

5 February 2024

To the Independent Board Committee and the Independent Shareholders

Dear Sirs or Madams,

**MAJOR AND CONNECTED TRANSACTION IN RELATION
TO THE DISPOSAL OF THE ENTIRE EQUITY INTEREST
IN THE TARGET COMPANY**

INTRODUCTION

We refer to our appointment as the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders in respect of the Equity Transfer Agreement and the transactions contemplated thereunder, details of which are set out in the letter from the Board (the “**Letter from the Board**”) contained in the circular issued by the Company to the Shareholders dated 5 February 2024 (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 the context otherwise requires.

Reference is made to the announcement of the Company dated 3 January 2024 in relation to, among other things, the Equity Transfer Agreement and the transactions contemplated thereunder (i.e. the Disposal). On 22 December 2023, the Vendor and the Purchaser entered into the Equity Transfer Agreement, pursuant to which the Vendor conditionally agreed to sell, and the Purchaser conditionally agreed to acquire, the Target Shares at a Consideration of RMB32.5 million.

As the Purchaser is a subsidiary of Zhejiang Yongli, the ultimate holding company of the Company, the Disposal constitutes a connected transaction of the Company under Chapter 20 of the GEM Listing Rules. Further, as one or more of the applicable percentage ratios calculated by reference to Rule 19.07 of the GEM Listing Rules in respect of the Disposal exceed(s) 25% but less than 75%, the Disposal constitutes a major transaction of the Company under Chapter 19 of the GEM Listing Rules and it is therefore subject to reporting, announcement, circular and Independent Shareholders’ approval requirements thereunder.

INDEPENDENT BOARD COMMITTEE

The Independent Board Committee comprising all the independent non-executive Directors, namely, Mr. Yu Weidong, Mr. Yuan Lingfeng and Mr. Zhang Jianyong, has been formed to advise the Independent Shareholders as to (i) whether the terms of the Equity Transfer Agreement are on normal commercial terms and fair and reasonable so far as the Independent Shareholders are concerned; and (ii) whether the Disposal is in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole. We, Lego Corporate Finance Limited, have been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in such regard.

OUR INDEPENDENCE

As at the Latest Practicable Date, we did not have any relationship with, or any interest in, the Company or any other parties that could reasonably be regarded as relevant to our independence. In the last two years prior to the Latest Practicable Date, we were once appointed by the Company as the independent financial adviser to provide our opinion in respect of the term of the property lease agreement dated 22 December 2023 entered into between the Company and 浙江永利經編股份有限公司 (Zhejiang Yongli Warp Knitting Co., Ltd.*) as set out in the announcement of the Company dated 3 January 2024. Apart from normal professional fees paid or payable to us in connection with this appointment as the Independent Financial Adviser, no arrangement exists whereby we had received or will receive any fees or benefits from the Company. Accordingly, we consider that we are eligible to give independent advice in respect of the Equity Transfer Agreement and the Disposal.

BASIS OF OUR OPINION

In formulating our opinion and recommendations to the Independent Board Committee and the Independent Shareholders, we have relied on the information, facts and representations contained or referred to in the Circular and the information, opinions and representations provided or expressed to us by the Directors and/or the management of the Company (the “**Management**”). We have assumed that all the information, facts and representations contained or referred to in the Circular, and all the information, opinions and representations provided or expressed by the Directors and/or the Management, for which they are solely responsible, were true, accurate and complete in all material respects at the time when they were provided and continue to be so as at the Latest Practicable Date and that they may be relied upon in formulating our opinion. We have also assumed that all such opinions and statements of intention or belief expressed by the Directors and/or the Management and those as set out or referred to in the Circular were reasonably made after due and careful enquiries.

The Directors have confirmed to us that no material facts have been withheld or omitted from the information provided, representations made or opinions expressed. We have no reason to suspect that any relevant information has been withheld or omitted, nor are we aware of any facts or circumstances which would render the information provided, representations made or opinions expressed to us untrue, inaccurate or misleading. We consider that we have been provided with, and have reviewed, sufficient information currently available, and 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, carried out any independent verification of the information provided, representations made or opinions expressed by the Directors and/or the Management, nor have we conducted any form of in-depth investigation into the businesses, affairs, operations, financial position 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 GEM Listing Rules for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief, the information contained in 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 therein or the Circular misleading.

This letter is issued for the information of the Independent Board Committee and the Independent Shareholders solely in connection with their consideration of the Equity Transfer Agreement and the Disposal. Except for its inclusion in the Circular, this letter 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 Equity Transfer Agreement and the Disposal, we have considered the following principal factors and reasons:

1. Information on the Group

The Company is a joint stock limited company established in the PRC, the H Shares of which have been listed on GEM (stock code: 8211) since 8 November 2002. The Group is principally engaged in (i) the manufacture and sales of woven fabrics; and (ii) the provision of woven fabrics subcontracting services. The Group's operations have been expanded worldwide, including mainland China, Europe, South America, Middle East and other overseas regions, with mainland China being the primary market.

Set out below is a summary of the financial results of the Group (i) for the year ended 31 December 2021 (“FY2021”) and the year ended 31 December 2022 (“FY2022”) as extracted from the annual report of the Company for FY2022 (the “Annual Report 2022”); and (ii) for the nine months ended 30 September 2022 (“9M2022”) and the nine months ended 30 September 2023 (“9M2023”) as extracted from the third quarterly report of the Company for 9M2023 (the “Third Quarterly Report 2023”):

	For the year ended		For the	
	31 December		nine months ended	
	2021	2022	2022	2023
	RMB'000	RMB'000	RMB'000	RMB'000
	(audited)	(audited)	(unaudited)	(unaudited)
Revenue	98,184	78,998	60,364	43,997
— Woven fabrics	93,263	76,165	57,876	41,940
— Subcontracting services	4,921	2,833	2,488	2,057
Gross profit (loss)	450	(12,069)	(2,843)	(1,845)
<i>Gross profit margin</i>	0.5%	N/A	N/A	N/A
Share of result of an associate	(5,908)	(2,086)	(824)	(4,558)
Impairment loss recognised in respect of interest in an associate	—	(5,491)	N/A	N/A
Loss for the year/period	(18,820)	(35,576)	(14,616)	(19,305)

For the years ended 31 December 2021 and 2022

The Group’s revenue decreased by approximately RMB19.2 million, or approximately 19.5%, from approximately RMB98.2 million for FY2021 to approximately RMB79.0 million for FY2022. According to the Annual Report 2022, such decrease was primarily attributable to the decrease in domestic sales of woven fabrics and subcontracting fee income. In addition, the outbreak of COVID-19 epidemic since 2020 caused the decline in demand of the products of the Group from both local and overseas customers.

The Group's gross loss amounted to approximately RMB12.1 million for FY2022, as compared to a gross profit of approximately RMB0.5 million for FY2021. According to the Annual Report 2022, such result was mainly due to the significant increase in the cost of raw materials, labour cost and dyeing cost, etc. in FY2022.

According to the Annual Report 2022, (i) share of result of an associate of approximately RMB2.1 million for FY2022 represented share of loss from the consolidated result of Tepia; and (ii) impairment loss recognised in respect of interest in an associate of approximately RMB5.5 million for FY2022 represented impairment of goodwill which was recognised upon completion of the acquisition of 41.67% equity interest in Tepia in August 2019.

The Group recorded a net loss of approximately RMB35.6 million for FY2022, representing an increase of approximately 89.0% as compared to that of approximately RMB18.8 million for FY2021, mainly due to the gross loss incurred and impairment loss recognised in respect of interest in Tepia for FY2022 as explained above.

For the nine months ended 30 September 2022 and 2023

The Group's revenue decreased by approximately RMB16.4 million, or approximately 27.1%, from approximately RMB60.4 million for 9M2022 to approximately RMB44.0 million for 9M2023. As advised by the Management, such decrease was primarily attributable to the decreases in both domestic and export sales of woven fabrics and subcontracting fee income.

The Group's gross loss amounted to approximately RMB1.8 million for 9M2023, representing a decrease of approximately 35.1% as compared to that of approximately RMB2.8 million for 9M2022. According to the Third Quarterly Report 2023, such decrease was mainly due to the decrease in the cost of raw materials in 9M2023.

According to the Third Quarterly Report 2023, share of result of an associate of approximately RMB4.6 million for 9M2023 represented share of loss from the consolidated result of Tepia.

The Group recorded a net loss of approximately RMB19.3 million for 9M2023, representing an increase of approximately 32.1% as compared to that of approximately RMB14.6 million for 9M2022. As advised by the Management, such increase was mainly attributable to the significant increase in share of loss from the consolidated result of Tepia for 9M2023 as explained above.

Set out below is a summary of the financial position of the Group (i) as at 31 December 2021 and 2022 as extracted from the Annual Report 2022; and (ii) as at 30 June 2023 as extracted from the interim report of the Company for the six months ended 30 June 2023 (the “**Interim Report 2023**”):

	As at 31 December		As at
	2021	2022	30 June
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
	(audited)	(audited)	(unaudited)
Total assets	276,887	245,891	234,351
— Non-current assets, including:	184,719	144,962	140,216
— Interest in an associate	40,665	33,088	32,402
— Current assets, including:	92,168	100,929	94,135
— Bank balances and cash	30,968	46,981	53,815
Total liabilities	55,716	72,858	71,145
— Non-current liabilities	26,726	29,563	30,753
— Current liabilities	28,990	43,295	40,392
Net current assets	63,178	57,634	53,743
Net assets	221,171	173,033	163,206
Gearing ratio	8.2%	19.5%	21.4%

As at 30 June 2023, the non-current assets of the Group mainly comprised (i) property, plant and equipment of approximately RMB102.4 million; and (ii) interest in an associate (i.e. Tepia) of approximately RMB32.4 million. Meanwhile, the Group’s current assets mainly consisted of (i) bank balances and cash of approximately RMB53.8 million; (ii) inventories of approximately RMB20.9 million; and (iii) trade and other receivables of approximately RMB19.4 million.

As at 30 June 2023, the non-current liabilities of the Group mainly comprised (i) amount due to immediate holding company of approximately RMB16.1 million; and (ii) deferred tax liabilities of approximately RMB13.9 million. Meanwhile, the Group’s current liabilities mainly consisted of (i) amount due to immediate holding company of approximately RMB18.8 million; (ii) trade and other payables of approximately RMB18.0 million; and (iii) contract liabilities of approximately RMB3.5 million.

As at 30 June 2023, the consolidated net current assets and net assets of the Group were approximately RMB53.7 million and RMB163.2 million, respectively. According to the Interim Report 2023, the Group’s gearing ratio, represented by the ratio of the interest free loan due to immediate holding company over shareholders’ equity, was approximately 21.4%.

2. Information on the Purchaser

The Purchaser was established in 2018 and has a registered share capital of RMB100 million. The Purchaser is a wholly-owned subsidiary of Zhejiang Yongli and is principally engaged in manufacture and sales of automotive parts. As at the Latest Practicable Date, the Purchaser held 8.34% equity interest in Tepia.

3. Information on the Target Group

3.1. Background and financial information of the Target Group

The Target Company is an investment holding company established in the PRC with limited liability and a wholly-owned subsidiary of the Company as at the Latest Practicable Date. As at the Latest Practicable Date, the Target Company held 41.67% of the issued share capital of Tepia (representing 60,000,000 Tepia Shares (as defined below)) and the Target Company had no other material assets and liabilities besides its investment in Tepia. The unaudited net asset value of the Target Group as at 30 September 2023 was approximately RMB28.53 million.

Tepia is a joint stock limited company established in the PRC on 27 November 2000 and its shares have been listed on National Equities Exchange and Quotations in the PRC (stock code: 838941) since 16 August 2016. As at the Latest Practicable Date, Tepia had a total of 144,000,000 ordinary shares in issue (“**Tepia Shares**”, each a “**Tepia Share**”).

Tepia and its subsidiary(ies) (collectively, “**Tepia Group**”) are principally engaged in providing information planning and design, software development, system integration and project-based systems operation and maintenance services for water management systems. Tepia further expanded its business area to the field of industrial circulating water treatment since 2021 and has increasingly focused on such segment which currently accounted for the major portion of Tepia Group’s revenue. Through equipment based on electrochemical and electromagnetic mixing physical technology, it solves the problems of industrial circulating water fouling, corrosion, bacteria and algae breeding, and can help customers achieve water saving, energy saving and consumption reduction.

Set out below is a summary of the financial results of Tepia Group (i) for FY2021 and FY2022 as extracted from the annual report of Tepia for FY2022 (the “**Tepia Annual Report 2022**”); and (ii) for the six months ended 30 June 2022 and 2023 as extracted from the interim report of Tepia for the six months ended 30 June 2023 (the “**Tepia Interim Report 2023**”), which are prepared in accordance with the PRC generally accepted accounting principles:

	For the year ended		For the	
	31 December		six months ended	
	2021	2022	2022	2023
	RMB'000	RMB'000	RMB'000	RMB'000
	(audited)	(audited)	(unaudited)	(unaudited)
Revenue	28,522	24,034	12,878	9,885
— System integration	15,011	3,900	1,815	519
— Water conservancy project management	8,919	10,841	6,691	1,522
— Software development	3,582	1,394	630	255
— Information planning and design	820	268	257	5
— Industrial circulating water treatment	190	7,631	3,485	7,584
Gross profit	4,946	4,937	2,650	2,200
<i>Gross profit margin</i>	17.3%	20.5%	20.6%	22.3%
Loss for the year/period	(15,206)	(10,411)	(4,790)	(5,116)

For the years ended 31 December 2021 and 2022

Tepia Group’s revenue decreased by approximately RMB4.5 million, or approximately 15.7%, from approximately RMB28.5 million for FY2021 to approximately RMB24.0 million for FY2022. According to Tepia Annual Report 2022, such decrease was primarily attributable to the combined effect of (i) the significant decrease in revenue from system integration due to the disposal of a major subsidiary engaging in such business during the year; (ii) the decrease in revenue from software development due to the decreased size of contracts secured by Tepia Group as compared to the previous year; (iii) the increase in revenue from water conservancy project management due to the successful retention of existing customers and acquisition of new customers during the year; and (iv) the increase in revenue from industrial circulating water treatment due to a wider brand and product recognition in the market.

Tepia Group's gross profit amounted to approximately RMB4.9 million for FY2022, which remained stable as compared to that of approximately RMB4.9 million for FY2021. The gross profit margin of Tepia Group increased from approximately 17.3% for FY2021 to approximately 20.5% for FY2022, which was mainly due to the higher gross profit margin achieved in the segments of water conservancy project management and software development during the year.

Despite the drop in revenue for the year, Tepia Group narrowed its net loss from approximately RMB15.2 million for FY2021 to approximately RMB10.4 million for FY2022, representing a decrease of approximately 31.5%. According to Tepia Annual Report 2022, such decrease was mainly attributable to the decrease in selling and distribution expenses, administrative expenses and research and development expenses for the year.

For the six months ended 30 June 2022 and 2023

Tepia Group's revenue decreased by approximately RMB3.0 million, or approximately 23.2%, from approximately RMB12.9 million for the six months ended 30 June 2022 to approximately RMB9.9 million for the six months ended 30 June 2023. According to Tepia Interim Report 2023, such decrease was primarily attributable to the decrease in revenue from water conservancy project management caused by the delay of commencement or completion of certain projects during the year.

Tepia Group's gross profit decreased by approximately 17.0% from approximately RMB2.7 million for the six months ended 30 June 2022 to approximately RMB2.2 million for the six months ended 30 June 2023. The gross profit margin of Tepia Group remained relatively stable at approximately 20.6% for the six months ended 30 June 2022 as compared to that of approximately 22.3% for the six months ended 30 June 2023.

Tepia Group recorded a net loss of approximately RMB5.1 million for the six months ended 30 June 2023, representing an increase of approximately 6.8% as compared to that of approximately RMB4.8 million for the six months ended 30 June 2022. According to Tepia Interim Report 2023, such increase was mainly due to the decrease in investment income and increase in impairment loss for the six months ended 30 June 2023, partly offset by the decrease in selling and distribution expenses for the six months ended 30 June 2023 and the turnaround from expected credit loss for the six months ended 30 June 2022 to expected credit gain for the six months ended 30 June 2023.

Set out below is a summary of the financial position of Tepia Group (i) as at 31 December 2021 and 2022 as extracted from the Tepia Annual Report 2022; and (ii) as at 30 June 2023 as extracted from the Tepia Interim Report 2023:

	As at 31 December		As at
	2021	2022	30 June
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
	(audited)	(audited)	(unaudited)
Total assets	96,209	82,924	78,516
— Non-current assets	6,903	6,176	6,401
— Current assets	89,306	76,748	72,115
Total liabilities	16,700	13,826	14,534
— Non-current liabilities	426	—	551
— Current liabilities	16,274	13,826	13,983
Net current assets	73,032	62,922	58,132
Net assets	79,509	69,098	63,982

As at 30 June 2023, the non-current assets of Tepia Group mainly comprised (i) deferred tax assets of approximately RMB3.4 million; (ii) intangible assets of approximately RMB1.7 million; (iii) fixed assets of approximately RMB0.7 million; and (iv) right-of-use assets of approximately RMB0.6 million. Meanwhile, Tepia Group's current assets mainly consisted of (i) contract assets of approximately RMB22.7 million; (ii) prepayments of approximately RMB13.3 million; (iii) inventories of approximately RMB8.8 million; (iv) other receivables of approximately RMB8.2 million; (v) bank balances and cash of approximately RMB5.9 million; (vi) trade receivables of approximately RMB5.1 million; (vii) bills receivables of approximately RMB4.4 million; and (viii) financial assets of approximately RMB3.5 million.

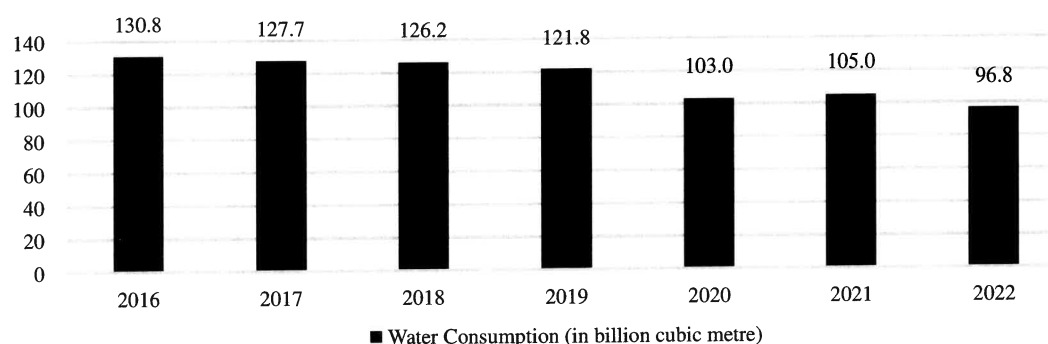
As at 30 June 2023, the non-current liabilities of Tepia Group comprised lease liabilities of approximately RMB0.6 million. Meanwhile, Tepia Group's current liabilities mainly consisted of (i) trade payables of approximately RMB8.0 million; (ii) other current liabilities of approximately RMB3.0 million; and (iii) contract liabilities of approximately RMB2.3 million.

As at 30 June 2023, the consolidated net current assets and net assets of Tepia Group were approximately RMB58.1 million and RMB64.0 million, respectively. As Tepia Group did not have any bank borrowings as at 30 June 2023, its gearing ratio was nil as at 30 June 2023.

3.2. Prospects of Tepia Group

The annual water consumption from industrial sector demonstrates a decreasing trend in recent years in China. According to the Ministry of Water Resources of the PRC, the annual water consumption from industrial sector has decreased from approximately 130.8 billion cubic metres in 2016 to approximately 96.8 billion cubic metres in 2022, showing a negative compound annual growth rate of approximately 4.9% during the period. One of the major factors contributing to the drop in water consumption in the industrial sector is the improvement of water usage efficiency. The adoption of the recirculating water system from the once-through water system allows used industrial water, such as contaminated or cooling water, to be repeatedly used, reducing the amount of water consumption by the industries. Other factors, including the advanced technologies in the crystallisation process and the promotion of cloud computing and big data to monitor the status of recirculating water systems, also play a vital role in improving water usage efficiency.

Annual Water Consumption of Industrial Sector in China



Source: Ministry of Water Resources of the PRC

As further stated in the Letter from the Board, the slow recovery of the PRC economy and the tightened budgets of local governments, who were previously major customers of Tepia Group, have adversely affected the demand for its services and the timely payment progress. These challenging operating conditions have also resulted in intense price competition during the project tendering process for Tepia Group, leading to fewer large-scale and profitable projects in the pipeline. Based on the abovementioned, the Directors are of the view that the water management-related business of Tepia Group is facing weak demand and a challenging operating environment.

4. Reasons for and benefits of the Disposal

The Group primarily operates in the textile industry, while the Target Group is principally engaged in the water management-related business. As disclosed in the Interim Report 2023, the Group recorded period-on-period decrease in both domestic and export sales of woven fabrics of approximately 24.3% and 32.7%, respectively, and the rise of electricity and labour cost further impacted the profitability of the Group. Due to the challenging business environment, the Directors consider that it is crucial for the Group to preserve its financial strength for its woven fabrics business and to continue to carry out measures to increase efficiency, reduce cost and improve liquidity.

The Group has been accounting for the share of results from the Target Group since the completion of its acquisition of the 41.67% equity interest in Tepia in August 2019. However, since then, Tepia Group has experienced a decline in revenue and has been consistently incurring losses, as detailed in the section headed “3.1. Background and financial information of the Target Group” above. Consequently, the return on the Group’s investment in the Target Group has been unsatisfactory. Upon completion of the Disposal, the Target Company and Tepia will cease to be a subsidiary and an associate of the Company, respectively, and the financial results and assets and liabilities of Tepia Group will no longer impact the financial statements of the Group thereafter.

Moreover, the Company is expected to recognise an unaudited gain on disposal of approximately RMB4.0 million (subject to assessment and audit) and the net proceeds arising from the Disposal of approximately RMB32.5 million will be utilised as general working capital of the Group as detailed in the Letter from the Board, which could strengthen the Group’s liquidity position and competitiveness.

Given that (i) the Disposal aligns with the Group’s strategy to preserve its financial strength for its woven fabrics business; (ii) the financial performance of the Target Group has been deteriorating in recent years which led to unsatisfactory return on the Group’s investment in the Target Group; (iii) the net proceeds from the Disposal could strengthen the Group’s liquidity position and competitiveness; and (iv) the water management-related business of Tepia Group is facing weak demand and a challenging operating environment as mentioned in the section headed “3.2. Prospects of Tepia Group” above, we consider that the Disposal represents a favourable opportunity for the Group to realise its investment in the Target Group and to redirect the Group’s resources towards its core business.

Having considered the above reasons and benefits, we concur with the Directors’ view that although the Disposal is not in the ordinary and usual course of business of the Group, it is in the interests of the Company and the Shareholders as a whole.

5. Principal terms of the Equity Transfer Agreement

The principal terms of the Equity Transfer Agreement, details of which are set out in the section headed “THE EQUITY TRANSFER AGREEMENT” in the Letter from the Board, are summarised below:

- Date:** 22 December 2023
- Parties:**
- (i) The Company (as the Vendor);
 - (ii) 紹興柯橋領悅汽車配件有限公司 (Shaoxing Keqiao Lingyue Automotive Parts Co., Ltd.*) (as the Purchaser); and
 - (iii) 浙江紹興慧聚水務科技有限公司 (Zhejiang Shaoxing Huiju Water Technology Co., Ltd.*) (as the Target Company)
- Subject matter:** The Vendor has conditionally agreed to sell, and the Purchaser has conditionally agreed to purchase, the Target Shares free from all encumbrances at a Consideration of RMB32.5 million.
- Consideration and payment terms:** The Consideration of RMB32.5 million shall be settled in cash.
- The Consideration was determined on the basis of normal commercial terms and after arm’s length negotiations between the Vendor and the Purchaser after taking into account the preliminary valuation of the Target Group of approximately RMB32.5 million, which mainly included the fair market value of the 41.67% equity interest in Tepia held by the Target Company as at 30 September 2023 as appraised by the Valuer adopting the market approach.
- Conditions precedent:** The Disposal is conditional upon and subject to the satisfaction of the following conditions:
- (1) the Independent Shareholders having approved the Equity Transfer Agreement and the transactions contemplated thereunder at the EGM in accordance with the requirements of the GEM Listing Rules and such approval not being revoked;

- (2) the Purchaser being satisfied with the results of due diligence review conducted in respect of the Target Group's assets, liabilities, business and affairs; and
- (3) the parties to the Equity Transfer Agreement having obtained all the necessary waivers, approvals, grants, licenses, authorisations, consents and orders (if required) in relation to the Equity Transfer Agreement and the transactions contemplated thereunder required by laws, regulations and rules (including the GEM Listing Rules) and other third parties and such waivers, approvals, grants, licenses, authorisations, consents and orders not being revoked.

If any of the aforesaid conditions precedent has not been fulfilled on or before 5:00 p.m. on 30 April 2024 (or such other later date as may be agreed between the Vendor and the Purchaser), the Equity Transfer Agreement shall cease and terminate and no party to the Equity Transfer Agreement shall have any obligations and liabilities thereunder save for any antecedent breaches of the terms thereof.

As at the Latest Practicable Date, conditions (2) and (3) have been fulfilled.

Completion:

Completion of the Equity Transfer Agreement shall take place within 10 business days after the fulfilment of the conditions precedent save and except for any delays caused by regulatory authorities and force majeure. The completion date of the Equity Transfer Agreement shall be the date on which the change in industrial and commercial registration in the name of the Purchaser is completed. From and inclusive of the completion date of the Equity Transfer Agreement, the risks, benefits and burden of the Target Shares are transferred from the Vendor to the Purchaser.

Upon completion, the Company will cease to have any interests in the Target Company and Tepia. The Target Company and Tepia will cease to be a subsidiary and an associate of the Company, respectively.

Taking into account the Consideration being fair and reasonable as discussed below, we are of the view that the terms of the Equity Transfer Agreement are on normal commercial terms and fair and reasonable so far as the Independent Shareholders are concerned.

6. Analysis of the Consideration

6.1. Independent valuation of the Target Company

According to the Letter from the Board, the Consideration of RMB32.5 million was determined on the basis of normal commercial terms and after arm's length negotiations between the Vendor and the Purchaser with reference to the preliminary valuation of the Target Group of approximately RMB32.5 million, which mainly included the fair market value of the 41.67% equity interest in Tepia held by the Target Company as at 30 September 2023 as appraised by the Valuer adopting the market approach.

In order to assess the fairness and reasonableness of the Consideration, we have obtained and reviewed the valuation report in relation to the 100% equity value of the Target Company (the "**Valuation Report**") and the underlying workings prepared by the Valuer. As stated in the Valuation Report, the fair value of the 100% equity value of the Target Company as of 30 September 2023 (the "**Valuation Date**") is appraised at RMB32,533,000 (the "**Valuation**"). Accordingly, the Consideration is approximately equivalent to such valuation. Independent Shareholders' attention is drawn to the full text of the Valuation Report as set out in Appendix II to the Circular.

We have performed the works as required under Note 1(d) to Rule 17.92(2)(b) of the GEM Listing Rules and paragraph 5.3 of the Corporate Finance Adviser Code of Conduct in respect of the Valuation Report, which included, among others, (i) review of the terms of engagement and the scope of work of the Valuer; (ii) assessment of the Valuer's qualification and experience in relation to the preparation of the Valuation Report and its independence; and (iii) discussion on the bases, assumptions and methodologies adopted by the Valuer.

Scope of work

We have reviewed the terms of engagement of the Valuer and consider that its scope of work is appropriate to the opinion required to be given and we are not aware of any limitation on the scope of work which might adversely impact on the degree of assurance given by the Valuation Report. We also understand from the Valuer that it had performed necessary procedures for the purpose of the Valuation Report, which included, among others, obtaining and reviewing relevant information and documents of the Target Group such as legal documents and financial statements, discussion with relevant personnel of the Company and the Target Group to understand the history, business model, operations and development plan of the Target Group, carrying out its proprietary research in the sectors concerned and collecting and analysing relevant market data from reliable sources.

Furthermore, it is noted that the Valuation Report has been prepared in compliance with the requirements of International Valuation Standards published by The International Valuation Standards Council.

Qualification, experience and independence

We have enquired into the qualification, experience and independence of the Valuer in relation to the preparation of the Valuation Report. We are given to understand that (i) the Valuer is an established professional appraisal firm with extensive experience in business valuation and other kinds of valuation services; (ii) Mr. Vincent Pang (being the managing partner of the Valuer and the signor of the Valuation Report) is a member of the CFA Institute and CPA Australia, a fellow member of the Hong Kong Institute of Certified Public Accountants and a member and registered valuer of the Royal Institution of Chartered Surveyors who has over 20 years of experience in financial valuation and business consulting in Hong Kong and China; and (iii) the core project team members of the Valuer possess relevant experience in conducting business valuation. We have also reviewed the track record of the Valuer and noted that it provided a wide range of valuation services to numerous companies listed in Hong Kong in the past. The Valuer has also confirmed that it is independent of the Group, the parties to the Equity Transfer Agreement and their respective core connected persons. Based on the above, we are satisfied with the expertise and independence of the Valuer.

Bases, assumptions and methodologies

According to the Valuation Report, the Valuer has appraised the Valuation on a fair value basis, which refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As further disclosed in the Valuation Report, since the Target Company does not have any business operation other than holding the investment in Tepia Group, the fair value of the Target Company is derived by first determining the fair value of Tepia Group and adding it to the fair values of assets and liabilities on the balance sheet of the Target Company as of the Valuation Date.

We note from the Valuation Report that the Valuer has made several key assumptions, including, that (i) there will be no material change in the existing political, legal, technological, fiscal or economic conditions, which might adversely affect the business of the Target Company; (ii) the operational and contractual terms stipulated in the relevant contracts and agreements entered into between Tepia Group and any other parties will be honored; (iii) the Target Company will retain and have competent management, key personnel and technical staff to support its ongoing operation and will continue to operate as a going concern and have sufficient liquidity and capability; (iv) there are no hidden or unexpected conditions associated with the assets valued that might adversely affect the reported value; and (v) the trading share price of Tepia on NEEQ is not considered as it is deemed illiquid with negligible trading volume. As advised by the Valuer, such assumptions are commonly adopted in valuing business entities of similar nature.

We have further discussed with the Valuer on the selection of valuation methodology. In determining the appropriate valuation approach(es), the Valuer has considered the three generally accepted approaches, namely, income approach, cost approach and market approach. Please refer to the Valuation Report as set out in Appendix II to the Circular for the key features of these three different valuation approaches.

Firstly, the Valuer considered that cost approach is not appropriate for valuing Tepia Group as it assumes the assets and liabilities of Tepia Group are separable and it fails to consider the future economic benefits of ownership of the business. Secondly, income approach is also considered inappropriate as plenty of assumptions are involved in formulating the financial projection of Tepia Group, and the assumptions may not be able to reflect the uncertainties in the future performance of Tepia Group. Given that improper assumptions will impose significant impact on the fair value, income approach has not been adopted in the valuation. On the other hand, market approach has the merit of capturing the market sentiment to infer an objective valuation and is relatively more objective as publicly available data is used which reflects the market consensus on the pricing of similar business. Taking into account (i) the applicability of each of the aforesaid valuation approaches based on the status of Tepia Group as of the Valuation Date; (ii) the fact that only one recent comparable transaction can be identified by the Valuer; and (iii) the fact that there is a sufficient number of comparable companies which can provide a benchmark of valuation multiples, the Valuer has adopted market approach with comparable companies method to derive the equity value of Tepia. Having considered (i) the characteristics and business nature of Tepia Group; (ii) that during the course of determining the appropriate valuation approach(es), the Valuer considered and decided not to adopt cost approach and income approach and the reasons thereof; and (iii) that the Valuation Report is prepared by the Valuer in compliance with the requirements of International Valuation Standards which contain guideline on the basis and valuation approaches used in business valuation, we concur with the Valuer's view that it is most appropriate to adopt market approach for the valuation of Tepia Group and accordingly, we have not cross-checked the Valuation with the other two valuation approaches. We also understand from the Valuer that market approach is one of the commonly adopted approaches for valuing companies of similar nature.

In identifying comparable companies, the Valuer has considered the following selection criteria: (i) the primary industry of the companies is being in industry of Industrial Machinery and Supplies and Components or Environmental and Facilities Services, under Global Industry Classification Standard, as extracted from S&P Capital IQ; (ii) the principal business of the companies is in the provision of the design, development and manufacturing of industrial water treatment machinery in China; (iii) the companies are listed in all major exchange markets in China (including Hong Kong); and (iv) the financial information of the companies is available to the public. Based on the above criteria, the Valuer has identified an exhaustive list of seven comparable companies (the "**Comparable Companies**") that are engaged in similar business with Tepia Group. We have discussed with the

Valuer on such selection criteria and assessed the appropriateness of the selected Comparable Companies. As stated in the Valuation Report, the Valuer conducted its research of comparable companies through S&P Capital IQ database, which is considered to be a reliable source of market information of Hong Kong and international markets. We have also reviewed the business scope of each of the Comparable Companies and note that the Comparable Companies are listed on the Shenzhen Stock Exchange or Shanghai Stock Exchange with over 50% of total revenue being generated from the design, development and manufacturing of industrial water treatment machinery. Based on the foregoing, we are of the view that (i) the selection criteria of the Comparable Companies are fair and reasonable; and (ii) the Comparable Companies identified by the Valuer are fair and representative for the purpose of valuation multiples analysis.

In determining the appropriate valuation multiple(s), the Valuer has considered various multiples such as price-to-earnings (“P/E”), price-to-book (“P/B”), price-to-sales (“P/S”), enterprise value-to-sales (“EV/S”), enterprise value-to-earnings before interests and taxes (“EV/EBIT”) and enterprise value-to-earnings before interests, taxes, depreciation and amortisation (“EV/EBITDA”) multiples. As explained in the Valuation Report, P/B multiple is considered not appropriate for the valuation of Tepia Group because book value only captures the tangible assets of a company while it does not capture the intangible company-specific competencies and advantages. Thus, P/B multiple is not a good measurement of the fair value of a company. P/S multiple is also considered not appropriate for the valuation of Tepia Group because it does not capture differences in financial leverage and related risk features across the Comparable Companies. Moreover, P/E, EV/EBIT and EV/EBITDA multiples are not adopted as Tepia Group recorded net losses, negative EBIT and negative EBITDA for the trailing 12-months period ended 30 September 2023 and no meaningful results based on P/E, EV/EBIT and EV/EBITDA multiples of the Comparable Companies can be generated. The Valuer therefore considered EV/S multiple to be the most appropriate indicator of the fair values of the Comparable Companies as it eliminates the difference in capital structure and related risk features. Hence, EV/S multiple has been adopted in the valuation of Tepia Group. For our due diligence purpose, we have searched for the relevant financial information of Tepia and the Comparable Companies on S&P Capital IQ database and also reviewed their relevant published financial statements. We note that Tepia Group’s capital structure was different from that of each of the Comparable Companies. In particular, Tepia Group had no borrowings or minority interest and was in net cash position as at 30 June 2023 according to Tepia Interim Report 2023, whereas the Comparable Companies had different amounts of debts and borrowings as at 30 June 2023, resulting in the vast difference in leverage levels between Tepia Group and the Comparable Companies.

In arriving at the Valuation, the Valuer firstly derived the estimated 100% enterprise value of Tepia Group by multiplying the sales of Tepia Group for the trailing 12-months period ended 30 September 2023 by the median of EV/S multiple of the Comparable Companies, and then adjusted for (i) the cash and debt of Tepia Group; (ii) a discount for lack of marketability (“**LOMD**”) of 20.5%; (iii) the shareholding percentage of Tepia held by the Target Company; and (iv) the value of other assets and liabilities on the balance sheet of the Target Company as of the Valuation Date.

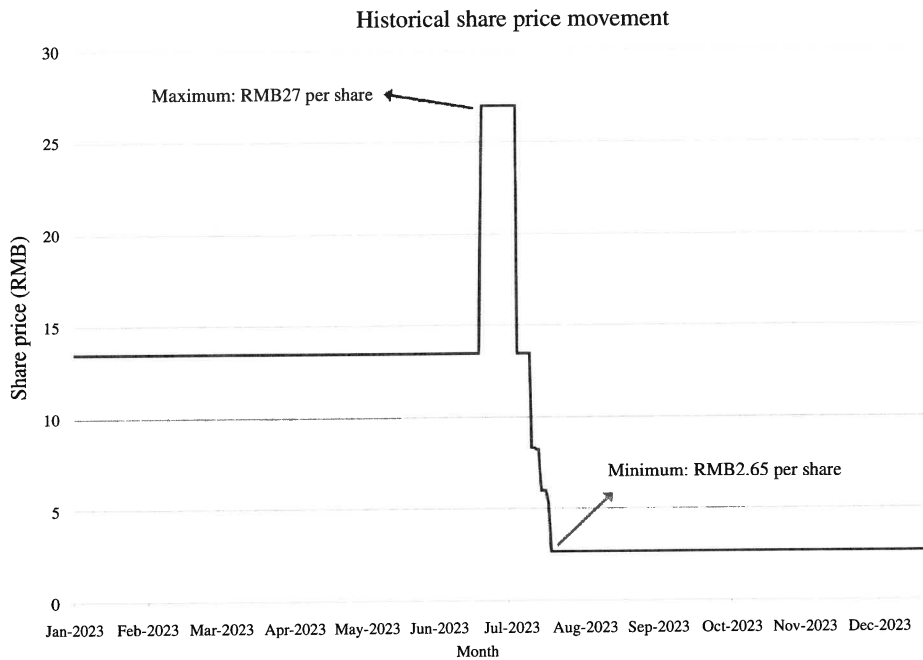
We have discussed with the Valuer in relation to the adoption of LOMD of 20.5%. We understand that LOMD reflects the fact that there is no ready market for shares in a closely held company. Ownership interests in closely held companies are typically not readily marketable compared to similar interests in publicly listed companies and therefore, a share of stock in a privately held company is usually worth less than an otherwise comparable share in a publicly listed company. The Target Company is a privately held company. Although the 60,000,000 Tepia Shares held by the Target Company are listed on NEEQ, given the inactive trading and negligible trading volume of Tepia Shares on NEEQ, the Valuer considered that the listing status of Tepia on NEEQ may not provide sufficient liquidity for immediate transaction of Tepia Shares. The Valuer further advised that since the EV/S multiple adopted in the valuation was calculated from publicly listed companies which represents marketable ownership interest, a marketability discount shall be adopted to adjust such marketable interest fair value to non-marketable interest fair value of the Target Company. We understand from the Valuer that the LOMD of 20.5% was adopted with reference to the report “Stout Restricted Stock Study Companion Guide (2022 edition)” by Stout Risius-Ross, LLC, a reputable research company. In view of the above, the Valuer considered that it is appropriate and suitable to adopt the LOMD of 20.5% in the valuation.

In the course of our discussion with the Valuer, we have not identified any major factors which would lead us to cast doubt on the fairness and reasonableness of the bases, assumptions and methodologies adopted in the Valuation Report. On the above basis and having considered the expertise and independence of the Valuer as discussed above, we are of the opinion that the Valuation is arrived at after due and careful consideration.

6.2. Historical share price movement and trading liquidity of Tepia Shares

The Disposal is in substance the disposal of the 41.67% equity interest in Tepia (representing 60,000,000 Tepia Shares) held by the Target Company. As mentioned in the section headed “3.1. Background and financial information of the Target Group” above, Tepia Shares are listed on NEEQ, which is an over-the-counter trading platform in the PRC. Owing to the nature of NEEQ and based on the information obtained from NEEQ, Tepia Shares were not actively traded and the trading volume was negligible. As such, the Company and the Purchaser have not taken into account of the share price of Tepia Shares on NEEQ in determining the Consideration. For reference purpose only, we have reviewed the historical share price and trading volume of Tepia Shares on NEEQ during the period from 1 January 2023 up to and including the date of the Equity Transfer Agreement (i.e. 22 December 2023) (the “**Review Period**”), being approximately a one-year period prior to the date of the Equity Transfer Agreement.

The chart below sets out the historical share price movement of Tepia Shares during the Review Period:



Source: National Equities Exchange and Quotations

As illustrated in the chart above, there was a significant fluctuation in the share price of Tepia Shares during the Review Period, with the maximum price at RMB27 per share and the minimum price at RMB2.65 per share.

The table below sets out the monthly trading volume of Tepia Shares during the Review Period:

Period	Monthly trading volume	Percentage to the total number of Tepia Shares in issue (Note) (approximate)
2023		
January	62,000	0.043%
February	1,600	0.001%
March	0	0%
April	0	0%
May	0	0%
June	1,700	0.001%
July	1,800	0.001%
August	0	0%
September	0	0%
October	0	0%
November	0	0%
December (up to and including the date of the Equity Transfer Agreement)	0	0%

Source: National Equities Exchange and Quotations

Note: Computed by dividing the monthly trading volume by the total number of Tepia's ordinary shares in issue of 144,000,000 as at the date of the Equity Transfer Agreement

As shown in the table above, the monthly trading volume of Tepia Shares was negligible during the Review Period, suggesting that the listing status of Tepia on NEEQ may not provide sufficient liquidity for immediate transaction of Tepia Shares. Considering the illiquidity of Tepia Shares and the substantial amount of the 60,000,000 Tepia Shares which represents 41.67% of Tepia's issued share capital, it will be unlikely for the Company to dispose of such 60,000,000 Tepia Shares in the market via NEEQ. The Disposal therefore represents an opportunity for the Company to dispose of such 60,000,000 Tepia Shares in one lot at a fixed price.

In light of the above, we are of the view that the listing status of Tepia on NEEQ is not a relevant factor to assess the Consideration and it is more appropriate to base our assessment of the Consideration on the analysis of the Valuation as set out in the section headed "6.1. Independent valuation of the Target Company" above.

Given that the Consideration of RMB32.5 million (i) is approximately equivalent to the Valuation of RMB32,533,000; and (ii) indeed represents a premium of approximately 13.9% over the unaudited net asset value of the Target Group as at 30 September 2023 of approximately RMB28.53 million, we concur with the Directors' view that the Consideration is fair and reasonable so far as the Independent Shareholders are concerned.

7. Financial effects of the Disposal

Upon completion of the Disposal, the Company will cease to have any interests in the Target Company and Tepia, and the Target Company and Tepia will cease to be a subsidiary and an associate of the Company, respectively. Accordingly, Tepia Group's financial results and assets and liabilities will no longer be equity accounted for in the consolidated financial statements of the Group. The financial effects of the Disposal on the Group are set out below:

7.1. Earnings

As stated in the Letter from the Board, subject to assessment and audit, the Company is expected to recognise an unaudited gain on disposal of approximately RMB4.0 million, being the difference between the Consideration and the unaudited net asset value of the Target Group as at 30 September 2023. Therefore, it is expected that the Disposal would have an immediate positive effect on the earnings of the Group upon completion.

Furthermore, having considered the recent financial performance of Tepia, more particularly, the deterioration in revenue and net loss position since FY2021 as described above, it is expected that the Disposal would improve the profitability of the Group.

7.2. Net assets

According to the Interim Report 2023, the net asset value of the Group amounted to approximately RMB163.2 million as at 30 June 2023. Taking into account the estimated gain on disposal of approximately RMB4.0 million, it is expected that the Disposal would increase the net asset value of the Group upon completion.

7.3. Working capital

According to the Letter from the Board, the Consideration of RMB32.5 million will be settled and paid in cash to the Company and the net proceeds arising from the Disposal of approximately RMB32.5 million will be utilised as general working capital of the Group. Therefore, it is expected that the Disposal would have a positive effect on the working capital of the Group upon completion.

Shareholders are reminded that the above analysis is for illustrative purposes only and does not purport to represent how the financial performance or financial position of the Group would be upon completion of the Disposal.

RECOMMENDATION

Having considered the above principal factors and reasons, we are of the opinion that the terms of the Equity Transfer Agreement are on normal commercial terms and fair and reasonable so far as the Independent Shareholders are concerned, and although the Disposal is not in the ordinary and usual course of business of the Group, it is in the interests of the Company and the Shareholders as a whole. Accordingly, we advise the Independent Board Committee to recommend, and we ourselves recommend, the Independent Shareholders to vote in favour of the ordinary resolution(s) to be proposed at the EGM to approve the Equity Transfer Agreement and the transactions contemplated thereunder.

Yours faithfully,
For and on behalf of
Lego Corporate Finance Limited



Stanley Ng
Managing Director

Mr. Stanley Ng is a licensed person registered with the Securities and Futures Commission and a responsible officer of Lego Corporate Finance Limited to carry out Type 6 (advising on corporate finance) regulated activity under the SFO. He has over 19 years of experience in the accounting and investment banking industries.