Gram Capital Limited
嘉林資本有限公司

25 June 2024

To: The Independent Board Committee and the Independent Shareholders of Hengxin Technology Ltd.

Dear Sir/Madam,

VERY SUBSTANTIAL ACQUISITION AND CONNECTED TRANSACTION IN RELATION TO THE ACQUISITION OF THE REMAINING EQUITY INTEREST IN NANJING ZHANGYU AND SHANGHAI ZHANGYU

INTRODUCTION

We refer to our appointment as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the Acquisition, details of which are set out in the letter from the Board (the "**Board Letter**") contained in the circular dated 25 June 2024 issued by the Company to the Shareholders (the "**Circular**"), of which this letter forms part. Terms used in this letter shall have the same meanings as defined in the Circular unless the context requires otherwise.

With reference to the Board Letter, on 20 May 2024 (after trading hours of the Stock Exchange), the Purchaser and the Vendors entered into the Equity Purchase Agreement pursuant to which the Purchaser conditionally agreed to acquire, and the Vendors have conditionally agreed to sell the Sale Equity, representing the remaining 49% equity interest in each of the Target Companies, at the Consideration of RMB522.0 million in cash.

With reference to the Board Letter, the Acquisition constitutes a very substantial acquisition and connected transaction for the Company under Chapter 14 and Chapter 14A of the Listing Rules and is subject to the reporting, announcement and Independent Shareholders' approval requirements under the Listing Rules.

The Independent Board Committee comprising Mr. Qian Ziyan, Dr. Li Jun, and Mr. Pu Hong, being all of the independent non-executive Directors, has been formed to advise the Independent Shareholders on (i) whether the terms of the Acquisition are on normal commercial terms and are fair and reasonable; (ii) whether the Acquisition is in the interests of the Company and the Shareholders as a whole and are conducted in the ordinary and usual course of the business of the Group; and (iii) how the Independent

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Shareholders should vote in respect of the resolution to approve the Acquisition at the EGM. We, Gram Capital Limited, have been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in this respect.

INDEPENDENCE

During the past two years immediately preceding the Latest Practicable Date, Gram Capital was engaged as independent financial adviser in relation to (i) the continuing connected transaction as set out in the Company's circular dated 3 February 2023; (ii) the major and connected transactions as set out in the Company's circular dated 11 April 2024; and (iii) the duration of the continuing connected transaction as set out in the Company's announcement dated 22 April 2024. Save for the aforesaid engagements, there was no other service provided by Gram Capital to the Company relating to any transaction of the Company with executed agreement during the past two years immediately preceding the Latest Practicable Date. Notwithstanding the aforesaid engagements, we were not aware of any relationships or interests between Gram Capital and the Company or any other parties during the past two years immediately preceding the Latest Practicable Date that could be reasonably regarded as a hindrance to Gram Capital's independence to act as the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders.

BASIS OF OUR OPINION

In formulating our opinion to the Independent Board Committee and the Independent Shareholders, we have relied on the statements, information, opinions and representations contained or referred to in the Circular and the information and representations as provided to us by the Directors. We have assumed that all information and representations that have been provided by the Directors, for which they are solely and wholly responsible, are true and accurate at the time when they were made and continue to be so as at the Latest Practicable Date. We have also assumed that all statements of belief, opinion, expectation and intention made by the Directors in the Circular were reasonably made after due enquiry and careful consideration. We have no reason to suspect that any material facts or information have been withheld or to doubt the truth, accuracy and completeness of the information and facts contained in the Circular, or the reasonableness of the opinions expressed by the Company, its advisers and/or the Directors, which have been provided to us. Our opinion is based on the Directors' representation and confirmation that there is no undisclosed private agreement/arrangement or implied understanding with anyone concerning the Acquisition. We consider that we have taken sufficient and necessary steps to form a reasonable basis and an informed view for our opinion in compliance with Rule 13.80 of the Listing Rules.

We have not made any independent evaluation or appraisal of the assets and liabilities of the Target Companies or its subsidiaries, and we have not been furnished with any such evaluation or appraisal, save as and except for the valuation report on Nanjing Zhangyu as contained in Appendix VA (the "**NZ Valuation Report**") to the Circular and the valuation report on Shanghai Zhangyu as contained in Appendix VB to the Circular (the "**SZ Valuation Report**", together with the NZ Valuation Report, the "**Valuation Reports**"). The NZ Valuation Report and SZ Valuation Report were prepared by the Independent Valuer. Since we are not experts in the valuation of assets or business, we have relied solely upon the NZ Valuation Report for the market value of equity interest in Nanjing Zhangyu and SZ Valuation Report for the market value of equity interest in Shanghai Zhangyu, as at 31 December 2023 (the "**Valuation Date**").

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The Circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the 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 herein or this circular misleading. We, as the Independent Financial Adviser, take no responsibility for the contents of any part of the Circular, save and except for this letter of advice.

We consider that we have been provided with sufficient information to reach an informed view and to provide a reasonable basis for our opinion. We have not, however, conducted any independent in-depth investigation into the business and affairs of the Company, the Vendors, the Target Companies, or their respective subsidiaries or associates (if applicable), nor have we considered the taxation implication on the Group or the Shareholders as a result of the Acquisition. 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. Shareholders should note that subsequent developments (including any material change in market and economic conditions) may affect and/or change our opinion and we have no obligation to update this opinion to take into account events occurring after the Latest Practicable Date or to update, revise or reaffirm our opinion. In addition, nothing contained in this letter should be construed as a recommendation to hold, sell or buy any Shares or any other securities of the Company.

Lastly, where information in this letter has been extracted from published or otherwise publicly available sources, it is the responsibility of Gram Capital to ensure that such information has been correctly extracted from the relevant sources while we are not obligated to conduct any independent in-depth investigation into the accuracy and completeness of those information.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion in respect of the Acquisition, we have taken into consideration the following principal factors and reasons:

Information on the Group

With reference to the Board Letter, the Company is an investment holding company. The Group is principally engaged in the provision of digital technology and digital security products and services, the provision of new energy and services and the provision of telecommunications products and services.

Set out below are the Group's audited consolidated financial information for the two years ended 31 December 2023 as extracted from the Company's annual report for the year ended 31 December 2023 (the "**2023 Annual Report**"):

	For the year ended 31 December 2022	For the year ended 31 December 2023	Change
	RMB'000	*RMB'000*	*Approximate %*
Revenue	2,039,583	2,255,903	10.61
– *Digital technology and digital security*	*94,218*	*202,671*	*115.11*
– *New energy and services*	–	*77,064*	*N/A*
– *Telecommunications*	*1,945,365*	*1,976,168*	*1.58*
Gross profit	375,525	434,698	15.76
Profit for the year attributable to equity shareholders of the Company	63,602	69,702	9.59

As depicted from the above table, the Group's revenue for the year ended 31 December 2023 ("**FY2023**") increased by approximately 10.61% as compared to that for the year ended 31 December 2022 ("**FY2022**"), mainly attributable to revenue generated from new energy and services segment (the "**New Energy Segment**") and increase in revenue from digital technology and digital security segment (the "**Digital Segment**"). Along with the aforesaid increase in the Group's revenue, the Group's gross profit for FY2023 also increased by approximately 15.76% as compared to that for FY2022.

Profit attributable to equity shareholders of the Company for FY2023 increased by approximately 9.59% as compared to that for FY2022. With reference to the 2023 Annual Report and as confirmed by the Directors, the aforesaid increase in profit attributable to equity shareholders of the Company was mainly attributable to increase gross profit and decrease in other operating expenses, as partially offset by impairment loss on trade receivables for FY2023 and increase in interest expense and income tax.

With reference to the 2023 Annual Report and as confirmed by the Directors:

(i) The Directors expected that the Digital Segment and the New Energy Segment will be able to gain favorable development opportunities from the PRC national policies.

(ii) In respect of the Digital Segment, the Group will endeavour to implement intelligent internet-of-things ("**IoT**") data privacy computing project plan and develop a recommendation system based on differential privacy. Through analyses on user data with privacy protection, the Group is committed to realizing specific information recommendations and thereby achieving models for cooperation in the fields of electricity, energy, medical and industrial IoT.

(iii) In respect of the New Energy Segment, the Group will continue to ensure continuous and stable operation and development of its solar thermal molten salt energy storage power plant projects and provision of operations and maintenance services using its leading technologies.

Information on the Purchaser

With reference to the Board Letter, the Purchaser (an indirect wholly-owned subsidiary of the Company) is a company established under the PRC laws with limited liability and its principal activity is investment holding.

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Information on the Vendors

With reference to the Board Letter:

(i) Xuzhou Jinkan is a limited partnership established under the laws of the PRC and its principal activity is investment holding. As at the Latest Practicable Date, the interest in Xuzhou Jinkan is owned as to 99% by Shanghai Gaolai (as limited partner) (which is in turn held as to approximately 99% by Mr. Peng Yinan and 1% by Mr. Gao Xi) and 1% by Mr. Xu Huigeng (as general partner).

(ii) Mr. Bai Yuanliao is an individual who is a PRC resident.

Information of the Target Companies

With reference to the Board Letter:

(a) Nanjing Zhangyu is a company established under the PRC laws with limited liability and principally engaged in the development, design and sale of integrated circuits, digital products, computer hardware, computer technology application and software, as well as technology consultation and technology services. As at the Latest Practicable Date, Nanjing Zhangyu is held as to 51% indirectly by the Company and 49% directly by Xuzhou Jinkan. As at the Latest Practicable Date, Wuxi Sihai, Qinghai Zhongkong, Qinghai Solar, Zhongguang Qinghai, Zhejiang Zhongguang, Longkong Zhongguang are the major operating subsidiaries of Nanjing Zhangyu, of which (i) Wuxi Sihai is principally engaged in chip design and mass production services and system integration services; and (ii) Qinghai Zhongkong, Qinghai Solar and Zhongguang Qinghai are principally engaged in the supply of electricity with a focus on the production and sales of solar power as well as the provision of development consultation and technical services of the solar thermal power generation technology; (iii) Zhejiang Zhongguang is principally engaged in provision of related technical and consultancy services; and (iv) Longkong Zhongguang is principally engaged in investment holding.

(b) Shanghai Zhangyu is a company established under the PRC laws with limited liability and principally engaged in the provision of cyber security and software solution in the financial sector. As at the Latest Practicable Date, Shanghai Zhangyu is held as to 51% indirectly by the Company, 39% directly by Xuzhou Jinkan and 10% by Mr. Bai Yuanliao.

Further details of the Target Companies are set out in the sections headed "Information of the Target Companies" of the Board Letter.

Set out below are the audited consolidated financial information of Nanjing Zhangyu Group for the two years ended 31 December 2023 as extracted from Appendix IIA to the Circular:

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	For the year ended 31 December 2022	For the year ended 31 December 2023	Change
	RMB'000	*RMB'000*	*Approximate %*
Revenue	132,538	235,984	78.05
– Digital technology and digital security	*132,538*	*158,920*	*19.91*
– New energy and services	–	*77,064*	*N/A*
Gross profit	58,429	126,545	116.58
Profit for the year	36,260	61,432	69.42

With reference to the "MANAGEMENT DISCUSSION AND ANALYSIS OF NANJING ZHANGYU GROUP" as contained in Appendix IIIA to the Circular and as confirmed by the Directors:

(i) Nanjing Zhangyu Group's revenue for FY2023 increased by approximately 78.05% as compared to that for FY2022. Such increase was mainly attributable to revenue contribution from the new energy and services business segment, which was formed after completion of acquisition of 51% equity interest in Zhejiang Zhongguang by Nanjing Zhangyu in July 2023 (the "**Zhejiang Zhongguang Acquisition**").

(ii) Nanjing Zhangyu Group's gross profit for FY2023 increased by approximately 116.58% as compared to that for FY2022 mainly due to gross profit contribution from the new energy and services business segment which was formed after completion of the Zhejiang Zhongguang Acquisition.

(iii) Nanjing Zhangyu Group's profit for FY2023 increased by approximately 69.42% as compared to that for FY2022 mainly due to increase in gross profit as partially offset by increase in administrative expense and interest expense.

Set out below are the audited consolidated financial information of Shanghai Zhangyu Group for the two years ended 31 December 2023 as extracted from Appendix IIB to the Circular:

	For the year ended 31 December 2022	For the year ended 31 December 2023	Change
	RMB'000	*RMB'000*	*Approximate %*
Revenue	15,413	43,751	183.86
– Digital technology and digital security	*15,413*	*43,751*	*183.86*
Gross profit	11,428	30,792	169.44
Profit for the year	6,389	17,218	169.49

With reference to the "MANAGEMENT DISCUSSION AND ANALYSIS OF SHANGHAI ZHANGYU GROUP" as contained in Appendix IIIB to the Circular and as confirmed by the Directors:

(i) Shanghai Zhangyu Group's revenue for FY2023 increased by approximately 183.86% as compared to that for FY2022. Such increase was mainly due to increase in operation size and diversity of products and services offered to customers.

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(ii) Shanghai Zhangyu Group's gross profit for FY2023 increased by approximately 169.44% as compared to that for FY2022, generally corresponding with revenue increase.

(iii) Shanghai Zhangyu Group's profit for FY2023 also increased by approximately 169.49% as compared to that for FY2022 mainly due to increase in gross profit as partially offset by increase in administrative expenses, other operating expenses and income tax.

Reasons for and benefits of the Acquisition

Detailed reasons for and benefits of the Acquisition were set out under the section headed "REASONS FOR AND BENEFITS OF THE ACQUISITION" of the Board Letter. With reference to the Board Letter:

(i) The Digital Segment contributed a revenue of approximately RMB202.7 million for FY2023, representing a significant increase in revenue of approximately RMB108.5 million or 115.1% as compared to the previous year.

(ii) The New Energy Segment contributed a revenue of approximately RMB77.1 million in the second half of 2023, following the completion of the Zhejiang Zhongguang Acquisition in July 2023.

(iii) For FY2023, the Digital Segment and the New Energy Segment achieved gross profit margin of 41.7% and 61.8%, respectively, while the Group's telecommunications business segment achieved a gross profit margin of approximately 15.3%.

(iv) The Digital Segment is expected to be continually benefited from the supportive policies released by the PRC government.

(v) The Acquisition is an important and pivotal move that aligns with the Group's long-term business development strategy and asset allocation strategy to further strengthen the business layout in the Digital Segment and the New Energy Segment, with a positive and crucial impact on the Group's future development and the sustainability of profitability.

(vi) The Acquisition will also allow the Group to gain full control over the management and operations of the Target Companies, simplify the decision-making process and enable the Company to implement strategic plans that are consistent with the Company's business objectives in a timely manner.

(vii) Upon the Completion, the Company would also be able to streamline the regulatory reporting and approval procedures, resulting in cost savings related to connected transactions involving the Target Companies, and hence improve the efficiency of operation.

Industry overview

With reference to the 2023 Annual Report and as confirmed by the Directors, the Target Group is mainly engaged in (i) the Digital Segment, their services are mainly relating to chips and integrated circuits; and (ii) the New Energy Segment, their services and production are mainly relating to solar thermal power generation.

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The Digital Segment

Set out below are the total production of integrated circuits in the PRC from 2019 to 2023 as published by the National Bureau of Statistics of the PRC:

	2019	2020	2021	2022	2023
Total production of integrated circuits in the PRC (thousand pieces)	201,822,000	261,423,000	359,435,000	324,185,172	351,440,000
Changes (%)		*29.53*	*37.49*	*(9.81)*	*8.41*

As shown in the above table, the total production of integrated circuits in the PRC increased from approximately 201.82 billion pieces in 2019 to approximately 359.44 billion pieces in 2021. Subsequently, the total production of integrated circuits in the PRC decreased to approximately 324.19 billion pieces in 2022 and recovered to approximately 351.44 billion pieces in 2023. The total production of integrated circuits in the PRC from 2019 to 2023 represented a compound annual growth rate ("**CAGR**") of approximately 14.87%.

In recent years, the PRC government issued various policies regarding the PRC integrated circuits market as set out below:

In July 2020, the State Council of the PRC issued《新時期促進積體電路產業和軟體產業高品質發展的若干政策》(Several Policies for Promoting High-quality Development of the Integrated Circuit and Software Industries in the New Era*), which outlined that the PRC government should promote the development of the integrated circuit and software industries, support the formation of industry clusters for information technology services and integrated circuits, and facilitate the specialized and high-end development of software industrial parks.

In December 2022, the Central Committee of the Chinese Communist Party and the State Council of the PRC collectively issued《擴大內需戰略規劃綱要(2022—2035年)》(Outline of the Strategy for Expanding Domestic Demand (2022-2035)*), which indicated that the PRC government should enhance the core competitiveness of the information technology industry, driving technological innovation and application in areas such as artificial intelligence, advanced communication, integrated circuits, cutting-edge display technologies, and advanced computing.

In August 2023, the Ministry of Industry and Information Technology of the PRC and the Ministry of Finance of the PRC collectively published《電子信息製造業2023-2024年穩增長行動方案》(Action Plan for Stable Growth in the Electronic Information Manufacturing Industry for 2023-2024*), which indicated that the PRC government should effectively mobilize various funds and social capital, expand investment opportunities, and systematically promote the commencement of major projects in key areas such as integrated circuits, new display technologies, communication devices, smart hardware, and lithium-ion batteries.

The New Energy Segment

Set out below is the cumulative installed capacity of solar thermal power generation in the PRC from 2019 to 2023 with reference to a report titled《中國太陽能熱發電行業藍皮書2023》(Blue Book of China's Solar Thermal Power Generation Industry 2023*) collectively published by China Solar Thermal Alliance (a national-level industry technology innovation strategic alliance led by the Institute of Electrical Engineering, Chinese Academy of Sciences, a national research institution in the field of electrical science and engineering technology in the PRC) and Solar Thermal Power Generation Professional Committee of the China Renewable Energy Society (a committee under the China Renewable Energy Society, a voluntary national, academic, and non-profit social organization composed of scientific and technological workers and relevant institutions engaged in research, development, and application of new energy and renewable energy. China Renewable Energy Society is registered in accordance with the law and subject to the guidance and supervision of the China Association for Science and Technology and the Ministry of Civil Affairs of the PRC).

	2019	2020	2021	2022	2023
Cumulative installed capacity of solar thermal power generation in the PRC (megawatt)	438	538	538	588	588
Changes (%)		*22.83*	–	*9.29*	–

As shown in the table above, the cumulative installed capacity of solar thermal power generation in the PRC increased from 438 megawatts in 2019 to 588 megawatts in 2022 with a CAGR of approximately 10.31%. Such installed capacity remained the same in 2023.

In recent years, the PRC government issued various policies regarding the PRC solar thermal power market as set out below:

In January 2022, the National Development and Reform Commission of the PRC and the National Energy Administration of the PRC collectively issued《關於完善能源綠色低碳轉型體制機制和政策措施的意見》(Opinions on Improving the Institutional Mechanisms and Policy Measures for Energy Green and Low-Carbon Transformation*), which outlined that the PRC government should enhance the construction and operational mechanisms for flexible power sources, leverage the regulating capabilities of solar thermal power generation, and improve the price compensation mechanisms supporting the operation of adjustable power sources such as solar thermal power generation and energy storage.

In April 2023, the National Energy Administration of the PRC issued《2023年能源工作指導意見》(Guiding Opinions on Energy Work in 2023*), which indicated that the PRC government should develop wind and solar power generation, actively promote the large-scale development of solar thermal power generation.

In September 2023, the National Energy Administration of the PRC published《關於組織開展可再生能源發展試點示範的通知》(Notice on Organizing Pilot Demonstrations for Renewable Energy Development *), which indicated that the PRC government should support the innovation and application of new technologies in solar thermal power generation, driving cost reduction, efficiency improvement, and the scaling up of solar thermal power development.

Having considered the potential prospects of the Digital Segment and the New Energy Segment as indicated above and the improved financial performance of the Target Companies as illustrated under the section headed "Information on the Target Companies" above, we are of the view that although the Acquisition is not conducted in the ordinary and usual course of business of the Company, it is in the interests of the Company and its Shareholders as a whole.

Principal terms of the Acquisition

Summarised below are the principal terms of the Acquisition under the Equity Purchase Agreement, details of which are set out in the Board Letter.

Date

20 May 2024

Parties

(i) the Purchaser;

(ii) the Vendors;

(iii) Nanjing Zhangyu; and

(iv) Shanghai Zhangyu

Equity interests to be acquired

The Purchaser conditionally agreed to purchase and the Vendors conditionally agreed to sell the Sale Equity at the Consideration of RMB522 million. The Sale Equity represents 49% equity interest in each of the Target Companies as at the date of the Equity Purchase Agreement and immediately before the Completion.

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Consideration

The Consideration of RMB522,000,000, among which the consideration for 49% equity interest in Shanghai Zhangyu is RMB127,000,000 (the "**SZ Consideration**") and Nanjing Zhangyu is RMB395,000,000 ("**NZ Consideration**"), shall be payable by the Purchaser to the Vendors in cash in accordance with the following manner:

(i) RMB52,200,000, representing 10% of the Consideration (i.e. the First Instalment), shall be paid to Xuzhou Jinkan's designated account within 10 Business Days from the date of signing of the Equity Purchase Agreement; and

(ii) RMB469,800,000, representing 90% of the Consideration, shall be paid to the Vendors' designated account within 5 Business Days after all conditions precedent set out in the Equity Purchase Agreement are fulfilled or waived (as the case may be), and the registration of the industrial and commercial change of Sale Equity by parties in relation to the Acquisition is completed (subject to the Target Company obtaining the business license after the industrial and commercial change), among which the Purchaser shall pay approximately RMB443.9 million to Xuzhou Jinkan and approximately RMB25.9 million to Mr. Bai Yuanliao.

With reference to the Board Letter, the Consideration payable by the Purchaser is referenced to the pro rata shareholding of the Vendors in the Sale Equity and will be satisfied by internal resources of the Group and bank borrowings. The bank borrowings to be obtained by the Purchaser and guaranteed by the Company amounted to approximately RMB313.2 million, representing 60% of the Consideration, and will be fully utilised for the payment of the Consideration. With reference to the unaudited pro forma financial information of the Enlarged Group as set out in Appendix IV to the Circular (the "**Pro Forma FI**") and as confirmed by the Directors, the aforesaid bank borrowings will be unsecured, repayable within 4.5 years after drawdown and bear interest at 3.95% per annum (the "**Interest Rate**").

With reference to the 2023 Annual Report, as at 31 December 2023, the Group's unsecured bank loans carried interest at annual rates of 1.26% to 4.00%. As the Interest Rate is within the aforesaid interest rate range of the Group's unsecured bank loans, we consider the bank borrowings for satisfying part of the Consideration to be acceptable.

Basis of the Consideration

The Consideration was determined after arm's length negotiations between the parties to the Equity Purchase Agreement by taking into consideration various factors, including but not limited to (i) historical financial performance of the Target Companies; (ii) the Valuation Reports prepared by the Independent Valuer in respect of the 100% equity interest of the Target Companies with aggregated market value of approximately RMB1,066.8 million as at the Valuation Date under market approach; (iii) the business development opportunities and prospects of the Target Group; and (iv) the benefits to be derived by the Group upon Completion as described under the section headed "REASONS FOR AND BENEFITS OF THE ACQUISITION" of the Board Letter.

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The Valuation Reports

According to the SZ Valuation Report, the market value of 100% equity interest in Shanghai Zhangyu was RMB260,056,000 as at the Valuation Date (the "**SZ Valuation**"), 49% of which was approximately RMB127,427,440. The SZ Consideration represents a slight discount to "49% of the SZ Valuation".

According to the NZ Valuation Report, the market value of 100% equity interest in Nanjing Zhangyu was RMB806,727,000 as at the Valuation Date (the "**NZ Valuation**"), 49% of which was approximately RMB395,296,230. The NZ Consideration represents a slight discount to "49% of the NZ Valuation".

As disclosed in the Valuation Report, as at the Valuation Date, Nanjing Zhangyu held 80% equity interest in Wuxi Sihai, and the market value of such equity interest was used in the NZ Valuation. With reference to the Board Letter, in January 2024, Nanjing Zhangyu further acquired 10% equity interest of Wuxi Sihai (i.e. Wuxi Sihai Acquisition) at a consideration of RMB8,037,000. The impact of the Wuxi Sihai Acquisition was not considered in the NZ Valuation as it took place after the Valuation Date. Taking into account the impact of the increased shareholding in Wuxi Sihai and the cash consideration paid for the Wuxi Sihai Acquisition, the adjusted valuation of 100% equity interest in Nanjing Zhangyu would be approximately RMB807.4 million, which would be slightly higher than the NZ Valuation. Based on the above, the Directors confirmed us that the Wuxi Sihai Acquisition would have minor positive impact on the valuation of 100% equity interest in Nanjing Zhangyu and it is appropriate to use the NZ Valuation as one of the factors for determining the NZ Consideration.

For our due diligence purpose, we reviewed and enquired into (i) the terms of engagement of the Independent Valuer with the Company; (ii) the Independent Valuer's qualification in relation to the preparation of the Valuation Reports; and (iii) the steps and due diligence measures taken by the Independent Valuer for conducting the Valuation Reports. From the mandate letter and other relevant information provided by the Independent Valuer and based on our interview with them, we were satisfied with the terms of engagement of the Independent Valuer as well as their qualification for preparation of the Valuation Reports. The Independent Valuer also confirmed that they are independent to the Group, the parties to the Acquisition and the Target Group.

With reference to the Valuation Reports:

(i) In arriving the market value of 100% equity interest in the Target Companies, the Independent Valuer considered three generally accepted approaches, namely the market approach, income approach and cost approach.

(ii) The market approach considers prices recently paid for similar assets, with adjustments made to market prices to reflect condition and utility of the appraised assets relative to the market comparative. Assets for which there is an established secondary market may be valued by this approach. Benefits of using this approach include its simplicity, clarity, speed and the need for few or no assumptions. It also introduces objectivity in application as publicly available inputs are used. However, one has to be wary of the hidden assumptions in those inputs as there are inherent assumptions on the value of those comparable assets. It is also difficult to find comparable assets. Furthermore, this approach relies exclusively on the efficient market hypothesis.

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(iii) The cost approach considers the cost to reproduce or replace in new condition of the assets appraised in accordance with current market prices for similar assets, with allowance for accrued depreciation or obsolescence present, whether arising from physical, functional or economic causes. The cost approach generally furnishes the most reliable indication of value for assets without a known secondary market. Despite the simplicity and transparency of this approach, it does not directly incorporate information about the economic benefits contributed by the subject assets.

(iv) The income approach is the conversion of expected periodic benefits of ownership into an indication of value. It is based on the principle that an informed buyer would pay no more for the project than an amount equal to the present worth of anticipated future benefits (income) from the same or a substantially similar project with a similar risk profile. This approach allows for the prospective valuation of future profits and there are numerous empirical and theoretical justifications for the present value of expected future cash flows. However, this approach relies on numerous assumptions over a long-time horizon and the result may be very sensitive to certain inputs. It also presents a single scenario only.

(v) To select the most appropriate approach, the Independent Valuer considered the purpose of the valuation engagement and the resulting basis of value as well as the availability and reliability of information provided to them to form perform an analysis. The Independent Valuer also considered the relative advantages and disadvantages of each approach to the nature and circumstances of the Target Companies. In the Independent Valuer's opinion, the cost approach is inappropriate for valuing the Target Companies, as it does not directly incorporate information about the economic benefits contributed by the Target Companies. The income approach is not the most optimal approach as it involves long-term financial projections and the adoption of numerous assumptions, not all of which can be easily quantified or ascertained. The Independent Valuer therefore relied on the market approach in determining their opinion of value.

(vi) There are two common methods under the market approach, namely, guideline public companies method and guideline transaction method. Guideline public companies method requires identifying suitable guideline public companies and selection of appropriate trading multiples, while guideline transaction method takes reference to recent mergers and acquisitions transaction between unrelated parties and ratio of transaction price to Target's financial metrics. In this exercise, the market value of equity interest in the Target Companies was developed through the guideline public company method. The guideline transaction method is not adopted due to lack of sufficient recent market transactions with similar nature as the Target Companies. The guideline public company method requires the research of comparable companies' benchmark multiples and selection of an appropriate multiple.

(vii) By adopting the market approach, the Independent Valuer had to determine the appropriate valuation multiples of comparable companies, in which the Independent Valuer had considered price-to-earnings, price-to-book, price-to-sales, enterprise value-to-sales and enterprise value-to-earnings before interest, taxes, depreciation and amortization (**"EV/EBITDA"**) multiples. The price-to-earnings multiples were not selected as it does not capture the financial leverage and other related risk feature across the Target Companies. The price-to-book multiples were not selected as it fails to capture the intangible company-specific competencies and advantages so in general, the equity's book value has little bearing with the Target Companies' fair value. The price-to-sales multiples and the enterprise value-to-sales multiples were not selected as they do not take into accountant the Target Companies' profitability. Therefore, the Independent Valuer adopted the EV/EBITDA multiples as the Independent Valuer considered it is suitable for profitable companies and can factor in differences in balance sheet positions between the Target Companies and the comparable companies.

We further reviewed and enquired into the Independent Valuer on the methodologies adopted and the basis and assumptions adopted in the Valuation Reports in order for us to understand the Valuation Reports.

We noticed the adoption of control premium and discount for lack of control in the Valuation Reports. With reference to the Board Letter and as confirmed by the Directors, they understood from the Independent Valuer that such mechanism was commonly used in the valuation to reflect the differences between the comparables and subject asset with regard to the ability to make decisions. Having considered (i) the shareholdings structure of the Subject Companies; (ii) the group structure and diversity of business of the Target Companies; (iii) the valuation methodology as detailed in Appendices VA and VB to the Circular; (iv) the minority equity interests to be acquired under the Acquisition; and (v) the qualification and independence of the Independent Valuer, the Board is of the view that the adoption of such mechanism in the Valuation Reports is reasonable.

We noticed a slight difference between the applications of discount of lack of control between the NZ Valuation and SZ Valuation. Should the same discount of lack of control (i.e. 22.90%) applied to SZ Valuation, there would be an upward adjustment of approximately RMB0.3 million in the SZ Valuation.

During our discussion with the Independent Valuer, we did not identify any major factor which caused us to doubt the fairness and reasonableness of the methodology, principal bases, assumptions and parameters adopted for the Valuation Reports. Given (i) the disadvantages and limitations of income approach and cost approach, being two other commonly adopted valuation approaches; and (ii) that the EV/EBITDA multiple (under the market approach) is an appropriate multiple for the Valuation Reports, as mentioned above, we did not adopt other valuation approaches to assess the SZ Valuation or the NZ Valuation.

Having considered (i) our independent work performed on the Valuation Reports; (ii) that the SZ Consideration represents a slight discount to "49% of the SZ Valuation"; and (iii) that the NZ Consideration represents a slight discount to "49% of the NZ Valuation", we are of the view that the Consideration (being the sum of the SZ Consideration and NZ Consideration) is fair and reasonable.

We noticed that (i) the consideration for the First Acquisition (i.e. acquisition of 51% equity interest in each of the Target Companies) was RMB255 million (the "**First Acquisition Consideration**"); and (ii) the original acquisition cost of the 10% equity interest of Shanghai Zhangyu to Mr. Bai Yuanliao (being one of the Vendors) was approximately RMB1,000,000 (the "**Bai's Acquisition Cost**") (such acquisition was completed on 6 May 2022) according to the Board Letter.

According to Appendices IIA and IIB to the Circular:

(a) Nanjing Zhangyu Group's revenue increased from approximately RMB45 million for the year ended 31 December 2021 ("**FY2021**") to approximately RMB133 million for FY2022 (caused by increase in revenue from digital technology and digital security segment) and to approximately RMB236 million for FY2023 (caused by continuous increase in revenue from digital technology and digital security segment and revenue contribution from the new energy and services business segment, which was formed after completion of the Zhejiang Zhongguang Acquisition).

(b) Nanjing Zhangyu Group's loss was approximately RMB553,000 for FY2021, profit was approximately RMB36 million for FY2022 and profit was approximately RMB61 million for FY2023.

(c) Shanghai Zhangyu Group did not generate any revenue for FY2021. Shanghai Zhangyu Group's revenue increased from approximately RMB15 million for FY2022 to approximately RMB43 million for FY2023.

(d) Shanghai Zhangyu Group's profit increased from approximately RMB1 million for FY2021 (mainly from written back of other payables) to approximately RMB6 million for FY2022 and to approximately RMB17 million for FY2023.

Given (i) the aforesaid improvement in financial performance of Nanjing Zhangyu Group and Shanghai Zhangyu Group; and (ii) that the SZ Consideration represents a slight discount to "49% of the SZ Valuation" and the NZ Consideration represents a slight discount to "49% of the NZ Valuation", we consider that the First Acquisition Consideration and Bai's Acquisition Cost do not affect our assessment on the fairness and reasonableness of the Consideration.

Completion

The Completion shall take place on the Completion Date upon all conditions set out in the Equity Purchase Agreement are satisfied or waived (as the case may be).

Taking into account the principal terms of the Acquisition as set out above, we consider that the terms of the Acquisition are fair and reasonable.

Financial effects in relation to the Acquisition

With reference to the Board Letter, upon the Completion, the Company will indirectly own the entire equity interest of the Target Companies; each of the Target Companies will become an indirect wholly-owned subsidiary of the Company; and the financial statements of every company in the Target Group will continue to be consolidated into the financial statements of the Group.

With reference to the 2023 Annual Report, the Group's total assets was approximately RMB4.25 billion and total liabilities was approximately RMB1.51 billion as at 31 December 2023. With reference to the 2023 Annual Report, the Group's profit for the year attributable to equity shareholders of the Company for FY2023 was approximately RMB69.70 million.

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With reference to the Pro Forma FI:

(i) The unaudited consolidated total assets and total liabilities of the Enlarged Group would be approximately RMB4.04 billion and RMB1.82 billion respectively as if the Acquisition had been completed on 31 December 2023.

(ii) The unaudited profit for FY2023 attributable to equity shareholders of the Company would be approximately RMB77.97 million as if the Acquisition had been completed on 1 January 2023.

It should be noted that the aforementioned analysis is for illustrative purposes only and do not purport to represent how the financial position of the Enlarged Group will be upon Completion.

RECOMMENDATION

Having taken into consideration the factors and reasons as stated above, we are of the opinion that (i) the terms of the Acquisition are on normal commercial terms and are fair and reasonable; and (ii) although the Acquisition is not conducted in the ordinary and usual course of the business of the Company, it is in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Board Committee to advise the Independent Shareholders to vote in favour of the resolution to be proposed at the EGM to approve the Acquisition and we recommend the Independent Shareholders to vote in favour of the resolution in this regard.

Yours faithfully,
For and on behalf of
Gram Capital Limited

Graham Lam
Managing Director

Note: Mr. Graham Lam is a licensed person registered with the Securities and Futures Commission and a responsible officer of Gram Capital Limited to carry out Type 6 (advising on corporate finance) regulated activity under the SFO. He has over 25 years of experience in investment banking industry.

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