	<u>Nil</u>	<u>Nil</u>	<u>Nil</u>

Note: The number of transactions involved refers to the number of times our Group conducted discounting or swapping of bank acceptance bills with the Independent Third Party (i.e. multiple number of bills with smaller face value in exchange for one bill with larger face value was treated as one transaction, or multiple number of bills in exchange for a cash payment was treated as one transaction).

Save as the bank acceptance bills involved, during the Track Record Period, there was no written contract or other side agreement entered into between our Group and our related party or the Independent Third Party in relation to the Bills-To-Cash/Bills Arrangement.

PRC laws and regulations

According to Article 10 of the Law on Negotiable Instruments of the PRC (《中華人民共和國票據法》, as amended in 2004 (“**Law on Negotiable Instruments**”)), the issuance, acquisition and transfer of a negotiable instrument shall follow the principle of authenticity and credibility and shall possess real underlying transactions and debtor-creditor relationships. As advised by our PRC Legal Advisers, there is no mandatory requirement that the Bills-To-Cash/Bills Arrangement must be carried out with financial institutions. As the amount of bills swapped by our Group for bills or cash with the counterparties under the Bills-To-Cash/Bills Arrangement did not correspond to any

BUSINESS

transaction of goods and/or services, the act of swapping bills for cash and/or together with bills of total equal value did not comply with the Law on Negotiable Instruments if a prudent legal interpretation was adopted.

Reasons for the Bills-To-Cash/Bills Arrangement

Our Bills-To-Cash/Bills Arrangement was mainly conducted for the purpose of obtaining cash or for subsequent discounting in order to facilitate the business operation and to fulfil the need of working capital of our Group and due to a lack of understanding of the laws and regulations in the PRC by our Directors, which led to such inadvertent and probable breach of the Law on Negotiable Instruments. Our Directors had no intention and no financial incentive to breach the relevant rules and regulations and/or did not obtain any direct and personal benefit from it. As such, there was no issue on our Directors’ integrity or suitability as required under Rules 3.08 and 3.09 of the Listing Rules. Further, by swapping our bank acceptance bills with related parties for cash, our Group could save time from engaging in the complicated procedures involved in the bills discounting arrangement with financial institutions. In essence, the swapping of bills with our related parties (being companies controlled by our Controlling Shareholders) for cash is similar in nature to inter-group transaction between our Group and its related parties (e.g. amount due to/due from related parties).

Remedial measures

We ceased all Bills-To-Cash/Bills Arrangement with related parties and the Independent Third Party since June 2019 and July 2019, respectively.

We have obtained written confirmation from the People’s Bank of China, Wenjiang Branch (中國人民銀行溫江支行) on 1 July 2020 confirming that no administrative penalty has been imposed on Sichuan Huanlong in relation to any breach of bills related laws and regulations since 1 January 2017 to 1 July 2020.

Our Controlling Shareholders, Ms. Shen and Mr. Zhou, committed in writing that they will fully and unconditionally pay any penalties which may be imposed by People’s Bank of China, Wenjiang Branch (中國人民銀行溫江支行) or such other relevant authorities on us together with any related costs in relation to the Bills-To-Cash/Bills Arrangement.

BUSINESS

Opinion of our PRC Legal Advisers

Our PRC Legal Advisers advised that, based on Article 4 of the Administrative Penalty Law of the People’s Republic of China (as amended in 2017) (《中華人民共和國行政處罰法》(2017年修正)), administrative penalties for illegal acts shall be published and that unpublished rules shall not be used as basis for administrative penalties. Our PRC Legal Advisers further advised that no relevant laws and regulations stipulate any penalties against our PRC subsidiaries, its legal representative, directors and senior management in respect of its involvement in the Bills-To-Cash/Bills Arrangement. Our PRC Legal Advisers further advised that the People’s Bank of China, Wenjiang Branch* (中國人民銀行濶江支行) is competent to issue the aforesaid confirmation.

Given that there has been no official ruling or adjudication on the legality of the Bills-To-Cash/Bills Arrangement and, based on the search performed by our PRC Legal Advisers, there is no precedent case which the relevant regulatory authority in the PRC has adjudicated that similar bills arrangement constituted non-compliance and where the entity involved has been penalised due to such bills arrangement, our PRC Legal Advisers are of the view that the risk of our Group being penalised as a result of such arrangement is relatively low.

Immaterial impact on our business operation and financial condition

We had not ceased the Bills-To-Cash/Bills Arrangement since commencement of the Track Record Period upon the reminder from the reporting accountants that any non-compliant bills arrangement should be ceased because our Directors, at the relevant time, were not aware that the Bills-To-Cash/Bills Arrangement was a probable breach of the Law on Negotiable Instruments. Our Directors further explained that, if they were aware of this probable breach, they would not have undertaken such arrangement. We ceased all Bills-To-Cash/Bills Arrangement with the Independent Third Party since July 2019. Further, as explained in the paragraph above, our exchange of bank acceptance bills with related parties is actually similar in nature to inter-group transaction between our Group and our related parties. Such inter-group transaction between a listing applicant and its related parties is common prior to listing. The listing applicant can generally demonstrate its financial independence from such related parties provided that such financing has ceased and been fully settled on or before listing. Given that all the bills arrangements with our related parties had ceased since June 2019, our Directors are of the view such bill arrangement do not reflect negatively on our ability to operate independently from our Controlling Shareholders.

BUSINESS

The financial impact or the finance costs avoided under the Bills-To-Cash/Bills Arrangement was estimated to be approximately RMB0.4 million, RMB45,000, nil and nil, respectively, for the Track Record Period, which was calculated by multiplying the total amount of cash received by our Group for the Track Record Period (i.e. approximately RMB19.4 million, RMB3.8 million, nil and nil, respectively) by the average discount rate which financial institutions would charge our Group for the respective year (i.e. 2.17%, 1.19%, nil and nil, respectively). It is respectfully submitted that there is no financial impact to our Group from swapping bank acceptance bills with smaller face value for bank acceptance bills with larger face value under the Bills-To-Cash/Bills Arrangement as the financial institutions would charge the Group finance costs upon subsequent discounting of such bills with larger face value.

For the Track Record Period, among bills of RMB0.5 million, RMB8.2 million, nil and nil received by our Group under this arrangement, nil, two, nil and nil bank acceptance bills with larger face value, amounting to approximately nil, RMB5.4 million, nil and nil, respectively, were subsequently discounted with financial institutions for cash, while the rest were used to fulfill various payment obligations with our Group’s suppliers.

Although there was not a small number of bank acceptance bills involved under the Bills-To-Cash/Bills Arrangement for the Track Record Period, the transactions under such arrangement were infrequent with 12, 6, nil and nil transactions, respectively. There is no financial impact to the Group since 2020 as such arrangement was ceased in the year ended 31 December 2019.

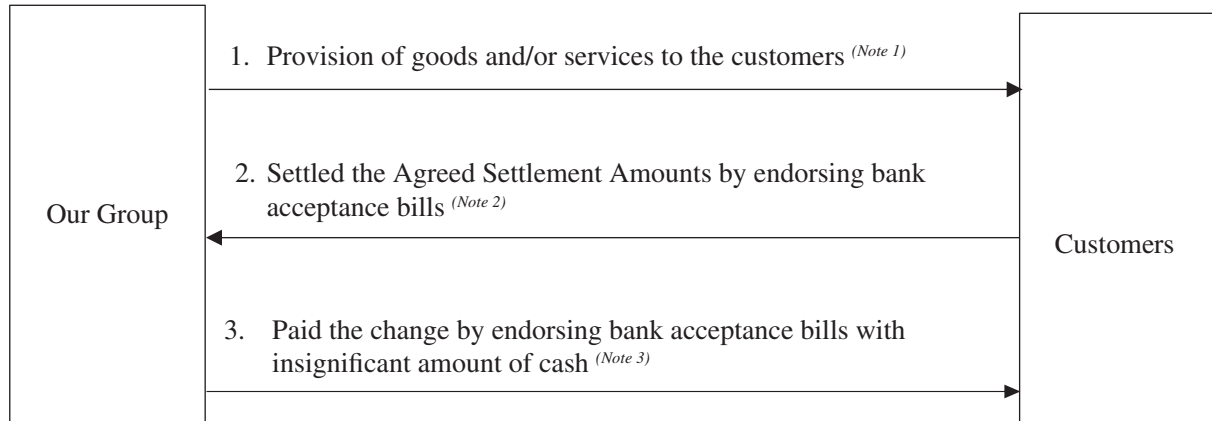
Scenario Two — Bills Change Arrangement

Background

During the Track Record Period, after the provision of goods and/or services by our Group to its customer, our Group generally communicated and discussed payment for the purchases with its customers. Customers of our Group may settle their purchases from time to time at agreed amounts (“**Agreed Settlement Amounts**”) which were determined based on factors including but not limited to the amount of goods and/or services provided by our Group, credit terms offered to the customers and outstanding trade receivable balance, after discussion and communication with the Group. Customers of our Group had occasionally settled their purchases by endorsing bank acceptance bills in addition to settlement by cash, where they might not have provided bills with the exact amount equivalent to the Agreed Settlement Amounts but bills with face value larger than the Agreed Settlement Amounts. Under such circumstances, our Group would return the change (being the excess of the amount of bank acceptance bills received over the Agreed Settlement Amounts) to the customer by way of endorsing the customers with bank acceptance bills of a

BUSINESS

smaller amount (with payment of insignificant amount of cash by our Group to the customers in order to match the exact amount of change payable to the customers) (“**Bills Change Arrangement**”). The following diagram illustrates the processes generally involved:



Notes:

1. Our Group provided goods and/or services to the customers.
2. The customers settled the purchases by endorsing bank acceptance bills with an amount larger than the Agreed Settlement Amounts to our Group. For example, the customer settles part of its cumulative purchases with total amount of RMB1,000,000 at the Agreed Settlement Amounts of RMB450,000 at a particular time by endorsing bank acceptance bills with an amount of RMB500,000.
3. Our Group paid the change to the customers by endorsing bank acceptance bills of a smaller amount with insignificant amount of cash in order to match the exact amount of change payable to the customers. Following the example in note 2 above, our Group would pay the change of RMB50,000 to the customer by endorsing bills with an amount of RMB49,000 and cash of RMB1,000 to the customer.

Save as the contracts or purchase orders with the relevant customers for the provision of goods and/or services by our Group as well as the bank acceptance bills involved, during the Track Record Period, there was no other side agreement entered into between our Group and the relevant customers under the Bills Change Arrangement.

BUSINESS

The Bills Change Arrangement was supported by underlying transactions of goods and/or services and arose solely in the course of returning change to customers when our Group received bank acceptance bills from customers. The Bills Change Arrangement was merely a way to return change to its customers on the excess amount between the amount of bank acceptance bills received and the Agreed Settlement Amounts. As confirmed by our Directors, our Group did not receive any cash and/or other financial benefits under the Bills Change Arrangement. Therefore, such arrangement was non-financing in nature. Further, the number of customers involved in the Bills Change Arrangement was relatively small as compared to the total number of customers of our Group, details of which is set out in the table as below:

	For the year ended 31 December			For the six months ended 30 June
	2018	2019	2020	2021
Total number of customers of our Group	498	473	483	371
Number of customers using bills as settlement method	229	209	197	170
Number of customers involved in the Bills Change Arrangement	49	46	7	Nil
	(representing approximately 9.8% of the total number of customers)	(representing approximately 9.7% of the total number of customers)	(representing approximately 1.4% of the total number of customers)	

The table below sets out the total number and corresponding total gross amount of bills endorsed and received by the Group in respect of the Bills Change Arrangement for the Track Record Period. The Group did not obtain any financial benefit from the Bills Change Arrangement and such arrangement had no financial impact on the Group for the Track Record Period.

	For the year ended 31 December						For the six months ended 30 June	
	2018		2019		2020		2021	
	<i>Number of bills</i>	<i>RMB'000</i>	<i>Number of bills</i>	<i>RMB'000</i>	<i>Number of bills</i>	<i>RMB'000</i>	<i>Number of bills</i>	<i>RMB'000</i>
Agreed Settlement Amounts	N/A	6,807	N/A	7,294	N/A	1,040	N/A	Nil
Bills paid by the customer for Agreed Settlement Amounts	91	17,263	81	15,931	9	1,363	Nil	Nil
Change required to be made by our Group	N/A	10,456	N/A	8,637	N/A	323	N/A	Nil
Bills and cash paid by our Group as change:								
— Bills ^(Note)	148	10,263	116	8,429	6	281	Nil	Nil
— Cash	N/A	193	N/A	208	N/A	42	N/A	Nil
Subtotal	148	10,456	116	8,637	6	323	N/A	Nil

Note: Most of the transactions involved changes of bills with relatively small face value, while only a few of transactions involved changes of bills with relatively large face value given the related changes were relatively large.

BUSINESS

The details of the bills used as change returned to our Group’s customers are set out below:

	Number of transactions involved							
	For the year ended 31 December						For the six months ended 30 June	
	2018		2019		2020		2021	
	Aggregate amount		Aggregate amount		Aggregate amount		Aggregate amount	
Bills of the amount (RMB)	Number of bills	(RMB'000) (approximate)	Number of bills	(RMB'000) (approximate)	Number of bills	(RMB'000) (approximate)	Number of bills	(RMB'000) (approximate)
1 — 100,000	132	7,103	100	5,307	5	81	Nil	Nil
100,001 — 200,000	15	2,660	12	1,934	1	200	Nil	Nil
Over 200,000	1	500	4	1,188	0	—	Nil	Nil
Total:	<u>148</u>	<u>10,263</u>	<u>116</u>	<u>8,429</u>	<u>6</u>	<u>281</u>	<u>Nil</u>	<u>Nil</u>

PRC laws and regulations

According to Article 10 of the Law on Negotiable Instruments, the issuance, acquisition and transfer of a negotiable instrument shall follow the principle of authenticity and credibility and shall possess real underlying transactions and debtor-creditor relationships. As advised by our PRC Legal Advisers, Article 10 of the Law on Negotiable Instruments, which regulates the issue and usage of bank acceptance bills in the PRC, is subject to various interpretations and there has been no official ruling or adjudication on the legality of the Bills Change Arrangement. In the opinion of our PRC Legal Advisers, there is an uncertainty as to whether the Bills Change Arrangement would be classified as non-compliance, and there is no precedent case which the relevant regulatory authority in the PRC has adjudicated that similar bills change arrangement constituted non-compliance and where the entity involved has been penalised due to such bills change arrangement, based on the search performed by our PRC Legal Advisers.

Reasons for the Bills Change Arrangement

In general, owing to the complicated procedures and processing time involved in issuing bank acceptance bills in the PRC, PRC banks generally prefer to issue bank acceptance bills with larger amount due to their own administrative convenience. As a result, the amount of bank acceptance bills issued rarely matches exactly with the value of each subsequent transaction. When the amount of the subsequent transactions of goods and/or services is less than the amount of the bank acceptance bills endorsed by the purchaser, the seller may have to repay the purchaser the difference through the Bills Change Arrangement. Against this background, the primary objective of the Bills Change Arrangement is to assist trade partners to overcome the general difficulty in collecting or obtaining bank acceptance bills which match exactly with the value of each particular transaction of goods and/or services.

BUSINESS

In addition, it is administratively inconvenient and cumbersome for holders of bank acceptance bills to apply to the banks to convert them into several bills of smaller amounts. Therefore, where a purchaser intended to settle the invoices of a seller through endorsement of bills, the purchaser might encounter the situation that the amount of the bills held by it exceeded the amount of invoices.

Further, our Group had also carried out the Bills Change Arrangement partly due to our commitment in maintaining business relationship with our customers by accommodating to their payment practices. Our Group used bills to settle the difference between the amount of the bank acceptance bills endorsed by its customers and the Agreed Settlement Amounts under the Bills Change Arrangement as such arrangement was in accordance with market practice and was initiated by our Group's customers and our Directors were not aware of its possible non-compliance when such arrangement was undertaken. Our Directors had no intention and no financial incentive to breach the relevant rules and regulations and/or did not obtain any direct and personal benefit from it. As such, there was no issue on our Directors' integrity or suitability as required under Rules 3.08 and 3.09 of the Listing Rules.

Remedial measures

According to the Frost & Sullivan Report, the Bills Change Arrangement which involves the returning of changes by sellers by endorsing bank acceptance bills to purchasers is common in the manufacturing industry, including the papermaking felts industry in the PRC and Frost & Sullivan is not aware of any bills change arrangement being treated as non-compliance or any penalty arising therefrom in the market practice in the PRC, based on the information available in the public domain such as financial reports of listed manufacturing companies in the PRC. Due to the lack of relevant legal knowledge and professional advice at the material times and the customary practice of the Bills Change Arrangement in the manufacturing industry in the PRC, our executive Directors and senior management were previously unaware of the potential non-compliance in relation to the Bills Change Arrangement. The Bills Change Arrangement was unintentional and did not involve any deliberate attempt to deceive third party for financial gains. We had enhanced our internal control measures upon becoming aware of the potential non-compliance in relation to the Bills Change Arrangement. Since early 2020, our sales and marketing staff began to inform our customers about our plan to gradually cease the Bills Change Arrangement. Since July 2020, if our customers opt to settle their payments to us by bank acceptance bills, the bills provided to us shall exactly match with or be smaller than our invoiced amount. In the latter case, our customers shall be required to settle the remaining amount of payment through other acceptable means such as bank remittance. As advised by our PRC Legal Advisers, such arrangement complies with the relevant laws and regulations. We adopted a gradual approach to cease the Bills Change Arrangement in order to allow time for our customers to adapt to our new practice without causing any material disruption to our business transactions with them. We ceased all Bills Change Arrangement since July 2020.

BUSINESS

We have obtained written confirmation from the People's Bank of China, Wenjiang Branch (中國人民銀行濶江支行) on 1 July 2020 confirming that no administrative penalty has been imposed on Sichuan Huanlong in relation to any breach of bills related laws and regulations since 1 January 2017 to 1 July 2020.

Our Controlling Shareholders, Ms. Shen and Mr. Zhou, committed in writing that they will fully and unconditionally pay any penalties which may be imposed by People's Bank of China, Wenjiang Branch (中國人民銀行濶江支行) or such other relevant authorities on us together with any related costs in relation to the Bills Change Arrangement.

Opinion of our PRC Legal Advisers

Our PRC Legal Advisers advised that, based on Article 4 of the Administrative Penalty Law of the People's Republic of China (as amended in 2017) (《中華人民共和國行政處罰法》(2017年修正)), administrative penalties for illegal acts shall be published and that unpublished rules shall not be used as basis for administrative penalties. Our PRC Legal Advisers further advised that no relevant laws and regulations stipulate any penalties against our PRC subsidiaries, its legal representative, directors and senior management in respect of its involvement in the Bills Change Arrangement. Our PRC Legal Advisers further advised that the People's Bank of China, Wenjiang Branch* (中國人民銀行濶江支行) is competent to issue the aforesaid confirmation.

As mentioned above, the Law on Negotiable Instruments is subject to various interpretations and there has been no official ruling or adjudication on the legality of the Bills Change Arrangement. In the opinion of our PRC Legal Advisers, there is an uncertainty as to whether the Bills Change Arrangement would be classified as non-compliance, and there is no precedent case which the relevant regulatory authority in the PRC has adjudicated that similar bills change arrangement constituted non-compliance and where the entity involved has been penalised due to such bills change arrangement, based on the search performed by our PRC Legal Advisers. Based on an interview attended by the PRC Legal Advisers with the chief of the credit management department of the People's Bank of China, Wenjiang Branch, a competent authority, on 18 December 2020, which the interviewee was acknowledged our Group's Bills Change Arrangement and he confirmed that the Bills Change Arrangement was supported by underlying transactions and that using bank acceptance bills for the settlement of purchases is common in the PRC, our PRC Legal Advisers opine that the risk that our Group's Bills Change Arrangement would be regarded as non-compliance is relatively low, and our PRC Legal Advisers reasonably believes that based on their prudent judgement our Group will not be penalised as a result of the Bills Change Arrangement. Based on the advice of our PRC Legal Advisers, even if the Bills Change Arrangement was prudently interpreted as non-compliance, it should nevertheless be classified as immaterial non-compliance as it did not and will not result in any legal consequences and financial liabilities on our Group. Further, based on a further interview attended by the PRC Legal Advisers and the legal advisers to the Sole Sponsor as to PRC laws with the chief of the credit management department of the People's Bank of China, Wenjiang Branch, a competent authority, on 1 February 2021, no administrative penalty has been imposed on us due to the breach of Law on Negotiable Instruments since 1 January 2018 to the date of interview. According to the information disclosed on the website of the Chengdu Municipal People's Government, the function of Wenjiang Branch of the People's Bank of China includes implementing monetary and credit policies within the

BUSINESS

jurisdiction, supervising and managing financial markets, participating in the prevention of systemic financial risks in the jurisdiction in accordance with relevant regulations, and maintaining regional financial stability. The credit management department is one of the internal institutions of the People’s Bank of China, Wenjiang Branch. Based on the above and the oral confirmation from the chief of the credit management department of the People’s Bank of China, Wenjiang Branch, our PRC Legal Advisers are of the view, as concurred by the Sole Sponsor and the legal advisers to the Sole Sponsor as to PRC laws, that (i) the credit management department of the People’s Bank of China, Wenjiang Branch is a competent and direct government authority and thus duly authorised to advise on the compliance related matters of our Group’s bills arrangements; and (ii) the chief of such department has the appropriate authority to respond to the compliance of our Group’s bills arrangements. In addition, based on the responses to the enquiries with the People’s Bank of China, Chengdu Branch through official channels, including (i) the oral reply from section chief of the payment and settlement division of the People’s Bank of China, Chengdu Branch (being a competent government authority at provincial level) that the People’s Bank of China, Chengdu Branch does not issue any regulatory confirmation and the People’s Bank of China, Wenjiang Branch under Chengdu Branch is responsible to supervise the relevant actions of the enterprises within Wenjiang region; and (ii) the reply from officer of the money and credit statistics division via general hotline of the People’s Bank of China, Chengdu Branch, that issuing regulatory confirmation is not within the service scope of Chengdu Branch as an authority at provincial level and we may consult Wenjiang Branch on the bills related enquiries, our PRC Legal Advisers are of the view, as concurred by the Sole Sponsor and the legal advisers to the Sole Sponsor as to PRC laws, that the possibility of the view of such chief being challenged by higher-level authorities is remote.

Based on the aforesaid, our PRC Legal Advisers are of the view that the possibility of any actual material adverse effect on the existence, operation and production of our Group resulting from our involvement in the Bills Change Arrangement is relatively small.

Immaterial impact on our business operation and financial condition

Our Group had not ceased the Bills Change Arrangement together with the other bills arrangement earlier in 2019 because our Directors were not aware of its possible non-compliance when such arrangement was undertaken and our Directors were still discussing with professional advisers about the legality of this arrangement at that time and our Directors still believed that it would not have material impact on the [REDACTED] given such arrangement’s impact on our Group is immaterial. Since early 2020, our Group has begun to inform our Group’s customers about its plan to gradually cease the Bills Change Arrangement. The amount under the Bills Change Arrangement for the year ended 31 December 2020 therefore decreased significantly and our Group has ceased all Bills Change Arrangement since July 2020. After the cessation of the Bills Change Arrangement, if our Group’s customers opt to settle their payments to our Group by bank acceptance bills, as requested by our Group, such bills provided to our Group shall exactly match the Agreed Settlement Amounts. As such, the cessation of the Bills Change Arrangement has no impact on the business operation and cashflow of our Group. As our Group was entitled to the consideration of the respective transactions under the Bills Change Arrangement as goods were

BUSINESS

sold and delivered to its customers and its customers had the obligation to settle the payments in cash or by other means, our Group could not obtain any financial benefit from the Bills Change Arrangement, regardless of whether our Group returned change by way of endorsing bank acceptance bills of a smaller amount or cash to the customers as change. There would be no negative financial impact on our Group’s performance if the Bills Change Arrangement had not been conducted, as such, any hypothetical analysis on the financial impact to our Group on the basis that the Bills Change Arrangement had not been conducted would distort the nature of this arrangement. Our executive Directors consider that the Bills Change Arrangement had no material impact on our liquidity level or financial performance during the Track Record Period and did not and will not have a material impact on our business operation and financial condition.

Deed of Indemnity

Ms. Shen and Mr. Zhou, being our Controlling Shareholders, have entered into a Deed of Indemnity in favour of us to provide indemnities on a joint and several basis in respect of, among other matters, any penalty, claims, actions, demands, proceedings, judgements, losses, liabilities, damages, costs, administrative or other charges, fees, expenses and fines of whatever nature (which shall include legal fees and costs) which may be imposed on, suffered or incurred by any member of our Group as a result of or in connection with, among others, any non-compliance with the applicable laws, rules or regulations by any member of our Group on or before the date on which the [REDACTED] becomes unconditional. Please refer to the paragraph headed “Statutory and General Information — E. Other information — 1. Tax and other indemnities” in Appendix V to this document for details of the Deed of Indemnity.

Enhanced Internal Control Measures

A set of policies and procedures has been established to ensure compliance with the relevant PRC laws and regulatory requirements for construction projects, timely account opening procedures and accurate payment of social insurance and housing provident fund, and bills arrangement. The following procedures are included:

Construction projects

- a checklist is established which includes the necessary permits and certificates to be obtained, as well as the timeframe for the relevant registration and filing procedures.
- a designated person in our administration department is responsible to monitor the actual registration and filing status against the construction progress. In particular, land use right certificate(s), construction land planning permit(s), construction project planning permit(s) and construction project commencement permit(s) must be obtained prior to commencement of construction, while fire prevention filing procedure and completion acceptance filing must be completed before delivery of property for use.

BUSINESS

Social insurance and housing provident fund

- administrative officer and administrative manager are responsible to prepare and review the breakdown of monthly salaries and ensure that the calculations of social insurance and housing provident fund of each employee are accurate and complied with the related laws.
- when there is any new employment or resignation of staff, the administrative officer is responsible to register and report to the relevant authorities regarding the social insurance and housing provident fund. The administrative manager oversees the abovementioned procedures to ensure such filing is performed within the required timeframe.

Bills arrangement

The management of our Group has established the measures for the administration of commercial bills* (商業匯票管理辦法) to standardise the procedures of bills arrangement, which includes but not limited to the following:

- when there is a need for our Group to obtain immediate cash for its operations, our finance department may consider discounting the bank acceptance bills by filling in the application form(s) for approval of discounting of commercial bills* (商業匯票貼現申請審批表). The above form will be passed to our Director(s), who is/are responsible for checking its validity and ensuring the counterparty is a financial institution. Upon obtaining the approval from our Director(s), our finance department will obtain several quotations from different financial institutions, compare the terms and select the optimal plan for our Group; and
- a register is maintained by the cashier of our Group for monitoring the conditions of bank acceptance bills. Information such as the issuer, issuance date, expiry date and discounted amount will be recorded. The said register, bank acceptance bills and other supporting documents will be submitted to the head of our finance department during month-end closing. Investigations will also be performed by our Group if any irregularity is found.

In addition, we have adopted the following internal control measures to prevent the recurrence of non-compliance incidents in relation to bank acceptance bills:

- all discounting of bank acceptance bills must be carried out with financial institutions which are authorised by the relevant government authorities to engage in such activity;
- our finance department shall ensure each application form for approval of discounting commercial bills* (商業匯票貼現申請審批表) is supported by valid underlying transaction with documentations during the approval process;

BUSINESS

- the Bills-To-Cash/Bills Arrangement is strictly forbidden with effect from July 2019, and thereafter, bank acceptance bills shall be used as payment only to the trade partners of our Group in our ordinary course of business;
- since early 2020, our sales and marketing staff began to inform customers about our plan to gradually cease the Bills Change Arrangement;
- the Bills Change Arrangement is strictly forbidden with effect from July 2020, and thereafter, if our customers opt to settle their payments to us by bank acceptance bills, the bills provided to us shall exactly match with or be smaller than our invoiced amount. In the latter case, our customers shall be required to settle the remaining amount of payment through other acceptable means such as bank remittance;
- upon receipt of bank acceptance bills, our finance department shall verify that such bills are endorsed to our Group by its trade partners. When our finance department discovers that the bills endorsed by customers to us is larger than the Agreed Settled Amounts, further checking shall be conducted whether the excess amount is for prepayment, and if not, such bills shall be returned to the customers;
- training was provided by our PRC Legal Advisers to our executive Directors and senior management with respect to major PRC laws and regulatory requirements for bank acceptance bills and training materials were provided by our Hong Kong legal advisers to our executive Directors and senior management with respect to compliance requirements under the guidance letters and/or the listing decisions issued by the Stock Exchange in relation to bank acceptance bills;
- Mr. Xie, our executive Director, and Ms. Liu Jiayan, our financial controller and a joint company secretary, are responsible for monitoring our Group's bills arrangements going forward;
- we will engage appropriate external legal advisers and/or institutions and/or consultants to advise, update the knowledge of and/or provide trainings to our Directors, senior management and/or relevant employees on the relevant laws and regulations, including changes thereto, in relation to bank acceptance bills;
- we will engage an independent internal control consultant to conduct periodic review and assessment of our internal control measures in relation to bank acceptance bills and report to the Board and the Audit Committee the results of such review and assessment for our first financial year after [REDACTED], which will cover (i) receipt, endorsement, discounting and use of bank acceptance bills, (ii) record, approval and monitoring of bank acceptance bills, (iii) verification on the endorsement of bank acceptance bills and their underlying transactions, and (iv) implementation status of our

BUSINESS

preventive measures for bills arrangements. Our Company will disclose in our first annual report after [REDACTED] any non-compliant bills arrangements identified during the internal and external reviews of our internal control system; and

- our Audit Committee, comprising three independent non-executive Directors, continuously provides our Directors with an independent review of the effectiveness of the financial reporting process, internal control and risk management system of our Group and oversees the audit process and performs other duties and responsibilities as assigned by our Directors.

Moreover, regular internal training will be provided to relevant employees and management on compliance policy and all applicable PRC laws and regulations to ensure awareness and compliance of the policies.

We engaged an internal control consultant in January 2021 to review our bills arrangements and the enhanced internal control measures in this regard. Based on the findings and the work performed by the internal control consultant and their follow-up review in July 2021, our internal control consultant has confirmed that there are no major negative findings on our internal control system during the 12-month period after the cessation of our bills arrangement and had no further recommendations in our internal control system in relation to bank acceptance bills. If our Group implemented such enhanced internal control measures continuously, the internal control consultant is also of the view that the enhanced internal control measures are adequately and effectively designed to reasonably prevent any future non-compliance incidents in this regard.

Views of our Directors

Our Directors consider that (a) the abovementioned non-compliance incidents would not affect the suitability of our executive Directors under Rules 3.08 and 3.09 of the Listing Rules or the suitability for Listing of the Company under Rule 8.04 of the Listing Rules; and (b) various internal control measures adopted by our Group are adequate and effective having taken into account that:

- (a) facts and circumstances leading to the occurrence of the non-compliance incidents and that our Group has already adopted various remedial procedures as at the Latest Practicable Date as mentioned above;
- (b) the non-compliance incidents did not involve any element of fraud or dishonesty of our Directors and were principally unintentional due to the lack of relevant legal knowledge and professional advice at the relevant times;
- (c) our Directors did not obtain any personal benefit directly or indirectly from the non-compliance incidents;

BUSINESS

- (d) remedial internal control measures have been adopted to address deficiencies in our internal control systems, including monitoring the ongoing compliance with the internal control measures, to prevent further incidents of non-compliance and to ensure our compliance with the Listing Rules and the relevant laws in the PRC and Hong Kong;
- (e) our Directors and senior management attended training in respect of the duties of directors of companies listed in Hong Kong organised by our legal adviser as to Hong Kong law that they are reminded to seek professional advice whenever necessary to ensure compliance with relevant laws and regulations;
- (f) public search including litigation search was conducted on our Group and each of our Directors and no material adverse findings were noted; and
- (g) if appropriate, external professional adviser(s) will be appointed to render professional advices to our Directors and assist our Directors in ensuring ongoing compliance with the statutory requirements and the Listing Rules as applicable to our Group from time to time.