

信溢投資策劃有限公司

CHALLENGE CAPITAL MANAGEMENT LIMITED

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19 May 2018

To: *The Code Independent Board Committee,  
the LR Independent Board Committee and  
the Independent Shareholders  
of Cosmos Machinery Enterprises Limited*

Dear Sirs,

**(1) CONNECTED TRANSACTION IN RELATION TO  
SUBSCRIPTION OF NEW SHARES BY CONNECTED PERSONS  
AND  
(2) APPLICATION FOR WHITEWASH WAIVER**

**INTRODUCTION**

We refer to our engagement as the independent financial adviser to (i) the Code Independent Board Committee and the Independent Shareholders in respect of the Subscription and the Whitewash Waiver; and (ii) the LR Independent Board Committee and the Independent Shareholders in respect of the Subscription, details of which are set out in the letter from the Board (the “**Letter from the Board**”) contained in the circular of the Company to the Shareholders dated 19 May 2018 (the “**Circular**”), of which this letter forms part. Capitalised terms used in this letter shall have the same meanings as those defined in the Circular unless otherwise defined or the context requires otherwise.

On 30 April 2018 (after trading hours), the Company entered into the Subscription Agreement with the First Subscriber and the Second Subscriber, pursuant to which the Company will allot and issue, and the First Subscriber and the Second Subscriber will subscribe for 108,750,000 Shares and 36,250,000 Shares respectively, at the Subscription Price of HK\$0.550 per Subscription Share.

The 145,000,000 Subscription Shares represent (i) approximately 20.23% of the issued share capital of the Company as at the Latest Practicable Date; and (ii) approximately 16.82% of the issued share capital of the Company as enlarged by the allotment and issue of the Subscription Shares.

The Subscription Shares will be allotted and issued pursuant to the Specific Mandate to be sought from the Independent Shareholders at the EGM.

The First Subscriber is a controlling shareholder of the Company. As at the Latest Practicable Date, it directly holds 127,052,600 Shares (representing approximately 17.72% of the total issued share capital of the Company) and indirectly holds 170,104,452 Shares (representing approximately 23.73% of the total issued share capital of the Company), together representing approximately 41.45% in the issued share capital of the Company. Prior to the Subscription, the Second Subscriber does not directly hold any Shares. The Second Subscriber is owned as to 57.14% by Mr. Tang To and 42.86% by Mr. Tang Yu, Freeman, both executive Directors, and through its intermediate holding companies, the Second Subscriber indirectly controls the First Subscriber. Therefore the First Subscriber and the Second Subscriber are connected persons of the Company pursuant to the Listing Rules. Accordingly, the Subscription Agreement and the transactions contemplated thereunder constitute non-exempt connected transaction of the Company under Chapter 14A of the Listing Rules and are subject to the announcement, reporting and Independent Shareholders' approval requirements.

Upon Completion, the First Subscriber will directly hold 235,802,600 Shares and indirectly hold 170,104,452 Shares, together representing approximately 47.09% of the issued share capital of the Company as enlarged by the allotment and issue of the Subscription Shares. The Second Subscriber will directly hold 36,250,000 Shares, representing approximately 4.21% of the issued share capital of the Company as enlarged by the allotment and issue of the Subscription Shares. The First Subscriber, the Second Subscriber and their associates and parties acting in concert with them will be interested in a total of 450,949,858 Shares in aggregate, representing approximately 52.32% of the issued share capital of the Company as enlarged by the allotment and issue of the Subscription Shares.

Under Rule 26.1 of the Takeovers Code, the Subscribers would be obliged to make a mandatory general offer to the Shareholders for all the issued Shares and other securities of the Company not already owned or agreed to be acquired by them or parties acting in concert with them as their aggregate direct and indirect shareholding interests in the Company would increase from the existing approximately 41.45% to approximately 51.30% upon Completion, unless the Whitewash Waiver is granted by the Executive. In this regard, the Subscribers have made an application to the Executive for the Whitewash Waiver pursuant to Note 1 on Dispensation from Rule 26 of the Takeovers Code in respect of the allotment and issue of the Subscription Shares. The Whitewash Waiver, if granted by the Executive, will be subject to, among other things, approval by the Independent Shareholders of the Subscription and the Whitewash Waiver at the EGM by way of poll.

Pursuant to the Takeovers Code, the Code Independent Board Committee, which comprises Mr. Qu Jinping, being a non-executive Director, and Ms. Yeung Shuk Fan, Mr. Cheng Tak Yin, Mr. Ho Wei Sem and Mr. Huang Zhi Wei, all being independent non-executive Directors, has been established to advise the Independent Shareholders in relation to the Subscription Agreement, the transactions contemplated thereunder and the Whitewash Waiver. Since Mr. Kan Wai Wah, a non-executive Director, is a director of the First Subscriber, Mr. Kan Wai Wah has not been included in the Code Independent Board Committee. Pursuant to the Listing Rules, the LR Independent Board Committee, which comprises all the independent non-executive Directors, namely Ms. Yeung Shuk Fan, Mr. Cheng Tak Yin, Mr. Ho Wei Sem and Mr. Huang Zhi Wei, has been established to advise the Independent Shareholders in relation to the Subscription Agreement and the transactions contemplated thereunder. We, Challenge Capital Management Limited, have been appointed as the independent financial adviser to advise the Code Independent Board Committee and the Independent Shareholders in relation to the Subscription Agreement, the transactions contemplated thereunder and the Whitewash Waiver, and to advise the LR Independent Board Committee and the Independent Shareholders in relation to the Subscription Agreement and the transactions contemplated thereunder. Our appointment has been approved by the Code Independent Board Committee and the LR Independent Board Committee.

We have not acted as a financial adviser or independent financial adviser to the Company within the last two years. We are independent from and not connected with the Company, the First Subscriber, the Second Subscriber, any of their respective substantial shareholders, or any party acting, or presumed to be acting, in concert with any of them. Accordingly, we are considered eligible to give independent advice on the Subscription and the Whitewash Waiver. Apart from normal advisory fees payable to us for our services to the Company in connection with this appointment, no arrangement exists whereby we shall receive any other fees or benefits from the Company, the First Subscriber, the Second Subscriber or any of their respective associates.

## **BASIS OF OUR OPINION**

In formulating our opinion and recommendations, we have relied on the information, facts and representations contained or referred to in the Circular and the information, facts and representations provided to us by the Company, and the opinions expressed by its management. We have assumed that all information, facts and representations contained or referred to in the Circular, and the information, facts and representations provided by the Company, and the opinions expressed by its management, are true, accurate and complete in all material respects as at the Latest Practicable Date and that they may be relied upon in formulating our opinion. The Company will notify the Shareholders of any material changes during the offer period (as defined under the Takeovers Code) as soon as possible in accordance with Rule 9.1 of the Takeovers Code. Independent Shareholders will also be notified of any material changes to such information and representations provided and our opinion as soon as possible in accordance with Rule 9.1 of the Takeovers Code.

We have also assumed that all views, opinions and statements of intention provided by the Directors, advisors and representatives of the Company have been arrived at after due and careful enquiries. The Directors have confirmed to us that no material facts have been withheld or omitted from the information supplied and opinions expressed. We consider that we have been provided with, and have reviewed, all currently available information and documents which are available under present circumstances to enable us to reach an informed view and to provide a reasonable basis for our opinion. We have no reason to suspect that any relevant information has been withheld, nor are we aware of any facts or circumstances which would render the information provided and representations made to us untrue, inaccurate or misleading. We consider that we have performed all the necessary steps to enable us to reach an informed view and to justify our reliance on the information provided so as to provide a reasonable basis for our opinion. We have not, however, conducted any independent verification of the information provided by the Company and its management, nor have we conducted independent detailed investigation or audit into the businesses or affairs or future prospects of the Group. Our opinion is necessarily based on the financial, economic, market and other conditions in effect, and the information made available to us, as at the Latest Practicable Date.

The Circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Group. The Directors, having made all reasonable enquiries, confirm that to the best of their knowledge and belief the information contained in the Circular is accurate and complete in all material respects and not misleading or deceptive, and there are no other matters the omission of which would make any statement in the Circular misleading.

The Circular includes particulars given in compliance with the Takeovers Code. The Directors jointly and severally accept full responsibility for the accuracy of the information (other than those relating to the Subscribers and the parties acting in concert with them) contained in the Circular and confirm, having made all reasonable enquiries, that to the best of their knowledge, opinions expressed (other than those expressed by the Subscribers) in the Circular have been arrived at after due and careful consideration and there are no other facts not contained in the Circular, the omission of which would make any statement in the Circular misleading.

This letter is issued as our advice for the Code Independent Board Committee and the Independent Shareholders solely in connection with their consideration of the Subscription and the Whitewash Waiver, and the LR Independent Board Committee and the Independent Shareholders solely in connection with their consideration of the Subscription, and, except for its inclusion in the Circular, is not to be quoted or referred to, in whole or in part, nor shall this letter be used for any other purposes, without our prior written consent.

## PRINCIPAL FACTORS AND REASONS CONSIDERED

In formulating our opinion in respect of the Subscription and the Whitewash Waiver, we have considered the following principal factors and reasons:

### 1. Background to and reasons for the Subscription

#### (a) Information of the Group

The principal activities of the Group are manufacturing of machineries, manufacturing of plastic processing products, processing and trading of printed circuit boards and trading of industrial supplies.

#### *Financial performance of the Group*

Set out below is a summary of the audited consolidated financial performance of the Company for the three years ended 31 December 2015, 2016, and 2017 as extracted from the Company's annual reports for the year ended 31 December 2016 (the "2016 Annual Report") and 2017 (the "2017 Annual Report"):

	For the year ended 31 December		
	2015	2016	2017
	HK\$	HK\$	HK\$
	<i>in thousands</i>	<i>in thousands</i>	<i>in thousands</i>
	(audited)	(audited)	(audited)
Revenue	2,395,166	2,192,287	2,446,848
<i>Segment revenue:</i>			
Industrial consumables	356,085	340,539	346,582
Plastic processing products	449,469	393,403	388,857
Machinery	720,835	713,477	896,153
Printed circuit boards	845,766	721,005	788,612
Other operations	23,011	23,863	26,644
Gross profit	379,019	313,591	409,439
Gross profit margin	15.8%	14.3%	16.7%
<b>(Loss)/profit for the year</b>	<b>(38,818)</b>	<b>(333,885)</b>	<b>43,850</b>
(Loss)/profit attributable to equity shareholders of the Company	(49,601)	(303,160)	27,284

*For the year ended 31 December 2016*

The revenue of the Group decreased from approximately HK\$2,395.1 million for the year ended 31 December 2015 to approximately HK\$2,192.3 million for the year ended 31 December 2016, representing a decrease of approximately 8.5%. According to the 2016 Annual Report, such decrease was mainly attributable to (i) the slowdown of the economy in the Mainland China with a slump in the manufacturing sector; and (ii) the restructuring of certain business operations in the plastic products and processing segment and machinery manufacturing segment of the Group during the year of 2016.

The gross profit for the year ended 31 December 2015 and 2016 amounted to approximately HK\$379.0 million and HK\$313.6 million respectively, with a gross profit margin of approximately 15.8% and 14.3% respectively. With reference to the 2016 Annual Report and as confirmed by the management of the Company, despite the decrease in revenue, the gross profit margin recorded a comparatively mild drop of 1.5 percentage points due to the Group's continuous adjustment of sales strategy by focusing on higher-margin products and associated customers, and strengthening control over production costs during the year of 2016.

Net loss of the Group increased from approximately HK\$38.8 million for the year ended 31 December 2015 to approximately HK\$333.9 million for the year ended 31 December 2016. According to the 2016 Annual Report, such result was mainly attributable to the restructuring exercise of the Group's plastic products and processing segment and machinery manufacturing segment, which included the cessation of operation of certain manufacturing businesses. Accordingly, an amount of approximately HK\$135.2 million including the provision and payment for employee compensation, impairment of certain fixed assets, potential obsolete stocks and relocation expenses was incurred for the year ended 31 December 2016 in relation to the restructuring exercise.

*For the year ended 31 December 2017*

The revenue of the Group increased from approximately HK\$2,192.3 million for the year ended 31 December 2016 to approximately HK\$2,446.8 million for the year ended 31 December 2017, representing an increase of approximately 11.6% which was mainly attributable to the improvement in performance of the machinery manufacturing segment and the printed circuit board processing and trading segment during the year of 2017. In particular, revenue generated from the machinery manufacturing segment increased by approximately 25.6% as compared to that of the previous year. With reference to the 2017 Annual Report and as confirmed by the management of the Company, such increase was mainly attributable to (i) the enhanced overall production capacities as a result of the product re-alignment and adjustments in the Group's two main production plants of injection moulding machines; (ii) increase in sales of the Group's two-platen injection moulding machines product series; and (iii) increase in sales of injection moulding machines tailored-made for specific industries.

The gross profit for the year ended 31 December 2016 and 2017 amounted to approximately HK\$313.6 million and HK\$409.4 million respectively, with a gross profit margin of approximately 14.3% and 16.7% respectively. According to the 2017 Annual Report, the increase in gross profit margin was mainly due to the increased utilisation of production capacities and the strengthened control over production costs and operating overheads during the year.

For the year ended 31 December 2017, the Group achieved a turnaround with a net profit of approximately HK\$43.9 million as compared to a net loss of approximately HK\$333.9 million recorded for the year ended 31 December 2016. According to the 2017 Annual Report, such turnaround was mainly attributable to the improvement in revenue, gross profit margin, and control over the operating overheads. Furthermore, an amount of approximately HK\$135.2 million including payment and provision for restructuring costs in relation to the restructuring exercise of the Group was incurred for the year ended 31 December 2016. The unutilised portion of such provision was subsequently reversed and recorded as a non-recurring income of approximately HK\$31.1 million for the year ended 31 December 2017. The Group also incurred a non-recurring loss net of insurance recovery of approximately HK\$17.6 million for the year ended 31 December 2017 due to the damages caused by typhoon “Hato” to one of the production plants of the Group.

*Financial position of the Group*

Set out below is a summary of the audited consolidated financial position of the Company as at 31 December 2015, 2016, and 2017 as extracted from the 2016 Annual Report and the 2017 Annual Report:

	<b>As at 31 December</b>		
	<b>2015</b>	<b>2016</b>	<b>2017</b>
	<i>HK\$</i>	<i>HK\$</i>	<i>HK\$</i>
	<i>in thousands</i>	<i>in thousands</i>	<i>in thousands</i>
	(audited)	(audited)	(audited)
Non-current assets	929,267	835,330	827,876
Current assets	2,016,954	1,584,473	1,942,783
Total assets	2,946,221	2,419,803	2,770,659
Non-current liabilities	79,281	81,234	70,277
Current liabilities	1,299,120	1,181,657	1,408,243
Total liabilities	1,378,401	1,262,891	1,478,520
Net current assets	717,834	402,816	534,540
Net assets	1,567,820	1,156,912	1,292,139
Cash and bank balances	607,567	332,723	348,746
Bank borrowings	571,800	355,324	425,723

As at 31 December 2017, total assets of the Group amounted to approximately HK\$2,770.7 million, representing an increase of approximately HK\$350.9 million as compared to that as at 31 December 2016. Such increase was mainly contributed by the increase in trade and bills receivable of approximately HK\$125.8 million and the increase in inventory of approximately HK\$122.8 million primarily as a result of increase in raw materials for sales orders. Total liabilities of the Group increased from approximately HK\$1,262.9 million as at 31 December 2016 to approximately HK\$1,478.5 million as at 31 December 2017, representing an increase of approximately HK\$215.6 million. Such increase was mainly due to the combined effect of the increase in trade and bills payable of approximately HK\$117.9 million and the increase in bank borrowings of approximately HK\$70.4 million, which was partly offset by the decrease in provision for restructuring of approximately HK\$38.8 million. Net debt (calculated by bank borrowings less cash and bank balances) of the Group increased from approximately HK\$22.6 million as at 31 December 2016 to approximately HK\$77.0 million as at 31 December 2017, representing an increase of approximately HK\$54.4 million. The Group's gearing ratio (calculated by bank borrowings over net assets of the Group) increased from approximately 30.7% as at 31 December 2016 to approximately 32.9% as at 31 December 2017.

Having taken into account the above, in particular, (i) the turnaround achieved in the Group's results for the year ended 31 December 2017 after having recorded net losses consecutively during the past two financial years; and (ii) the increase in bank borrowings and net debt position of the Group as at 31 December 2017, we concur with Board that the Subscription could raise additional capital and funding to equip the Group with more resources to further develop the Group's existing businesses and make additional investments in research and development for further growth without incurring additional interest burden to the Group and strengthen its capital base.

**(b) Industry Prospects**

In 2015, the China State Council issued the "Made in China 2025" (the "**Made in China 2025**") strategy which is a ten-year action plan with the aim to remedy the PRC's manufacturing problems with a comprehensive upgrading of the sector to international standard. One of the core objectives of the Made in China 2025 strategy is to improve and enhance the quality of products which are manufactured in China and make China's manufacturing sector more innovative, efficient and competitive in the global market. The strategy involves the deepening restructuring of the manufacturing industry through promoting traditional manufacturers to move up the value chain to medium and high-end manufacturing stage and gradually solve the problem of excessive production capacity. Localisation is another objective, with the plan aiming to raise the domestic content of core components and materials to 40% by 2020, and 70% by 2025. Under the Made in China 2025 strategy, the PRC government identified ten key industries with development priority including information technology, numerical control tools and robotics, aerospace equipment, ocean engineering equipment and high-tech ships, railway equipment, energy saving and new energy vehicles, power equipment, new materials, medicine and medical devices, and agricultural machinery. The initiative spans the entire manufacturing industry, including processes, standards,



intellectual property rights and human capital, and has a strong focus on integrating production chains and factories. Furthermore, China's Thirteenth Five-Year Plan adopted in 2016 aims to deepen the implementation of the Made in China 2025 strategy over the next five-year period (2016-2020), with a focus on technological progress and improvements in quality, using high-end equipment to spearhead the development of China's advanced manufacturing sector. The Made in China 2025 strategy, together with the Thirteenth Five-Year Plan, are believed to create a favourable environment for the growth of new strategic industries, and optimise modern industrial systems. Based on the above, the management of the Company is of the view, and we concur, that the future prospect of the manufacturing industry in the PRC is generally positive.

***(c) Reasons for and benefits of the Subscription and use of proceeds***

According to the Letter from the Board, the Group has made considerable progress in the restructuring of its plastic products and processing segment and machinery manufacturing segment in the financial year ended 31 December 2017. With reference to the 2017 Annual Report, the Group commenced a restructuring exercise of its plastic products and processing segment and machinery manufacturing segment since 2016, which included the cessation of operation of certain manufacturing businesses and the optimisation of the production capacities in its Dongguan and Wuxi machinery manufacturing plants. In particular, the restructuring included assets relocation and optimisation, organisational restructuring and production efficiency enhancement. Through the re-alignment and adjustments of products in the two main production plants of injection moulding machines, the existing resources were able to be utilised more effectively and the overall production capacities of the two main production plants increased in 2017. Additionally, the Group strengthened the product development and optimisation of its plastic injection moulding machine business. Through the capability optimisation, the efficiency, speed and reliability of the Group's two-platen injection moulding machines product series were significantly enhanced to meet the demand of two major industries – auto parts and household electrical appliances, and became the sales growth driver in 2017. The plastic injection moulding machine business recorded growth of approximately 25.6% in revenue as compared to that of previous year with its results turned around to profit-making in 2017.

According to the 2017 Annual Report, under the Made in China 2025 strategy put forward by the PRC government, the Group expects that the industrial operating environment in the PRC will continue to improve. The support to the development of strategic emerging industries and the promotion of transformation and upgrade of traditional competitive industries by the Thirteenth Five-Year plan on technological innovations across the country, together with the plan on Guangdong-Hong Kong-Macao Greater Bay Area, are expected to further improve the business and investment environment in Guangdong and Hong Kong and also create new business opportunities for the market. Considering the overall macro situation, it is expected that innovative technologies will continue to emerge, resulting in advancements in the traditional operating models, products and services.

With the implementation of the supply-side structural reform by the PRC government, the large-scale enterprises in the PRC are encouraged to proactively develop high-end products, replace and purchase equipment for capacity expansion and optimise the supply chain selection. Such measures can improve the operating environment of the industrial sector in the PRC, and result in demand for good quality and high performance industrial products.

We understand from the Company that the Group will continue to align its business strategy with the Made in China 2025 initiative and the Thirteenth Five-Year Plan. In particular, it plans to continue to invest in research and development and innovation works of which include information technology, and strive to launch quality products with excellent performance to meet the demand of new markets. The Group will also apply new information and manufacturing technologies to optimise the automation, intelligence and information management of the internal production processes, with an aim to improve product and service quality and, at the same time, effectively control production and management costs. While maintaining the growth of existing businesses, the Group plans to further develop new business sectors such as new energy vehicles, medical equipment and robotic arms and, at the same time, secure orders for the “Industrial 4.0” system integration projects, such as digital real-time monitoring systems and other notification and analytic functions.

Nevertheless, the Group sees and will remain cautious of the key challenges lying ahead including the continuous increasing of manufacturing costs (in particular the raw materials cost), shorter life cycle of consumer products, the fluctuations of currencies and exchange rates, the upward trend of corporates’ borrowing costs, and volatile capital market. As such, we concur with the view of the management of the Company that the future performance of the Group remains conservatively optimistic.

The gross proceeds from the Subscription are expected to be approximately HK\$79,750,000 (based on the Subscription Price of HK\$0.550 per Share). The net proceeds of the Subscription (after deducting related professional fees and related transaction expenses) are expected to be approximately HK\$76,800,000 and the net Subscription Price per Subscription Share will be approximately HK\$0.530.

The Board considers that the Subscription could raise a substantial amount of additional capital and funding to equip the Group with more resources to further develop the Group’s existing businesses and additional investments in research and development for further growth.

The Company intends to use the net proceeds from the Subscription as follows:

- (a) 20% – 30% of the net proceeds for funding and working capital to support existing businesses of the Group in order to increase market share in high potential niche markets in its machinery manufacturing business, to expand business scale in its plastic products and processing business, to increase business scale and to enhance solution based business model in its industrial supplies trading business;

- (b) 15% – 20% of the net proceeds for investment in research and development of the Group in order to enhance product features and functionalities in its machinery manufacturing business such as applications enhancement, production quality/efficiency upgrade and development of new product series, and to ramp up industrial digitalisation solutions research and developments in its machinery manufacturing business such as refinement and enhancement of real-time machine data monitoring, analytics functions, and software/hardware integration solutions;
- (c) 15% – 25% of the net proceeds for investments in plants and machineries and other business in order to upgrade and expand manufacturing plants in Wuxi in its machinery manufacturing business, to invest in new machineries for the production plants in Zhuhai and Dongguan for the plastic processing business, to invest in digital systems in the manufacturing, warehousing, distribution facilities in its machinery manufacturing, plastic products and processing, as well as industrial supplies trading businesses; and
- (d) 5% – 10% of the net proceeds for funding for restructuring in order to further support restructuring of machinery business, which includes asset relocation and optimisation, organisational restructuring and production efficiency enhancement.

Besides, in anticipation of the possible interest rate hike in Hong Kong, the Board may consider to use 5% – 15% of the net proceeds from the Subscription to repay bank loans to reduce the finance cost of the Group.

As stated in the Letter from the Board, the Subscription would also enhance the general working capital of the Group without incurring additional interest burden and the capital base of the Group would be strengthened. The Company intends to use the remaining net proceeds for the general working capital of the Group.

Having considered the above, including (i) the future prospect of the manufacturing industry in the PRC is generally positive in view of the relevant policies put forward by the PRC government; (ii) the Subscription and the use of proceeds can complement the business strategy of the Group; and (iii) the Subscription represents an opportunity to raise readily available capital for the Company to enhance its capital base, we are of the view that the reasons for the Subscription is justifiable and the Subscription is in the interests of the Company and the Shareholders as a whole.

***(d) Financing alternatives of the Group***

As disclosed in the Letter from the Board and as advised by the management of the Company, the Board has considered other ways of fund raising methods apart from the Subscription such as bank borrowing, rights issue and open offer.

With regards to bank borrowing, having considered the contemplated interest rate hike, the Board considers that an increase in bank borrowings would result in additional interest burden to the Group, which could have an adverse effect on the profitability and gearing ratio of the Group. As such, while bank borrowing continues to play a key role to support ongoing operating working capital for the Group, the Board considers that it is not the optimal method for the Group to fund its product research and development plans. In contrast, (i) the Subscription is expected to improve the gearing ratio of the Group upon Completion as discussed under the section headed “4. Financial effects of the Subscription” below; and (ii) the Subscription would not incur interest expenses to the Group and would not require repayment of principal.

As regards to the viability of equity financing by way of rights issue or open offer, the Board considers that a rights issue or open offer would result in less favourable terms to the Company than the Subscription as well as incur more transaction costs including but not limited to underwriting commission and other additional costs for the preparation of the listing documents and that such corporate exercises would have a relatively more time consuming process which may affect the overall business plan of the Group. As advised by the management of the Company, given the thin trading volume of the Shares, it would be difficult to identify underwriter(s) which is/are interested to underwrite a rights issue or open offer with a fund raising size and issue price comparable to that of the Subscription as the subscription price of shares under a rights issue or open offer is normally at a discount to the prevailing market prices while the Subscription Price represents a premium to the most recent closing prices of the Shares prior to the date of the Announcement. Moreover, in contrast to rights issue and open offer, (i) the Subscription will not incur costly underwriting commission; and (ii) the Subscription can provide more certainty to the Company to raise the required fund.

Taking into account the above, we concur with the Board’s view that equity financing by way of the Subscription is comparatively a more appropriate and viable means of raising additional capital.

## **2. Principal terms of the Subscription Agreement**

The major terms and conditions of the Subscription Agreement are summarised below. For further details, please refer to the section headed “The Subscription Agreement” in the Letter from the Board.

### ***Date***

30 April 2018

### ***Parties***

- (i) the Company, being the issuer;
- (ii) Cosmos Machinery (Holdings) Limited, being the First Subscriber; and

(iii) Saniwell Holding Inc., being the Second Subscriber.

### ***The Subscription Shares***

The 145,000,000 Subscription Shares represent (i) approximately 20.23% of the issued share capital of the Company as at the Latest Practicable Date; and (ii) approximately 16.82% of the issued share capital of the Company as enlarged by the allotment and issue of the Subscription Shares. The aggregate consideration of the Subscription Shares is HK\$79,750,000.

The Subscription Shares to be allotted and issued shall rank *pari passu* in all respects among themselves and with all existing Shares in issue as at the date of Completion, including the right to rank in full for all distributions declared, made or paid by the Company at any time after the date of the Subscription Agreement.

### ***The Subscription Price***

The Subscription Price of HK\$0.550 per Subscription Share was arrived at after arm's length negotiations between the Company and the Subscribers with reference to recent market trading prices of the Shares.

Based on the Subscription Price of HK\$0.550 per Subscription Share and the 108,750,000 Subscription Shares and 36,250,000 Subscription Shares to be allotted and issued to the First Subscriber and Second Subscriber respectively, the total subscription monies payable by the First Subscriber and the Second Subscriber to the Company pursuant to the Subscription Agreement amount to approximately HK\$59,812,500 and approximately HK\$19,937,500 respectively, which will be settled in cash.

### ***Lock-up period***

Pursuant to the terms of the Subscription Agreement:

- (i) Each of the Subscribers undertakes to the Company that from the date of the Completion and on or prior to the date being 6 months after the date of the Completion, it will not and will procure that none of its nominees and companies controlled by it or trusts associated with it (whether individually or together and whether directly or indirectly) will (a) offer, lend, pledge, issue, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase, or otherwise transfer or dispose of (either conditionally or unconditionally, or directly or indirectly, or (otherwise) any Shares or any interests therein or any securities convertible into or exercisable or exchangeable for or substantially similar to any such Shares or interests or (b) enter into any swap or similar agreement that transfers, in whole or in part, the economic risk of ownership of such Shares, whether any such transaction described in (a) or (b) above is to be settled by delivery of Shares or such other securities, in cash or otherwise or (c) announce any intention to enter into or effect any such transaction described in (a) or (b) above; and

- (ii) The Company undertakes to each of the Subscribers that (except for (a) the new Shares to be allotted and issued to each of the Subscribers and (b) any Shares or other securities or rights issued or granted to shareholders by way of bonus or under any scrip dividend or similar arrangement providing for the allotment of shares in lieu of the whole or part of a dividend on shares of the Company in accordance with its articles of association or on the exercise of rights existing at the date of the Subscription Agreement from the date of the Completion and on or prior to the date being 6 months after the date of the Completion it will not (x) allot or issue or offer to allot or issue or grant any option, right or warrant to subscribe (either conditionally or unconditionally, or directly or indirectly, or (otherwise) any Shares or any interests in Shares or any securities convertible into or exercisable or exchangeable for or substantially similar to any Shares or interest in Shares or (y) agree (conditionally or unconditionally) to enter into or effect any such transaction with the same economic effect as any of the transaction described in (x) above or (z) announce any intention to enter into or effect any such transaction described in (x) or (y) above.

***Conditions precedent to the Subscription Agreement***

Completion is conditional upon:

- (i) the Listing Committee of the Stock Exchange granting or agreeing to grant the listing of, and permission to deal in, the Subscription Shares (and such listing and permission not subsequently revoked prior to Completion);
- (ii) the passing of resolution(s) by the Independent Shareholders at the EGM to approve the Subscription Agreement, the transactions contemplated thereunder and the Whitewash Waiver;
- (iii) the Executive granting or agreeing to grant the Whitewash Waiver in accordance with the requirements of the SFC and the Takeovers Code; and
- (iv) the representations and warranties of the Subscribers being true and accurate and not misleading at all times from the date of the Subscription Agreement up to and including the date of Completion.

The Company may waive in writing the condition set out in (iv) above. Save as aforementioned, none of the conditions precedent can be waived by any parties to the Subscription Agreement.

In the event that the conditions precedent above are not fulfilled or waived (as the case may be) by 5:00 p.m. on the Long Stop Date (or such later date as may be agreed by the Subscribers and the Company), the Subscription Agreement and all rights and obligations thereunder shall cease and terminate and none of the parties thereto shall have any claim against the other.

As at the Latest Practicable Date, none of the conditions precedent has been fulfilled.

### ***Completion of the Subscription***

Completion shall take place at 10:00 am (Hong Kong time) on the fifth Business Day after the date on which all the conditions precedent to the Subscription Agreement set out above have been fulfilled or waived (as the case may be) (or such other time and/or date as the Subscribers and the Company may agree in writing), and in any event not later than the Long Stop Date (or such later date as may be agreed by the Subscribers and the Company).

### **3. Evaluation of the Subscription Price**

#### ***(a) Comparison of the Subscription Price to market price***

The Subscription Price of HK\$0.550 per Subscription Share represents:

- (i) a discount of approximately 12.7% to the closing price of HK\$0.630 per Share as quoted on the Stock Exchange on the Latest Practicable Date;
- (ii) a premium of approximately 11.1% to the closing price of HK\$0.495 per Share as quoted on the Stock Exchange on the Last Trading Day;
- (iii) a premium of approximately 6.8% to the average closing price of approximately HK\$0.515 per Share as quoted on the Stock Exchange for the last five consecutive trading days up to and including the Last Trading Day;
- (iv) a premium of approximately 10.4% to the average closing price of approximately HK\$0.498 per Share as quoted on the Stock Exchange for the last ten consecutive trading days up to and including the Last Trading Day;
- (v) a premium of approximately 12.0% to the average closing price of approximately HK\$0.491 per Share as quoted on the Stock Exchange for the last thirty consecutive trading days up to and including the Last Trading Day;
- (vi) a discount of approximately 63.5% to the audited net asset value attributable to owners of the Company as at 31 December 2017 of approximately HK\$1.507 per Share; and
- (vii) a discount of approximately 64.0% to the adjusted net asset value attributable to owners of the Company as at 31 December 2017 after taking into account the market value of the properties of the Group as at 31 March 2018 as set out in the property valuation report in Appendix II to the Circular of approximately HK\$1.528 per Share.

(b) *Review of the historical Share price performance*

The chart below depicts the daily closing prices of the Shares as quoted on the Stock Exchange for the period from 3 May 2016 (being the first trading day of the 24-month period prior to the Last Trading Day) up to and including the Latest Practicable Date (the “**Review Period**”):



Source: Website of the Stock Exchange

As shown in the chart above, during the Review Period, the closing prices of the Shares fluctuated between HK\$0.420 per Share and HK\$0.630 per Share, with an average closing price of approximately HK\$0.503 per Share. The Subscription Price is within the range of the lowest and highest closing prices, and represents a premium of approximately 31.0% over the lowest closing price, a discount of approximately 12.7% to the highest closing price and a premium of approximately 9.3% over the average closing price per Share during the Review Period. In addition, we also noted that the closing prices of the Shares were generally below the Subscription Price, which accounted for 442 trading days out of 504 trading days during the Review Period.

Starting from 3 May 2016, the closing price of the Shares decreased gradually from HK\$0.500 to the lowest level during the Review Period of HK\$0.420 on 27 June 2016. Since 28 June 2016, the closing prices showed an upward trend in general and closed at HK\$0.570 on 24 October 2016. During this period, the Company published an announcement in relation to cessation of operation of a wholly-owned subsidiary of the Group on 8 July 2016 and the interim results announcement of the Company for the six months ended 30 June 2016 on 18 August 2016. From 24 October 2016 to the Last Trading Day, the closing prices fluctuated within the range of HK\$0.465 per Share and HK\$0.580 per Share, and closed at HK\$0.495 per Share on the Last Trading Day.

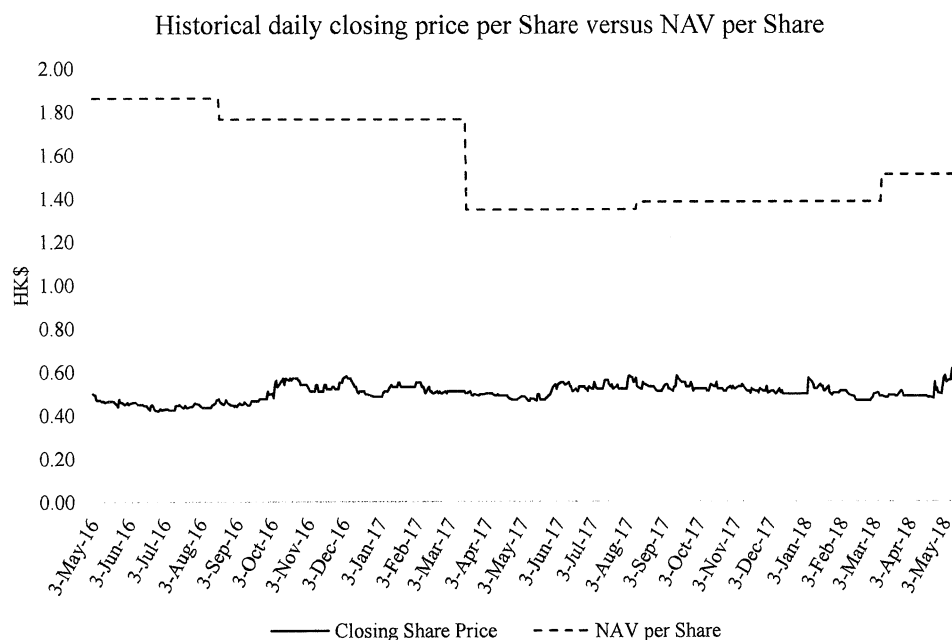


Subsequently, the Announcement was published on 2 May 2018 (before trading hours). The Share price closed at HK\$0.570 per Share on 2 May 2018, representing an increase of approximately 15.2% from the closing price of HK\$0.495 per Share on the Last Trading Day.

The Share price closed at HK\$0.630 per Share as at the Latest Practicable Date. The Subscription Price represents a discount of approximately 12.7% to the closing price per Share as at the Latest Practicable Date.

**(c) Review of the historical Share price performance to the net asset value attributable to owners of the Company per Share (“NAV per Share”)**

The following chart depicts the historical NAV per Share and the historical performance of the daily closing prices of the Shares during the Review Period:



Source: Website of the Stock Exchange

As illustrated in the chart above, we noted that the Shares have continuously traded below the historical NAV per Share during the Review Period. Details of the above chart have been summarised in the table set out below:

Release date of interim/ annual results	Period	NAV per Share (HK\$)	Daily closing price per Share			Discount of closing Share price to NAV per Share		
			Highest (HK\$)	Lowest (HK\$)	Average (HK\$)	Lowest (%)	Highest (%)	Average (%)
31-Mar-16	3-May-16 to 18-Aug-16	1.863	0.500	0.420	0.449	73.2	77.5	75.9
18-Aug-16	19-Aug-16 to 16-Mar-17	1.766	0.580	0.440	0.512	67.2	75.1	71.0
16-Mar-17	17-Mar-17 to 10-Aug-17	1.348	0.580	0.465	0.511	57.0	65.5	62.1
10-Aug-17	11-Aug-17 to 8-Mar-18	1.383	0.580	0.465	0.514	58.1	66.4	62.9
8-Mar-18	9-Mar-18 to Latest Practicable Date	1.507	0.630	0.475	0.514	58.2	68.5	65.9
<b>3-May-16 to Latest Practicable Date</b>						<b>57.0</b>	<b>77.5</b>	<b>67.2</b>

*Source: Website of the Stock Exchange*

As illustrated in the above table, we noted that during the Review Period, the highest, lowest and average daily closing price of the Shares for each of the respective periods indicated above have been at a discount to the then NAV per Share. Such discounts ranged from approximately 57.0% to approximately 77.5%, with an average discount of approximately 67.2% (the “**Historical Average Discount to NAV**”). The Subscription Price of HK\$0.550 represents a discount of approximately 63.5% to the NAV per Share of approximately HK\$1.507 as at 31 December 2017, which is lower than the Historical Average Discount to NAV as shown above.

**(d) Review of the trading liquidity of the Shares**

The table below sets out (i) the average daily trading volume of the Shares for each month and the respective percentage to the total number of issued Shares and the total number of issued Shares held by public Shareholders; and (ii) the average daily turnover of Hong Kong listed securities for each month and the respective percentage to the total market capitalisation of Hong Kong listed securities, during the Review Period:

Month	Total trading volume (Number of Shares)	Number of trading days (Number of days)	Average daily trading volume (Number of Shares) (Note 1)	Percentage of the average daily trading volume over total	Percentage of the average daily trading volume over total	Average daily turnover of Hong Kong listed securities for the month (HK\$ in billions) (Note 4)	Percentage of the average daily turnover over total market capitalisation of Hong Kong listed securities as at the end of the month	Percentage of the average daily turnover over total market capitalisation of Hong Kong listed securities as at the end of the month
				number of issued Shares as at the end of the month/period (Approx. %) (Note 2)	number of issued Shares held by public Shareholders as at the end of the month/period (Approx. %) (Note 3)		of Hong Kong listed securities as at the end of the month (Approx. %)	of Hong Kong listed securities as at the end of the month (Approx. %)
<b>2016</b>								
May (Note 5)	1,193,000	21	56,810	0.01%	0.02%	60	23,131	0.26%
June	4,363,000	21	207,762	0.03%	0.09%	62	23,063	0.27%
July	1,466,000	20	73,300	0.01%	0.03%	62	24,055	0.26%
August	6,896,000	22	313,455	0.04%	0.14%	69	25,197	0.27%
September	5,678,965	21	270,427	0.04%	0.12%	74	25,595	0.29%
October	7,605,000	19	400,263	0.06%	0.17%	61	25,413	0.24%
November	3,492,200	22	158,736	0.02%	0.07%	68	25,526	0.27%
December	3,837,350	20	191,868	0.03%	0.08%	64	24,761	0.26%
<b>2017</b>								
January	2,242,000	19	118,000	0.02%	0.05%	57	26,125	0.22%
February	6,941,200	20	347,060	0.05%	0.15%	82	26,680	0.31%
March	2,112,890	23	91,865	0.01%	0.04%	82	27,236	0.30%
April	2,426,000	17	142,706	0.02%	0.06%	74	27,665	0.27%
May	8,038,800	20	401,940	0.06%	0.17%	79	28,542	0.28%
June	7,713,105	22	350,596	0.05%	0.15%	80	28,681	0.28%
July	4,173,200	21	198,724	0.03%	0.09%	85	30,263	0.28%
August	4,061,000	22	184,591	0.03%	0.08%	99	31,020	0.32%
September	7,498,950	21	357,093	0.05%	0.15%	95	31,412	0.30%
October	2,248,510	20	112,426	0.02%	0.05%	96	32,253	0.30%
November	3,033,000	22	137,864	0.02%	0.06%	120	33,003	0.36%
December	1,304,400	19	68,653	0.01%	0.03%	105	33,999	0.31%

Month	Total trading volume (Number of Shares)	Number of trading days (Number of days)	Average daily trading volume (Number of Shares) (Note 1)	Percentage of the average daily trading volume over total issued Shares as at the end of the month/period (Approx. %) (Note 2)	Percentage of the average daily trading volume over total issued Shares held by public Shareholders as at the end of the month/period (Approx. %) (Note 3)	Average daily turnover of Hong Kong listed securities for the month (HK\$ in billions) (Note 4)	Total market capitalisation of Hong Kong listed securities as at the end of the month (HK\$ in billions)	Percentage of the average daily
								turnover over total market capitalisation of Hong Kong listed securities as at the end of the month (Approx. %)
<b>2018</b>								
January	3,726,495	22	169,386	0.02%	0.07%	161	37,197	0.43%
February	1,240,000	18	68,889	0.01%	0.03%	145	35,155	0.41%
March	2,314,000	21	110,190	0.02%	0.05%	132	34,402	0.38%
April	6,358,200	19	334,642	0.05%	0.15%	108	34,870	0.31%
May (Note 6)	23,697,000	12	1,974,750	0.28%	0.86%	N/A	N/A	N/A

Source: Website of the Stock Exchange and Bloomberg

Notes:

1. Average daily trading volume is calculated by dividing the total trading volume for the month/period by the number of trading days in the respective month/period
2. Based on 716,930,692 Shares in issue as at Latest Practicable Date
3. Based on 716,930,692 Shares in issue, 485,066,904 Shares held by the First Subscriber and parties acting in concert with it, 1,406,000 Shares held by Mr. Cheng Tak Yin and 230,457,788 Shares held by public Shareholders as at the end of relevant month/period and up to the Latest Practicable Date
4. Average daily turnover of Hong Kong listed securities is calculated by dividing the total turnover of Hong Kong listed securities for the month by the number of trading days in respective month
5. Since the beginning of the Review Period, i.e. 3 May 2016
6. Since the beginning of the month up to the Latest Practicable Date

As illustrated in the above table, the average daily trading volume of the Shares during the period from May 2016 to April 2017 ranged from of approximately 56,810 Shares to approximately 401,940 Shares, representing approximately 0.01% to 0.06% of the total number of Shares in issue as at the end of the relevant month/period (the “**Range to Total Issued Shares**”) and approximately 0.02% to 0.17% of the total number of issued Shares held by public Shareholders as at the end of the relevant month/period (the “**Range to Public Float**”). Furthermore, we noted that the Range to Total Issued Shares and the Range to Public Float were below the range of percentage of average daily turnover over the total market capitalisation of Hong Kong listed securities as at the end of the month of approximately 0.22% to 0.43%. Since the publication of the Announcement (before trading hours) on 2 May 2017 (being the first trading day of the month of May 2017) and up to the Latest Practicable Date, the average daily trading volume of the Shares increased significantly to approximately 1,974,750 Shares, representing approximately 0.28% of the total number of Shares in issue as at the end of the period and approximately 0.86% of the total number of issued Shares held by public Shareholders as at the end of the period. Save for during the aforesaid period, which represents the trading period of the Shares after the publication of the Announcement, the trading of the Shares was generally thin during the Review Period. The low liquidity of the Shares may imply the lack of interest from potential investors to invest in the Shares. As such, it may be difficult for the Company to conduct equity fund raising activities in the market with similar pricing to that of the Subscription.

(e) **Comparable issues analysis**

We have performed an analysis of comparable issues by searching the website of the Stock Exchange for all transactions announced during the 18 month period immediately prior to the Last Trading Day by companies listed on the Stock Exchange involving (i) subscription of new shares of the listed companies by subscriber(s) with cash under specific mandate; and (ii) the application of a whitewash waiver by the subscriber(s) (the “**Comparable Issues**”). We have excluded those transactions (i) announced by companies which were under prolonged suspension as at the date of announcement; (ii) involving only convertible securities; (iii) involving open offers or rights issues; and (iv) involving H-share companies. We have identified nine Comparable Issues which we consider an exhaustive list based on the aforesaid criteria.

It should be noted that all the subject companies involved in the Comparable Issues may have different principal activities, market capitalisation, profitability and financial position as compared with those of the Company. The circumstances leading to the subject companies to proceed with the subscription/issue may also be different from that of the Company. However, as (i) there are nine Comparable Issues identified during the period which provide a reasonable number of comparables for comparison purposes; and (ii) the Comparable Issues fulfill the above criteria with similar deal structures to the Subscription and can provide a reference of the recent market trend in relation to the subscription price of the subscription shares issued by Hong Kong listed companies as compared to their relevant prevailing market share prices of this type of transaction in Hong Kong equity capital market, we consider them to be an appropriate basis to assess the fairness of the Subscription Price. Details of the Comparable Issues are summarised in the table set out below:

Date of announcement	Company name	Stock code	Principal activities <i>(Note 1)</i>	Market capitalisation as at the last trading day <i>(HK\$ in millions)</i> <i>(Note 2)</i>	Premium/(discount) of the subscription price over/to the	
					closing price of the shares as at the last trading day <i>(Approx. %)</i> <i>(Note 3)</i>	average closing price of the shares for the last five consecutive trading days up to and including the last trading day <i>(Approx. %)</i> <i>(Note 3)</i>
26 March 2018	Central China Real Estate Limited	832	Real estate development and sales in the PRC.	8,352	7.0	8.2
14 December 2017	TSC Group Holdings Limited	206	Developing, manufacturing, marketing, installing and servicing a comprehensive line of products for the onshore and offshore oil and gas exploration and production and decommissioning industries.	679	(30.2)	(21.2)

Date of announcement	Company name	Stock code	Principal activities  (Note 1)	Market capitalisation as at the last trading day (HK\$ in millions) (Note 2)	Premium/(discount) of the subscription price over/to the	
					closing price of the shares as at the last trading day (Approx. %) (Note 3)	average closing price of the shares for the last five consecutive trading days up to and including the last trading day (Approx. %) (Note 3)
9 November 2017	Trinity Limited	891	Retailing and wholesale of premium menswear in Greater China, Singapore and Europe, as well as licensing its fully owned brands globally.	1,310	60.0	80.7
29 September 2017	Lenovo Group Limited	992	Sales and manufacturing of personal computers, tablets, smartphones, servers and related information technology products and provision of advanced information services across the world.	47,878	0.0	1.2
21 March 2017	Jutal Offshore Oil Services Limited	3303	Provision of technical support services in offshore oil and gas industry, fabrication of oil and gas facilities and oil and natural gas processing skid equipment, and provision of technical support services to the shipbuilding industry.	1,601	(40.0)	(39.4)
6 January 2017	Addchance Holdings Limited	3344	Production and sale of dyed yarns, knitted sweaters, cotton yarns, provision of dyeing and knitting services, and trading of cotton and yarns.	813	(91.7)	(92.1)
21 December 2016	A8 New Media Group Limited	800	Provision of digital entertainment services, including game publishing services and music-based entertainment services as well as property investment in the PRC.	863	(12.8)	(13.1)
16 November 2016	Ozner Water International Holding Limited	2014	Provision of water purification services and air sanitization services in the PRC.	2,889	2.4	7.6
11 November 2016	Yue Da Mining Holdings Limited	629	Exploration, mining and processing of zinc, lead, iron, gold and stone for construction.	266	31.0	35.2
		<b>Maximum</b>			60.0	80.7
		<b>Minimum</b>			(91.7)	(92.1)
		<b>Median</b>			0.0	1.2
		<b>Average</b>			(8.2)	(3.7)
30/4/2018	The Subscription			355	11.1	6.8

Source: Website of the Stock Exchange

*Note:*

1. The principal activities of the companies were extracted from the relevant circulars of the Comparable Issues.
2. The market capitalisation of the companies were calculated based on their respective number of shares in issue and their respective closing share price immediately prior to the publication of the relevant announcements.
3. For the Comparable Issues with share trading halted prior to the publication of relevant announcements, the last trading day refers to their respective last trading day of shares on the Stock Exchange immediately prior to the publication of relevant announcements. For the Comparable Issues without share trading halted prior to the publication of relevant announcements, the last trading day refers to the respective date of subscription agreement as the relevant subscription agreements were entered into among relevant parties after trading hours on the same date.

As illustrated in the table above, we noted that the premium/discount represented by the subscription prices of the Comparable Issues over/to their respective closing share prices on their respective last trading day (the “**Premium/Discount to Last Trading Day**”) ranged from a discount of approximately 91.7% to a premium of approximately 60.0%, with an average of a discount of approximately 8.2%. Similarly, we noted that the premium/discount represented by the subscription prices of the Comparable Issues over/to their respective average closing share prices for the last five consecutive trading days up to and including their respective last trading day (the “**Premium/Discount to Last Five Trading Days**”) ranged from a discount of approximately 92.1% to a premium of approximately 80.7%, with an average of a discount of approximately 3.7%.

The Subscription Price represents (i) a premium of approximately 11.1% to the closing Share price on the Last Trading Day; and (ii) a premium of approximately 6.8% to the average closing price for the last five consecutive trading days up to and including the Last Trading Day. Such premiums represented by the Subscription Price, therefore, falls within the range of the Premium/Discount to Last Trading Day and the Premium/Discount to Last Five Trading Days respectively, and are more favourable than the average and median of the Premium/Discount to Last Trading Day and the Premium/Discount to Last Five Trading Days, respectively.

**(f) Comparable companies analysis**

As mentioned under the section headed “1.(a) Information of the Group” above, the Group is principally engaged in manufacturing of machineries (such as plastic injection moulding machines), manufacturing of plastic processing products (such as plastic moulded products), processing and trading of printed circuit boards and trading of industrial supplies. According to the 2017 Annual Report, revenue derived from the manufacturing of machineries, manufacturing of plastic processing products, processing and trading of printed circuit boards, and trading of industrial supplies business segments represented approximately 36.6%, 15.9%, 32.2%, and 14.2% of the total revenue of the Group for the year ended 31 December 2017, respectively. Accordingly, we have researched for companies (the “**Comparable Companies**”) (i) listed on the Stock Exchange; and (ii) either having not less than (a) 30% of their respective total revenue derived from plastic moulding related business, including plastic moulded products and plastic moulding machines as these two segments are closely related to each other; and/or (b) 30% of their

respective total revenue derived from processing and trading of printed circuit boards related business for their respective latest financial year as set out in their respective latest published annual report. We have identified 12 Comparable Companies which we consider an exhaustive list based on the aforesaid criteria, and have compared the historical price-to-earnings (“P/E”) multiple and the historical price-to-book (“P/B”) multiple of the Comparable Companies to that implied by the Subscription Price.

It should be noted that the business, operation, and prospect of the Comparable Companies are not exactly the same as that of the Company and thus the P/E and P/B multiples of the Comparable Companies are used only to provide a reference of the recent valuation multiples of the Hong Kong-listed companies operating in the relevant industry to that of the Group. We have not conducted any in-depth investigation into the business and operation of the Comparable Companies save for the selection criteria above.

The list of the Comparable Companies and their respective P/E and P/B multiples are set out in the table below:

Comparable Companies (Stock code)	Principal business	Market capitalisation as at the Last Trading Day (HK\$ in millions)	Closing share price as at the Last Trading Day (HK\$)	Historical P/E (times) (Note 1)	Historical P/B (times) (Note 2)
Tongda Group Holdings Limited (698)	Design and production of plastic and metal casings and components for electrical appliance products; provision of metallic casings and other ironware parts for electrical and electronic appliances; and provision of plastic set top boxes and manufacturing of sports products.	10,591	1.75	10.53	1.82
China HKBridge Holdings Limited (2323)	Manufacturing and sale of a broad range of printed circuit boards; investment and trading of securities and related treasury activities; and advising on securities and asset management services.	4,858	2.2	10.65	1.46
China Aerospace International Holdings Limited (31)	Production and sale of plastic products, liquid crystal display, printed circuit boards, and intelligent chargers; property investment; and internet of things applications and cross-border e-commerce logistics	2,591	0.84	5.33	0.37



Comparable Companies (Stock code)	Principal business	Market capitalisation as at the Last Trading Day (HK\$ in millions)	Closing share price as at the Last Trading Day (HK\$)	Historical P/E (times) (Note 1)	Historical P/B (times) (Note 2)
AKM Industrial Company Limited (1639)	Manufacturing and sale of flexible printed circuits, flexible packaging substrates and their respective components.	2,230	1.45	28.23	3.02
Chen Hsong Holdings (57)	Manufacturing and sale of plastic injection moulding machines and related products.	1,438	2.28	27.92	0.53
CMMB Vision Holdings Limited (471)	Provision of mobile multimedia and data services and trading of printed circuit board components.	502	0.191	N/A	0.37
VS International Group Limited (1002)	Manufacturing and sale of plastic moulded products and parts, assembling of electronic products, and mould design and fabrication.	452	0.196	27.05	0.70
Tian Chang Group Holdings Limited (2182)	Provision of integrated plastic solutions including mould design and fabrication services, and plastic component design and manufacturing services; and manufacturing and sale of e-cigarette products.	279	0.45	13.90	0.98
Daisho Microline Holdings Limited (567)	Manufacturing and trading of printed circuit boards and trading of petroleum and energy products and related business.	213	0.37	N/A	1.06
IAG Holdings Limited (8513)	Manufacturing and sale of injection moulded plastic parts for disposable medical devices and provision of tooling services.	158	0.395	N/A	9.43
TC Orient Lighting Holdings Limited (515)	Manufacturing and trading of printed circuit boards and light emitting diode lighting and trading of tower and electric cables.	210	0.102	N/A	0.69

Comparable Companies (Stock code)	Principal business	Market capitalisation as at the Last Trading Day (HK\$ in millions)	Closing share price as at the Last Trading Day (HK\$)	Historical P/E (times) (Note 1)	Historical P/B (times) (Note 2)
			Maximum	28.23	9.43
			Minimum	5.33	0.37
			Median	13.90	0.98
			Average	17.66	1.86
<b>The Subscription</b>		<b>394</b> (Note 3)	<b>0.550</b>	<b>14.45</b> (Note 4)	<b>0.36</b> (Note 5)

Source: Website of the Stock Exchange

Notes:

- The historical P/E multiple of the Comparable Companies is calculated based on their respective market capitalisation as at the Last Trading Day divided by their respective latest published net profit attributable to owners of the Comparable Company as extracted from their respective latest published annual report. "N/A" represents Comparable Companies with net losses recorded in their respective latest published annual report.
- The historical P/B multiple of the Comparable Companies is calculated based on their respective market capitalisation as at the Last Trading Day divided by their latest published equity attributable to owners of the respective Comparable Company as extracted from their respective latest published annual or interim report.
- Theoretical market capitalisation of the Company is calculated based on the sum of the Subscription Price of HK\$0.550 per Subscription Share times the number of Shares in issue as at the Last Trading Day.
- The implied P/E multiple of the Subscription Price is calculated based on the theoretical market capitalisation of the Company divided by the net profit attributable to owners of the Company for the year ended 31 December 2017 as extracted from the 2017 Annual Report.
- The implied P/B multiple of the Subscription Price is calculated based on the theoretical market capitalisation of the Company divided by the equity attributable to owners of the Company as at 31 December 2017 as extracted from the 2107 Annual Report.
- For the purpose of this table, the translation of (i) RMB into HK\$ is based on an exchange rate of RMB1.00 = HK\$1.24; (ii) USD into HK\$ is based on an exchange rate of USD1.00 = HK\$7.85; and (iii) SGD into HK\$ is based on an exchange rate of SGD1.00 = HK\$5.92 for the purpose of illustration only.

As set out in the table above, the historical P/E multiples of the Comparable Companies ranged from approximately 5.33 times to approximately 28.23 times, with a median of approximately 13.90 times and average of approximately 17.66 times. We noted that the implied P/E multiple of the Subscription Price of approximately 14.45 times is within the range, higher than the median, and lower than the average of the historical P/E multiples of the Comparable Companies. As such, we consider the implied P/E multiple of the Subscription Price is in line with the market, having also taken into account (i) the turnaround achieved in the Group's results for the year ended 31 December 2017 after having recorded net losses consecutively during the past

two financial years; and (ii) the net profit of approximately HK\$43.9 million recorded for the year ended 31 December 2017 included a non-recurring income of approximately HK\$31.1 million relating to the reversal of unutilised portion of the provision for restructuring costs and a non-recurring loss net of insurance recovery of approximately HK\$17.6 million due to the damages caused by typhoon “Hato” as discussed under the section headed “1.(a) Information of the Group” above.

The historical P/B multiples of the Comparable Companies ranged from approximately 0.37 times to approximately 9.43 times, with a median of approximately 0.98 times and an average of approximately 1.86 times. We noted that the implied P/B multiple of the Subscription Price of approximately 0.36 times is below the range of the historical P/B multiples of the Comparable Companies. However, as discussed under the section headed “3.(c) Review of the historical Share price performance to the net asset value attributable to owners of the Company per Share” above, we noted that the closing price of the Shares has traded continuously below the NAV per Share since 3 May 2016 and the discount represented by the Subscription Price to the NAV per Share as at 31 December 2017 is lower than the Historical Average Discount to NAV, which is favourable to the Company.

**(g) Conclusion**

After taking into account the above, in particular, that:

- (i) the closing price of the Shares have been fluctuating within a range of HK\$0.465 per Share and HK\$0.580 per Share since 24 October 2016 until the Last Trading Day and was generally below the Subscription Price for 442 trading days out of 504 trading days during the Review Period;
- (ii) the discount represented by the Subscription Price to the NAV per Share as at 31 December 2017 of approximately 63.5% is lower than the Historical Average Discount to NAV of approximately 67.2%, which is favourable to the Company;
- (iii) the generally thin trading volume of the Shares during the Review Period may imply the lack of interest from potential investors to invest in the Shares and hence it may be difficult for the Company to conduct equity fund raising activities in the market with similar pricing to that of the Subscription;
- (iv) for reference purpose, while the average of the Premium/Discount to Last Trading Day of the Comparable Issues represents a discount of approximately 8.2% and the average of the Premium/Discount to Last Five Trading Days of the Comparable Issues represent a discount of approximately 3.7%, the Subscription Price represents (i) a premium of approximately 11.1% to the closing Share price on the Last Trading Day; and (ii) a premium of approximately 6.8% to the average closing price for the last five consecutive trading days up to and including the Last Trading Day, which is more favourable to the Company; and

- (v) the implied P/E multiple of the Subscription Price of approximately 14.45 times is within the range the range and higher than the median of the historical P/E multiples of the Comparable Companies of approximately 13.90 times, which is in line with the market,

we consider that the Subscription Price of HK\$0.550 per Subscription Share is fair and reasonable. As such, we are of the view that the terms of the Subscription Agreement, including the Subscription Price, are fair and reasonable so far as the Company and the Independent Shareholders are concerned.

#### **4. Financial effects of the Subscription**

##### ***(a) Working capital***

According to the 2017 Annual Report, as at 31 December 2017, cash and bank balances of the Group amounted to approximately HK\$348.7 million. Upon Completion, it is expected that the net proceeds of approximately HK\$76,800,000 from the Subscription will enhance the cash position and therefore working capital of the Group.

##### ***(b) Gearing ratio***

The gearing ratio of the Group is calculated as bank borrowings divided by net assets of the Group. As at 31 December 2017, the Group's gearing ratio was approximately 32.9%. Upon Completion, the Group's net assets is expected to be increased by the amount of net proceeds from the Subscription and therefore the gearing ratio and capital structure of the Group are expected to improve.

##### ***(c) Net asset value***

According to the 2017 Annual Report, net assets attributable to equity shareholders of the Company (the "NAV") was approximately HK\$1,080.5 million as at 31 December 2017. Upon Completion, it is expected that the NAV will increase by the amount of net proceeds from the Subscription. Accordingly, the Subscription is expected to have a positive impact on the NAV. On a per Share basis, given that the Subscription Price is lower than the NAV per Share as at 31 December 2017 of approximately HK\$1.507 per Share, the NAV per Share is expected to decrease upon Completion. However, having considered (i) the benefits of the Subscription as discussed under the section headed "1.(c) Reasons for and benefits of the Subscription and use of proceeds" above; and (ii) as discussed under the section headed "3. Evaluation of the Subscription Price" above, the terms of the Subscription Agreement, including the Subscription Price, are fair and reasonable so far as the Independent Shareholders are concerned, we consider the decrease in NAV per Share is commercially justifiable.

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

## 5. Potential dilution effect on the shareholding interests of the existing public Shareholders

The following table summarises the effect of the Subscription on the shareholding structure of the Company immediately upon Completion, assuming that there is no change in the issued share capital of the Company (other than the issue of the Subscription Shares) between the Latest Practicable Date and Completion. Please refer to the section headed “Effect on the shareholding structure” in the Letter from the Board for further details of the effect of the Subscription on the shareholding structure of the Company.

Shareholders	As at the Latest Practicable Date		Immediately upon Completion	
	Number of Shares	Approx. %	Number of Shares	Approx. %
The First Subscriber, the Second Subscriber and parties acting in concert with them				
The First Subscriber	127,052,600	17.72	235,802,600	27.36
The Second Subscriber	–	–	36,250,000	4.21
Tai Shing Agencies Limited <sup>(note 1)</sup>	170,104,452	23.73	170,104,452	19.73
Mr. Tang To <sup>(note 2)</sup> and his associates <sup>(note 3)</sup> (other than the First Subscriber, Tai Shing Agencies Limited and the Second Subscriber)	8,656,406	1.21	8,656,406	1.00
Mr. Wong Yiu Ming <sup>(note 4)</sup>	9,468,000	1.32	9,468,000	1.10
Mr. Kan Wai Wah <sup>(note 5)</sup>	136,400	0.02	136,400	0.02
China Resources (Holdings) Company Limited <sup>(note 6)</sup>	169,649,046	23.66	169,649,046	19.68
<b>Sub-total:</b>	<b>485,066,904</b>	<b>67.66</b>	<b>630,066,904</b>	<b>73.10</b>
Director				
Mr. Cheng Tak Yin <sup>(note 7)</sup>	1,406,000	0.20	1,406,000	0.16
Public Shareholders	230,457,788	32.15	230,457,788	26.74
<b>Total:</b>	<b>716,930,692</b>	<b>100.00</b>	<b>861,930,692</b>	<b>100.00</b>

*Notes:*

- (1) Tai Shing Agencies Limited is an indirect wholly-owned subsidiary of the First Subscriber.
- (2) Mr. Tang To is an executive Director and a director of both the First Subscriber and the Second Subscriber.
- (3) Out of these 8,656,406 Shares, 4,970,000 Shares are personally held by Mr. Tang To, 2,000 Shares are held by his spouse, 224,000 Shares are jointly held by Mr. Tang To and his spouse while 3,460,406 Shares are held by Ginta Company Limited, which is wholly owned by a company which in turn is owned as to 50% by Mr. Tang To and 50% by his spouse.
- (4) Mr. Wong Yiu Ming is an executive Director and is presumed to be acting in concert with the Subscribers under class (6) presumption under the definition of “acting in concert” under the Takeovers Code until Completion. This class (6) presumption will cease to apply after Completion.
- (5) Mr. Kan Wai Wah is a non-executive Director and a director of the First Subscriber.
- (6) China Resources (Holdings) Company Limited is presumed to be a party acting in concert with the Subscribers under Note 1 to the definition of “acting in concert” under the Takeovers Code. This presumption will cease to apply after Completion since China Resources (Holdings) Company Limited will hold less than 20% of the voting rights of the Company upon Completion.
- (7) Mr. Cheng Tak Yin is an independent non-executive Director.

As illustrated in the table above, the shareholding in the Company held by existing public Shareholders would be diluted from approximately 32.15% as at the Latest Practicable Date to approximately 26.74% immediately upon Completion.

Nonetheless, having considered (i) the benefits of the Subscription as discussed under the section headed “1.(c) Reasons for and benefits of the Subscription and use of proceeds” above; and (ii) as discussed under the section headed “3. Evaluation of the Subscription Price” above, the terms of the Subscription Agreement, including the Subscription Price, are fair and reasonable so far as the Independent Shareholders are concerned, we are of the view that the dilution effect on the shareholding of existing public Shareholders as a result of the Subscription is acceptable.

## **6. Whitewash Waiver**

As set out in the section headed “Implications under the Listing Rules and the Takeovers Code” in the Letter from the Board, upon Completion, (i) the First Subscriber will directly hold 235,802,600 Shares and indirectly hold 170,104,452 Shares, together representing approximately 47.09% of the issued share capital of the Company as enlarged by the allotment and issue of the Subscription Shares; the Second Subscriber will directly hold 36,250,000 Shares, representing approximately 4.21% of the issued share capital of the Company as enlarged by the allotment and issue of the Subscription Shares; and (ii) the First Subscriber, the Second Subscriber and their associates and parties acting in concert with them will be interested in a total of 450,949,858 Shares respectively representing approximately 52.32% of the issued share capital of the Company as enlarged by the allotment and issue of the Subscription Shares.

Under Rule 26.1 of the Takeovers Code, the Subscribers would be obliged to make a mandatory general offer to the Shareholders for all the issued Shares and other securities of the Company not already owned or agreed to be acquired by them or parties acting in concert with them as their aggregate direct and indirect shareholding interests in the Company would increase from the existing approximately 41.45% to approximately 51.30% upon Completion, unless the Whitewash Waiver is granted by the Executive. In this regard, the Subscribers have made an application to the Executive for the Whitewash Waiver pursuant to Note 1 on Dispensation from Rule 26 of the Takeovers Code in respect of the allotment and issue of the Subscription Shares. The Whitewash Waiver, if granted by the Executive, will be subject to, among other things, approval by the Independent Shareholders of the Subscription and the Whitewash Waiver at the EGM by way of poll.

It should be noted that the Subscription is subject to the fulfilment or waiver (as the case may be) of a number of conditions precedent, including the approval of the Whitewash Waiver by the Independent Shareholders at the EGM and the granting of the Whitewash Waiver by the Executive, which cannot be waived. If the Whitewash Waiver is not granted by the Executive or not approved by the Independent Shareholders, the Subscription will not proceed. Accordingly, the Company will then lose all the benefits that are expected to be brought to the Group by the Subscription, including but not limited to the availability of the funds to be raised from the Subscription.

Having taken into consideration (i) the benefits of the Subscription as discussed under the section headed “1.(c) Reasons for and benefits of the Subscription and use of proceeds” above; (ii) the terms of the Subscription Agreement, including the Subscription Price, are fair and reasonable so far as the Independent Shareholders are concerned as discussed under the section headed “3. Evaluation of the Subscription Price” above; and (iii) the dilution to the existing public Shareholders is acceptable as discussed under the section headed “5. Potential dilution effect on the shareholding interests of the existing public Shareholders” above, we are of the view that the Whitewash Waiver (the granting of which is one of the conditions precedent of the Subscription) is fair and reasonable, so far as the Independent Shareholders are concerned, and in the interests of the Company and the Shareholders as whole.

## RECOMMENDATION

Having considered the above principal factors and reasons, we are of the opinion that although the Subscription is not in ordinary and usual course of business of the Company, (i) the terms of the Subscription Agreement are on normal commercial terms, and are fair and reasonable so far as the Independent Shareholders are concerned; (ii) the Whitewash Waiver is fair and reasonable so far as the Independent Shareholders are concerned; and (iii) the Subscription and the Whitewash Waiver are in the interests of the Company and the Shareholders as a whole. Accordingly, we advise the Code Independent Board Committee and the LR Independent Board Committee to recommend the Independent Shareholders, and we also recommend the Independent Shareholders, to vote in favour of the ordinary resolution(s) to be proposed at the EGM to approve the Subscription Agreement, the Specific Mandate and the Whitewash Waiver.

Yours faithfully,  
For and on behalf of  
**Challenge Capital Management Limited**



**Jackson Woo**  
*Managing Director*



**Wilson Fok**  
*Managing Director*

*Mr. Jackson Woo is a licensed person registered with the SFC to carry out Type 6 (advising on corporate finance) regulated activity under the SFO and have over 10 years of experience in corporate finance.*

*Mr. Wilson Fok is a licensed person registered with the SFC to carry out Type 6 (advising on corporate finance) regulated activity under the SFO and has over 10 years of experience in corporate finance.*