道勤
資本 DILIGENT CAPITAL

Room 2203, 22/F
New World Tower 1
16-18 Queen's Road Central, Hong Kong

26 November 2024

To the Independent Board Committee and
the Independent Shareholders of
Zhi Sheng Group Holdings Limited

Dear Sirs and Madams,

CONNECTED TRANSACTION IN RELATION TO THE SUBSCRIPTION OF NEW SHARES UNDER SPECIFIC MANDATE I

INTRODUCTION

We refer to our appointment as the independent financial adviser (the "**Independent Financial Adviser**") to make recommendations to the independent board committee and the independent shareholders of Zhi Sheng Group Holdings Limited (the "**Company**") in respect of the Subscription Agreement I and the transactions contemplated thereunder (the "**Transaction**"), particulars of which are set out in the section heard "Letter from the Board" (the "**Letter**") contained in the circular of the Company to its Shareholders dated 26 November 2024 (the "**Circular**"), of which this letter forms part. Unless the context requires otherwise, capitalised terms used in this letter shall have the same meanings as ascribed under the section headed "Definition" in the Circular.

The Subscription I

Reference is made to the announcement of the Company dated 21 October 2024 in relation to, among others, the Subscription I.

On 21 October 2024, the Company and the Subscriber I entered into the Subscription Agreement I, pursuant to which the parties conditionally agreed that the Subscriber I shall subscribe for, and the Company shall allot and issue, the Subscription Shares I at the Subscription Price.

For the avoidance of doubt, the completion of the Subscription I and the Subscription II are not inter-conditional upon each other.

The Subscription Shares I represent (i) approximately 36.37% of the total number of issued Shares as at the Latest Practicable Date; (ii) approximately 26.67% of the total number of issued Shares as enlarged by the allotment and issue of the Subscription Shares I; and (iii) approximately 24.31% of the total number of issued Shares as enlarged by the allotment and issue of the Subscription Shares I and Subscription Shares II, assuming that there will be no changes in the total number of issued Shares between the Latest Practicable Date and the Completion Date.

GEM Listing Rules Implications

As at the Latest Practicable Date, Subscriber I is wholly and beneficially owned by Mr. Lai, an executive Director. Therefore, Subscriber I is considered a connected person of the Company under Chapter 20 of the GEM Listing Rules. Accordingly, Subscription I constitutes a connected transaction for the Company and is subject to the reporting, announcement, circular, and Independent Shareholder's approval requirements under Chapter 20 of the GEM Listing Rules.

Mr. Lai is deemed to have a significant interest in Subscription I and the related transactions. Therefore, he has abstained from voting on the Board resolution(s) of the Company that approved the Subscription Agreement I and the transactions contemplated thereunder.

THE INDEPENDENT BOARD COMMITTEE

The Independent Board Committee comprising all independent non-executive Directors, namely Mr. Chan Wing Kit, Ms. Chan Pui Shan, and Mr. Lin Xiaodong, has been established to consider and give a recommendation to the Independent Shareholders as to whether the terms of the Subscription Agreement I are on normal commercial terms or better and fair and reasonable, and are in the interests of the Company and its shareholders as a whole and to advice the Independent Shareholders as to how to vote at the EGM.

THE INDEPENDENT FINANCIAL ADVISER

We, Diligent Capital Limited ("**Diligent Capital**"), have been appointed and approved by the Independent Board Committee for the purpose of the GEM Listing Rules, our role is to give an independent opinion to advise the Independent Board Committee and the Independent Shareholders as to whether the terms of the Subscription Agreement I are on normal commercial terms or better and fair and reasonable, and are in the interests of the Company and its shareholders as a whole and to advice the Independent Shareholders as to how to vote at the EGM.

OUR INDEPENDENCE

Diligent Capital is a licensed corporation licensed under the Securities and Futures Ordinance (the "**SFO**") to carry out Type 6 (advising on corporate finance) regulated activity. Mr. Huen Felix Ting Cheung ("**Mr. Huen**") is signing off the opinion letter from Diligent Capital contained in the Circular. Mr. Huen has been a responsible officer of Type 6 (advising on corporate finance) regulated activity under the SFO since 2019, and he has participated in and completed various independent financial advisory transactions in Hong Kong.

During the past two years immediately preceding the Latest Practicable Date, Diligent Capital was engaged as the independent financial adviser to the Company, providing advice on the assessment and calculation of adjustments to the share options granted by the Company (details of which were set out in the Company's announcement dated 9 February 2024). Save for the aforesaid engagement, Diligent Capital has not provided any other services to the Company. We confirmed that there is no relationship or interest between Diligent Capital and the Company or any other parties that could reasonably be regarded as a hindrance to Diligent Capital's independence as set out under Rule 17.96 of the GEM Listing Rules to act as the Independent Financial Adviser to the Independent Board Committee and the Shareholders in respect of the Transaction.

We are not associated with and have no significant connection, financial or otherwise, with the Company, its subsidiaries, its associates, or their respective substantial shareholders or associates, and accordingly, are eligible to give independent advice and recommendations. Apart from normal professional fees payable to us in connection with this appointment as the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders, no arrangement exists whereby we will receive any fees from the Company, its subsidiaries, its associates or their respective substantial shareholders or associates.

Having considered the above, in particular (i) none of the circumstances as set out under the Rule 17.96 of the GEM Listing Rules existed as at the Latest Practicable Date; and (ii) the aforesaid past engagement was only independent financial adviser engagement and will not affect our independence to act as the Independent Financial Adviser, we are eligible to give independent advice on the Subscription Agreement I and the transactions contemplated thereunder (including the grant of the Specific Mandate for the issue and allotment of the Subscription Shares I).

BASIS OF OUR OPINION AND RECOMMENDATION

In formulating our opinion and recommendation to the Independent Board Committee and the Independent Shareholders in relation to the terms of the Subscription Agreement I and the transactions contemplated thereunder (including the grant of the Specific Mandate for the issue and allotment of the Subscription Shares I), we have relied on the information, facts and representations contained in or referred to in the Circular and the information, facts and representations provided by, and the opinions expressed by the Directors, management of the

Company and its subsidiaries (the "**Management**"). We have assumed that all information, facts, opinions and representations made or referred to in the Circular were true, accurate and complete at the time they were made and continued to be true and that all expectations and intentions of the Directors and the Management, will be met or carried out as the case may be. We have no reason to doubt the truth, accuracy and completeness of the information, facts, opinions and representations provided to us by the Directors and the Management. The Directors jointly and severally accept full responsibility for the accuracy of the information contained in the Circular and confirm, having made all reasonable enquiries, that to the best of their knowledge, opinions expressed 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. We have also sought and received confirmation from the Directors that no material facts have been omitted from the information supplied and opinions expressed.

We consider that we have been provided with, and have reviewed sufficient information to reach an informed view, to justify relying on the accuracy of the information contained in the Circular and to provide a reasonable basis for our opinion. We have no reason to doubt that any relevant material facts have been withheld or omitted from the information provided and referred to in the Circular or the reasonableness of the opinions and representations provided to us by the Directors and the Management. We have not, however, conducted any independent verification of the information provided, nor have we carried out any independent investigation into the business, financial conditions and affairs of the Company or its future prospects.

We consider that we have been provided with sufficient information to reach an informed view and to provide a reasonable basis for our opinion. In rendering our opinion in the Circular, we have researched, analyzed and relied on (i) the annual report of the Company for the year ended 30 June 2024; (ii) the Subscription Agreement I; (iii) the Circular; and (iv) market information obtained from the website of the Stock Exchange. Based on the foregoing, we confirm that we have taken all reasonable steps, which are applicable to the Subscription I, as referred to in Rule 17.92 of the GEM Listing Rules (including the notes thereto).

This letter is issued for the information for the Independent Board Committee and the Independent Shareholders solely in connection with their consideration of the Subscription I 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 arriving at our recommendation to the Independent Board Committee and the Independent Shareholders, we have considered the following principal factors and reasons:

1. Background of the Transaction

On 21 October 2024, the Company and the Subscriber I entered into the Subscription Agreement I.

1.1 *Information of the Company and the Group*

The Company is incorporated in the Cayman Islands with limited liability, and the issued Shares are listed on GEM. The Company is an investment holding company and the holding company of the Group.

1.1.1 Principal business of the Group

The Group is principally engaged in the manufacturing and selling of furniture products, primarily serving the domestic market in the PRC, where a substantial proportion of its sales is generated in Sichuan Province, Chongqing City, and Guizhou Province, along with its data centre operations within the PRC.

1.1.2 Financial information of the Group

Set out below are the audited consolidated financial information of the Group for the two years ended 30 June 2023 ("**FY2023**") and 30 June 2024 ("**FY2024**") as extracted from the annual report of the Company for FY2024 ("**2023/24 Annual Report**").

Summary of the Group's financial performance for the indicated period below

	For the years ended 30 June	
	2024	**2023**
	RMB'000	*RMB'000*
	(audited)	(audited)
Revenue		
Sale of furniture products	37,124	48,255
Information technology management service	438	1,607
Internet access connection service	211	279
Data centre operating and security service	170	85
Buildout management service	–	38,928
Rental of server racks	19,533	21,677
Total revenue	57,476	110,831

	For the years ended 30 June	
	2024	**2023**
	RMB'000	*RMB'000*
	(audited)	(audited)
Gross profit	**3,685**	**10,824**
(Loss) for the year	**(38,911)**	**(79,196)**
(Loss) attributable to the Shareholders	**(38,469)**	**(79,196)**

As noted above, the Group recorded revenue of approximately RMB57.5 million for FY2024, representing a decrease of approximately 48.1% compared to the revenue of approximately RMB110.8 million for FY2023. This decrease was primarily attributed to the absence of new buildout management projects initiated for FY2024. Consequently, no revenue was recognised from buildout management projects in FY2024, whereas approximately RMB38.9 million was generated from that segment in FY2023. Furthermore, as a result of these factors, the Group's gross profit margin decreased from approximately 9.8% in FY2023 to approximately 6.4% in FY2024.

The Group reported a loss attributable to the Shareholders of approximately RMB38.5 million for FY2024, representing a significant improvement compared to the loss of approximately RMB79.2 million for FY2023. This loss reduction was primarily attributable to a decrease in the Group's administrative and other expenses, along with a significant reduction in impairment loss on assets and investment losses related to wealth management products. Additionally, financing costs decreased by approximately RMB2.5 million year-on-year, contributing to the overall reduction in losses.

Summary of the Group's financial position as at the dates below

	As at 30 June	
	2024	**2023**
	RMB'000	*RMB'000*
	(audited)	(audited)
Non-current assets	34,355	29,091
Current assets		
Inventories	13,984	10,338
Contract assets	676	11,587

	As at 30 June	
	2024	**2023**
	RMB'000	*RMB'000*
	(audited)	(audited)
Trade, lease and other receivables	18,073	39,304
Loan receivables	–	50,000
Cash and cash equivalents	22,076	33,761
Total current assets	**54,809**	**144,990**
Total assets	**89,164**	**174,081**
Current liabilities		
Current liabilities	2,932	3,971
Trade and other payables	43,410	39,614
Lease liabilities	537	3,739
Convertible bonds	–	77,899
Tax payable	1,407	1,509
Total current liabilities	**48,286**	**126,732**
Non-current liabilities		
Lease liabilities	11,099	–
Convertible bonds	9,444	–
Total non-current liabilities	**20,543**	**–**
Total liabilities	**68,829**	**126,732**
Net assets	**20,335**	**47,349**

As of 30 June 2024, the Group's total assets were primarily composed of (i) goodwill arising from the acquisition of Polyqueue Limited, a company involved in the data centre business, which was completed on 15 January 2020; (ii) accounts receivables; (iii) inventories; and (iv) cash and cash equivalents.

As noted above, the Group's total assets experienced a decline from approximately RMB174 million as of 30 June 2023 to approximately RMB89.2 million as of 30 June 2024. This decrease was primarily due to (i) a reduction in contract assets amounting to approximately RMB10.9 million, (ii) a decrease in prepayments for material purchases by approximately RMB14.6 million, and (iii) a decline in trade and lease receivables of approximately RMB4.0 million.

As of 30 June 2024, the Group's total liabilities comprised trade and other payables, lease liabilities, and convertible bonds. As noted above, the total liabilities decreased from approximately RMB126.7 million as of 30 June 2023 to approximately RMB68.8 million as of 30 June 2024. This decline was attributed to two main factors: (i) a decrease in contract liabilities within the furniture manufacturing and sales segment, resulting from the collection of advance payments related to newly signed sales contracts; and (ii) a redemption of convertible loan notes totalling US$8 million at maturity, issued by the Company on 6 August 2021.

Furthermore, the non-current liabilities consist of convertible bonds issued by the Company on 26 February 2024, with a principal amount totalling HK$12.4 million. The maturity date for these bonds is set for 19 February 2025 (the "**2024 Convertible Bonds**").

1.2 Information of the Subscriber I

The Subscriber I is a company incorporated in the British Virgin Islands with limited liability and an investment holding company wholly owned by Mr. Lai. The Subscriber I principally invests in data centre business in the PRC through 固安福愛電子有限公司 (Gu'an Fu'ai Electronics Co., Ltd.*), an indirect subsidiary of a joint venture company partially owned by the Subscriber I through special purpose vehicle companies.

As of the Latest Practicable Date, Mr. Lai is an executive Director and holds 10,000,000 share options granted by the Company on 2 August 2021 under the share option deed of the Company dated 2 June 2021. None of these outstanding options have been exercised as of the Latest Practicable Date.

Mr. Lai has extensive experience in the data centre industry, having worked for several years at 21Vianet Group Inc. (a private, carrier-neutral Internet and data center service provider in the PRC) until 2017, where he served as the general manager of the network department and senior vice president. In 2017, he became one of the shareholders of Beijing Haokuan Network Technology Co., Ltd. （北京皓寬網絡科技有限公司）. Additionally, Mr. Lai has gained substantial management experience by overseeing the data centre business and his roles in various technology companies.

As of the Latest Practicable Date, Mr. Lai acts as a director and one of the shareholders of both Beijing Haokuan and Haokuan Hebei Network Technology Co., Ltd.* （皓寬河北網絡科技有限公司）, which are established technology firms in the PRC engaging in data centre business. His industry expertise and management experience are regarded as valuable assets for the future development of the Group's data centre business.

2. Reasons for and benefits of the Subscription I and the intended use of proceeds

As set out in the Letter, the gross proceeds from the Subscription I are approximately HK$9.9 million, with net proceeds (after deduction of relevant legal and advisory costs) estimated at approximately HK$9.3 million. The Board intends to apply the net proceeds from Subscription I to fulfill the repayment obligation for the 2024 Convertible Bonds.

2.1 The Board's view

As set out in the Letter, the Board considers that the Subscription I represents a good opportunity to reduce the indebtedness of the Group.

As mentioned above, the maturity date of the 2024 Convertible Bonds is set for 19 February 2025, and the amendments to the terms of the 2024 Convertible Bonds, particularly the shortening of the maturity date, are to comply with applicable laws, rules and regulations and in connection with certain filing/registration requirements applicable to the 2024 Convertible Bonds. At the material time, the Board believed that such amendments would not pose any significant impact on the operations of the Group after preliminary discussions with the existing bondholders on their willingness to change the maturity date and to consider renewal of the bonds by the time of maturity taking into account the financial conditions of the Group. However, to the best knowledge, information and belief of the Directors having made all reasonable inquiries, one of the bondholders of 2024 Convertible Bonds in the principal amount of HK$9.92 million, has indicated to the Company after the aforesaid amendment of terms that, after reconsidering the renewal issue given the maturity date of the 2024 Convertible Bonds is approaching, it does not intend to agree with the renewal or extension of the maturity date of the 2024 Convertible Bonds, or subscribe for new convertible bonds in the same principal amount from the Company after the maturity date of the 2024 Convertible Bonds.

Furthermore, as of 30 June 2024, the Group has cash and cash equivalents totalling approximately RMB22.1 million, with over 88% of which were denominated in RMB. These funds are held by the Company's subsidiaries operating in the PRC. However, transferring these cash resources out of the PRC is subject to restrictions imposed by the PRC's Foreign Exchange Control Regulations, which poses challenges for the Group in repatriating funds out of the PRC to repay the 2024 Convertible Bonds. Additionally, the Directors have determined that it is more beneficial for the Group to retain its internal cash resources to support ongoing operational needs. As a result, the Group is currently facing immediate funding requirements in Hong Kong.

Further, the Company considers that the Subscriptions (including Subscription I) would expand the Company's capital base and the subsequent redemption of all or part of the 2024 Convertible Bonds can reduce the liabilities of the Company, which together will lead to a better financial position of the Company and in turn strengthen its financial position and debt financing capability in the long run.

2.2 Our view

We have reviewed the consolidated financial statements of the Group for FY2024 and identified a significant concern regarding the availability of cash and cash equivalents in HK$ for fulfilling the redemption requirements of the 2024 Convertible Bonds upon maturity. This issue is further complicated by the difficulties in transferring RMB from the Group's main operating subsidiaries, which could affect its daily business operations.

Furthermore, we have received information from the Directors indicating that one of the bondholders of 2024 Convertible Bonds, with a principal amount of HK$9.92 million, has informed the Company that it does not agree with the renewal or extension of the maturity date of the 2024 Convertible Bonds. Additionally, such bondholder has stated that it will not subscribe to new convertible bonds of the same principal amount from the Company after the maturity date of the 2024 Convertible Bonds. As a result, such bondholder prefers a cash settlement at maturity instead of exercising its conversion rights.

In order to ensure sufficient liquidity for meeting the repayment obligations of the 2024 Convertible Bonds and to prevent any potential issues related to the Group's ongoing viability, we concur with the Directors' recommendation to initiate a fund-raising exercise. This would aim to secure the necessary funds for repayment and alleviate the liquidity pressures faced by the Group during its business operations.

2.3 Alternative fund-raising methods

We have discussed with the Directors and understand that the Board has considered other fund-raising methods including bank borrowing, placing of shares/ convertible bonds, rights issue and open offer before resolving to the Subscriptions.

The Board has assessed that (i) bank borrowing may incur relatively high financing cost, which would increase the Group's interest burden, and (ii) both rights issues and open offer involve considerable time and costs, as they necessitate the preparation and publication of listing documents, prospectuses, and/or application forms. Moreover, the acceptance levels for these approaches are uncertain, particularly in light of the Group's historically limited trading liquidity. Consequently, the Board has concluded that, despite the potential dilution effects associated with the Subscriptions, they represent a more favorable option, given the factors mentioned above and the urgent funding requirements of the Group.

Considering the factors mentioned, we believe that the Subscriptions are generally a more suitable option for raising additional capital for the Company for the following reasons:

(i) less documentation is typically required for subscription than rights issue or open offer;

(ii) the process of arranging a subscription generally requires less time compared to that of a rights issue or an open offer. Typically, the procedures for a rights issue or an open offer span around three months. This duration encompasses several steps that are generally not necessary for a placing or subscription. These steps include engaging auditors and overseas legal advisers to prepare arrangement and comfort letters, obtaining overseas legal opinions, and verifying and registering the prospectus. Additionally, it involves managing the commencement and closing of the offer period. In contrast, the procedures associated with a subscription are estimated to take approximately two months, subject to the vetting process of the draft circular;

(iii) it may be challenging for the Company to engage and secure underwriters and/or placing agents. In fact, the Company had shortlisted and finally approached two brokerage firms to assess the feasibility of acting as placing agents for the possible placement of shares or convertible bonds or underwriters for the possible rights issue or open offer, however, negative responses were received. This is due to several factors, including the current trading volume and liquidity of the Shares and ongoing financial losses of the Company. Additionally, there are uncertainties regarding shareholder participation in these initiatives. In addition, two Shareholders, namely Sun Universal Limited and Brillant Talent Global Limited, collectively holding over 37% equity interest in the Company in aggregate, have expressed their intention not to participate in any potential rights issue or open offer exercise of the Company. Moreover, the transaction volumes observed on most trading days are considerably low, further complicating the matter; and

(iv) the placing of shares shall incur additional placing commission, while placing of convertible bonds shall inevitably impose interest payment obligations on the Group.

When evaluating debt financing options, several critical considerations should be addressed: (i) engaging in debt financing may result in increased financial costs and a higher gearing level, which could impose additional financial pressure on the Group; (ii) debt financing typically involves the pledge of assets and/or securities, which may restrict the Group's ability to effectively manage and deploy its assets, thereby limiting operational flexibility; and (iii) the process often entails extensive due diligence and negotiations, making it both uncertain and time-consuming to secure borrowings at acceptable finance costs with favorable terms and conditions.

Upon careful consideration of the aforementioned concerns related to debt financing and the various factors associated with fundraising activities, we recognise that the net proceeds from the Subscription I will significantly enhance the Group's cash position. In light of this, we concur with the Company's perspective and conclude that the current fund-raising method by way of the Subscriptions (including the Subscription I), is appropriate and acceptable for the Company.

In addition to the considerations mentioned above, we recognize that Mr. Lai, the ultimate beneficial owner of Subscriber I and the executive Director, as a key management in leading the development of the Group's data center business. Engaging Mr. Lai as a shareholder of the Company may strengthen the alignment of interests toward the long-term and sustainable growth of the organization.

Furthermore, the Subscriber I undertakes to and covenants with the Company that, without the prior written consent of the Company, it should not, and shall procure the registered owner or nominee of the Subscription Shares (if applicable) not to, at any time during a period commencing on the Completion Date and ending on the date which is twelve (12) months from the Completion Date (both dates inclusive), offer, pledge, charge, sell, contract to sell, sell any option or contract to sell, grant or agree to grant any option, right or warrant to purchase or subscribe for, lend or otherwise transfer or dispose of (nor enter into any agreement to transfer or dispose of or otherwise create any options, rights, interests or encumbrances), either directly or indirectly, conditionally or unconditionally, any of the Subscription Shares I or any part thereof or any interest therein (the "**Lock-up Undertaking**"). This Lock-up Undertaking indicates a commitment to ongoing support and alignment of interests with the Company, which is crucial for ensuring the Group's stability and continued success. After thoroughly evaluating these factors, we concur that the Subscriptions (including the Subscription I) represent a viable financing strategy that aligns with the interests of both the Company and its Shareholders.

3. Principal terms of the Subscription Agreement I

Set out below are the principal terms of the Subscription Agreement I, with further details set out in the Letter:

Date:	21 October 2024
Parties:	(1) the Company; and (2) the Subscriber I
Number of Subscription Shares I:	The Subscription Shares I represent: (i) approximately 36.37% of the total number of issued Shares as at the Latest Practicable Date; (ii) approximately 26.67% of the total number of issued Shares as enlarged by the allotment and issue of the Subscription Shares I; and (iii) approximately 24.31% of the total number of issued Shares as enlarged by the allotment and issue of the Subscription Shares, assuming that there will be no changes in the total number of issued Shares between the Latest Practicable Date and the Completion Date.
Subscription Price:	HK$0.30 per Subscription Share.
Ranking of Subscription Shares I:	The Subscription Shares I when allotted and issued, shall rank pari passu in all respects among themselves, and with all other existing Shares outstanding on the date of allotment and issue of the Subscription Shares I including all dividends declared or payable or distribution made or proposed on or after the date of completion of the Subscription I.

4. Evaluation of the basis of the Subscription Price

As set out in the Letter, the Subscription Price was arrived at after arm's length negotiations between the Company and the Subscriber I with reference to, among other things, the prevailing market price of the Shares, the market conditions and the funding needs of the Group.

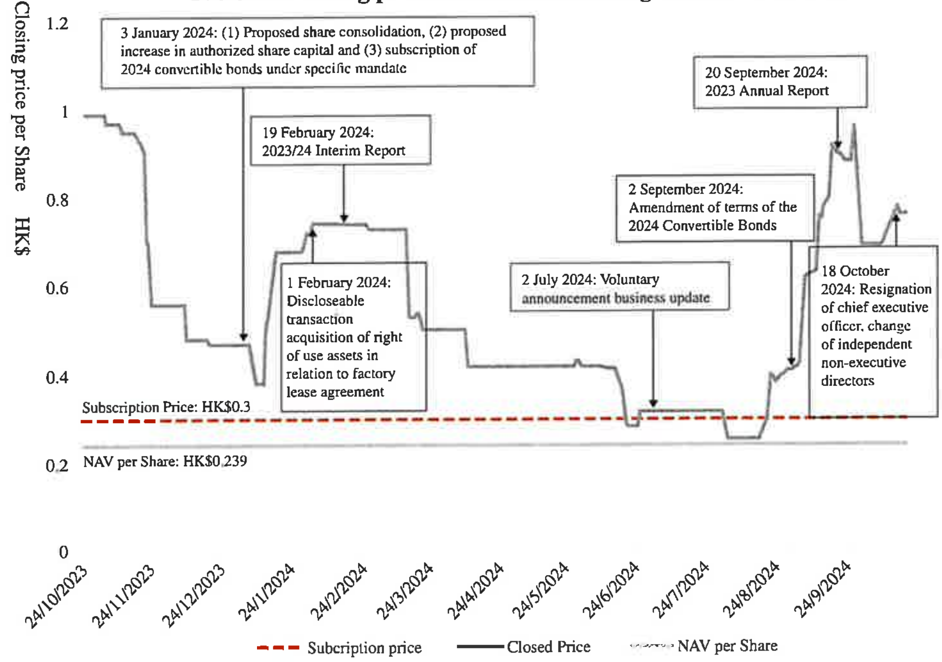
To assess the fairness and reasonableness of the Subscription Price, we have compared the Subscription Price with reference to (a) the historical Share price performance; (b) the historical trading volume and liquidity of the Shares; and (c) the market comparable in respect of recent issuance of subscription shares, as set out below.

4.1 Review of the historical price performance of the Shares

Set out below is a chart illustrating the movement of the closing prices of the Shares as quoted on the Stock Exchange from 24 October 2023 up to and including 21 October 2024, being a one-year period before the date of the Subscription Agreement I (the "**Review Period**").

After careful consideration, we have determined that a one-year review period is suitable as this timeframe provides a comprehensive overview of recent Share price performance, while fully integrating relevant information regarding the Group's overall performance. Therefore, we consider that the Review Period is adequate for effectively illustrating Share price performance and for making meaningful comparisons between the closing price of the Shares and the Subscription Price.

Historical closing prices of the Shares during the Review Period



Source: The website of the Stock Exchange

During the Review Period, the Shares listed on the Stock Exchange achieved the highest closing price of HK$0.99 between 24 October 2023 and 2 November 2023, while the lowest closing price of HK$0.25 was recorded between 2 August 2024 and 16 August 2024. The average closing price for the Shares during the Review Period was approximately HK$0.55. The Subscription Price reflects (i) a premium of approximately 20% over the lowest Share price of HK$0.25, (ii) a discount of approximately 69.70% to the highest Share price of HK$0.99, and (iii) a discount of approximately 45.45% to the average closing price of the Shares of approximately HK$0.55, observed during the Review Period.

As shown in the chart above, the Share price closed between HK$0.25 per Share and HK$0.99 per Share during the Review Period. During the Review Period, the Company released (i) proposed share consolidation, proposed increase in authorized share capital and subscription of 2024 convertible bonds under specific mandate as published on 3 January 2024; (ii) the 2023/24 Interim Report as published on 19 February 2024; (iii) the discloseable transaction relating to the acquisition of right of use assets in relation to factory lease agreement as published on 1 February 2024; (iv) a voluntary announcement about a business update as published on 2 July 2024; (v) the amendment of terms of the 2024 Convertible Bonds as published on 2 September 2024; (vi) the 2023/24 Annual Report as published on 20 September 2024; and (vii) the resignation of chief executive officer, change of independent non-executive directors as published on 18 October 2024. Save as the aforesaid, the Company did not announce any other material information to the public.

In addition to the previously mentioned announcements, we observed a significant decrease in the Share price between 24 October 2023 and 11 January 2024, and a significant increase in the Share price commencing on 16 August 2024 and reaching a peak of HK$0.96 per Share by 26 September 2024. Upon inquiring with the Group's management, it was confirmed that they do not have any information regarding any specific factors that could explain the fluctuations in closing Share prices between 24 October 2023 and 11 January 2024 and since 16 August 2024.

In light of the aforementioned considerations, we believe that the Share price performance during the Review Period reflects a volatile market environment characterized by sharp fluctuations. However, to evaluate the fairness and reasonableness of the Subscription Price, it is crucial to take additional factors into account.

In order to assess the fairness and reasonableness of the Subscription Price as compared to the recent closing price of the Shares, we have further, based on the information available from the Stock Exchange's website, observed the trading volume and liquidity of the Shares and identified the Comparables (as defined below) for further analysis. Please refer to the sub-section headed "Comparison with recent transactions" for analysis details.

4.2 Review on the trading volume and liquidity of the Shares

Set out below is the table showing (i) the monthly total trading volume of the Shares; (ii) the number of trading days of each month; (iii) the average daily trading volume of the Shares; and (iv) the percentage of the average daily trading volume of the Shares to the total issued Shares at the end of each month during the Review Period:

Month	**Monthly trading volume of the Shares** *(Shares)*	**Number of trading days in the month** *(days)*	**Average daily trading volume of the Shares in the month** *(Shares)* *(Note 1)*	**Percentage of average daily Trading Volume of the Shares to total number of Shares** *(approximate)* *(Note 2)*
2023				
From 24 October 2023 to 31 October 2023	–	6	–	–
November	18,400	22	836	0.0009%
December	14,400	19	758	0.0008%

Month	Monthly trading volume of the Shares	Number of trading days in the month	Average daily trading volume of the Shares in the month	Percentage of average daily Trading Volume of the Shares to total number of Shares
	(Shares)	*(days)*	*(Shares)* *(Note 1)*	*(approximate)* *(Note 2)*
2024				
January	127,200	22	5,782	0.0064%
February	1,600	19	84	0.0001%
March	98,400	20	4,920	0.0054%
April	–	20	–	–
May	293,600	21	13,981	0.0154%
June	220,000	19	11,579	0.0128%
July	–	22	–	–
August	584,000	22	26,545	0.0293%
September	934,400	19	49,179	0.0542%
October (up to the Last Trading Day)	696,000	13	53,538	0.0590%

Source: Website of the Stock Exchange

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. Calculation is based on the average daily trading volume of Shares divided by the total issued Shares of the Company at the end of each respective month.

The monthly trading volume of the Shares during the Review Period has varied significantly. It ranged from no transactions at all between 24 October 2023 and 31 October 2023, in April 2024 and in July 2024 to a peak of 934,400 Shares traded in September 2024. This represents approximately 0.0001% of the total issued Shares for the lowest volume and about 0.0590% for the highest.

In addition to the announcements above and the mentioned market sentiment between 24 October 2023 and 11 January 2024 and since 16 August 2024, we have not identified any specific reasons for the fluctuations observed during the Review Period. Therefore, we assess that trading activity for the Shares was relatively inactive throughout the Review Period. Given the low liquidity of the Shares, we believe it may be difficult to determine the potential outcomes of alternative equity financing methods, such as a rights issue or open offer. This uncertainty could directly impact the Group's ability to meet the repayment obligations associated with the 2024 Convertible Bonds.

4.3 Comparison with recent transactions

To evaluate the reasonableness of the Subscription Price, we have identified an exhaustive list of nine transactions conducted by companies listed on the Stock Exchange during the six-month period from 22 April 2024 to the Last Trading Day (the "**Six-month Period**") (the "**Comparables**"). This process was based on the information available from the Stock Exchange's website and conducted on a best-effort basis. The criteria for selecting the Comparables were as follows: (i) the companies must be listed on the Stock Exchange; (ii) the transactions must involve the subscription of new shares under a specific mandate by connected persons; (iii) we excluded issues related to (a) share awards or emoluments; (b) acquisitions; and/or (c) restructuring; and (iv) we did not consider issues of A shares or domestic shares.

We assessed our selection criteria for the Comparables and the duration of the Six-month Period, we considered both to be fair and reasonable, given (i) the Six-month Period includes an exhaustive list of the Comparables allowing for effective analysis; and (ii) it demonstrates recent market practices for similar transactions while considering comparable market conditions and sentiments, which helps to highlight current trends and terms in the market.

Since the terms of the Comparables are established under comparable market conditions and sentiments to those associated with the issuance of Subscription Shares I, we believe that the Comparables serve as an accurate reflection of the recent market trend regarding subscriptions of shares by connected parties. Consequently, we regard the Comparables as fair and representative samples for our analysis. It is essential to acknowledge that the companies referenced in the Comparables may differ in terms of their principal activities, market capitalizations, profitability, and overall financial positions when compared to the Company. Furthermore, the circumstances that led these Comparable companies to issue subscription shares may not align with that of the Company. This analysis is intended to provide a general reference for similar types of transactions in Hong Kong, and we consider these Comparables to be a credible foundation for assessing the fairness and reasonableness of the Subscription Price.

Date of Announcement (dd/mm/yy)	Company (Stock code)	Premium/(discount) of the subscription price over/(to) the closing price per share on the date of the respective subscription agreement *(approximate)%*	Premium/(discount) of the subscription price over/(to) the average closing price per share for the last 5 consecutive trading days immediately prior to the date of the respective subscription agreement *(approximate)%*	Premium/(discount) of the subscription price over/(to) the net asset value per share based on the latest audited consolidated net asset value attributable to the shareholders *(approximate)%*
23/10/2024	China Resources Power Holdings Company Limited (836)	(5.06)	(3.48)	(9.36)
10/10/2024	Virtual Mind Holding Company Limited (1520)	13.64	38.39	63.76
4/10/2024	CircuTech International Holdings Limited (8051)	(2.60)	0.30	(55.14)
27/9/2024	Sunway International Holdings Limited (58)	96.08	96.08	(86.75)
2/9/2024	Well Link Securities Holdings Limited (8350)	65.60	66.90	2,513.35 Note 1
8/7/2024	Winshine Science Company Limited (209)	(9.10)	(9.10)	–
17/6/2024	Zhuguang Holdings Group Company Limited (1176)	21.21	18.34	(77.09)
22/5/2024	Cornerstone Technologies Holdings Limited (8391)	12.28	20.75	449.80 Note 1
14/5/2024	Hua Yin International Holdings Limited (989)	19.05	6.38	(20.63)
	Average	21.96	26.06	(30.87)
	Maximum	96.08	96.08	63.76
	Minimum	(9.10)	(9.10)	(86.75)
	The Company	(60.53)	(60.63)	25.52

Source: the website of the Stock Exchange (www.hkex.com.hk)

Note 1: These extraordinary high figures of over 2,513.35% premium and 449.80% premium, compared to that of the other Comparables which ranged from a premium of approximately 63.76% to a discount of approximately 86.75%, were considered as outlier and were excluded in the analysis of subscription price to net asset value per share.

The table above presents a detailed overview of the subscription prices of the Comparables in relation to their respective closing prices on or before the dates of the corresponding agreements. These prices varied, showing a discount of approximately 9.10% to a premium of approximately 96.08%, with an average premium of approximately 21.96%.

In further examining the subscription prices in comparison to the average closing prices over the five trading days before the date of the corresponding agreements, we found that the results showed a comparable range, with the prices varying from a discount of approximately 9.10% to a premium of approximately 96.08%, with an average premium of approximately 26.06%.

As a result, the discount of approximately 60.53% to 60.63% to the closing price of HK$0.76 per share, as quoted on the Stock Exchange on the Last Trading Day, and the average closing price of HK$0.762 per share for the five consecutive trading days immediately preceding the Last Trading Day falls outside the established range of the Comparables. In view of that, we considered that the substantial discount from the closing Share price reflects an unfavorable condition regarding the Subscription Price prior to taking other factors into account.

Additionally, when comparing the subscription prices of the Comparables to the net asset value per share based on the most recent audited consolidated net asset value attributable to shareholders, the results showed a range from a discount of about 86.75% to a premium of approximately 63.76%, resulting in an average discount of approximately 30.87%. Based on the above, the Subscription Price of HK$0.30 reflects a premium of approximately 25.52% over the Group's audited consolidated net asset value attributable to shareholders per share as of 30 June 2024. This pricing is consistent with the relevant range observed among the Comparables.

In summary, as mentioned in the section headed "4.1 Review of the historical price performance of the Shares", we observed that the historical performance of Share prices has been characterised by a volatile market environment with significant fluctuations. This high level of volatility often leads to increased uncertainty in pricing, making it difficult for investors to accurately assess the fair value of Shares using fundamental analysis. Moreover, in such conditions, investors may expect a higher return to compensate for the increased risk. As a result, we believe that high volatility presents notable challenges in determining the fair value of Shares, leading to substantial adjustments in evaluations. Therefore, despite the Subscription Price representing a significant discount of approximately 60.53% to 60.63% to the closing price of HK$0.76 per share, as quoted on the Stock Exchange on the Last Trading Day, and the average closing price of HK$0.762 per share for the five consecutive trading days immediately preceding the Last Trading Day, we will take into account, among others, the following factors when assessing the Subscription Price:

(i) the Subscription Price represents a premium of approximately 25.52% over the Group's audited consolidated net asset value attributable to shareholders per share as of 30 June 2024, which falls within the relevant range observed among the Comparables;

(ii) the Group is currently facing continuous financial losses, which have a significant impact on its financial position. This situation may adversely influence the determination of the Subscription Price;

(iii) the limited liquidity of the Shares observed during the Review Period indicates the potential for a considerable discount to the Subscription Price. This adjustment may serve to encourage Subscriber I to acquire the specified number of Subscription Shares I; and

(iv) the reasons in the section headed "Reasons for and benefits of the Subscription I and use of proceeds" above in this letter.

After careful consideration, we have determined that the potential advantages of Subscription I considerably outweigh the costs associated with offering a significant discount on the Subscription Price. Accordingly, we are of the view that the terms of Subscription Shares I are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned.

5. Possible dilution effect on shareholding interests of the public Shareholders

As illustrated in the table relating to the "EFFECTS ON SHAREHOLDING STRUCTURE OF THE COMPANY" as set out in the Letter, the shareholding of existing public Shareholders in the Company will be reduced from approximately 62.12% as at the Latest Practicable Date to approximately 45.55% immediately after the completion of the Subscription I (assuming that there will be no other change to the total issued share capital of the Company between the Latest Practicable Date and the Completion Date). The dilution effect on the shareholding of the Company immediately upon completion of the Subscription I is approximately 16.57%.

Furthermore, the Subscription Price represents (i) a theoretical dilution effect (as defined in Rule 10.44A of the GEM Listing Rules) of approximately 16.17% represented by the theoretical diluted price of approximately HK$0.639 per Share to the benchmarked price of HK$0.762 per Share (as defined under Rule 10.44A of the GEM Listing Rules, taking into account the higher of the closing price on the date of the Subscription Agreement I of HK$0.76 per Share and the average of the closing prices of the Shares as quoted on the Stock Exchange for the five (5) consecutive trading days immediately prior to the date of the Subscription Agreement I of HK$0.762 per Share); and (ii) a cumulative theoretical dilution effect (as defined under Rule 10.44A of the GEM Listing Rules) of approximately 20.10% (the aggregation of the Subscription I and the Subscription II), represented by the cumulative theoretical diluted price of approximately HK$0.609 per Share to the benchmarked price of approximately HK$0.762 per Share (as defined under Rule 10.44A of the GEM Listing Rules, taking into account the higher of the closing price on the date of the Subscription Agreement II of HK$0.76 per Share and the average of the closing prices of the Shares as quoted on the Stock Exchange for the five (5) consecutive trading days immediately prior to the date of the Subscription Agreement II of HK$0.762 per Share).

Nonetheless, having considered (i) the reasons for and benefits of the Subscription I and use of proceeds as discussed in this letter; (ii) the Subscription Price being fair and reasonable as discussed above; and (iii) the positive financial effects on the Group as a result of the Subscription I as summarised below, we are of the view that the dilution in the shareholding interests of the public Shareholders upon completion of the Subscription I is not prejudicial to their interests and thus is acceptable.

6. Financial effects of the Subscription I

Upon completion of the Subscription I, it is anticipated that the Group's net asset value and cash and cash equivalents will both increase by approximately HK$9.3 million. This figure reflects the estimated net proceeds generated from the Subscriptions.

The analysis provided are for illustrative purposes only and do not claim to accurately represent the Group's financial position or results upon completion of the Subscription I.

Based on the above analysis, we anticipate that the Subscription I will have a favorable impact on the Group's financial position. Consequently, we are confident that Subscription I aligns with the best interests of both the Company and its Shareholders as a whole.

RECOMMENDATION

Having taken into account the above-mentioned principal factors and reasons, we are of the view that despite the Subscription I is not in the ordinary and usual course of the business of the Group, it is in the interests of the Company and the Shareholders as a whole, and the terms of the Subscription Agreement I are on normal commercial terms and fair and reasonable so far as the Independent Shareholders are concerned. Accordingly, we recommend the Independent Shareholders, as well as the Independent Board Committee to recommend the Independent Shareholders, to vote in favor of the resolutions to be proposed at the EGM to approve the Subscription I (including the allotment and issue of the Subscription Shares I under the Specific Mandate I).

Yours faithfully,
For and on behalf of
Diligent Capital Limited

Huen Felix Ting Cheung
Director