

---

**BUSINESS**

---

**OVERVIEW**

We are an established EMS provider in the PRC offering integrated manufacturing services which include provision of design enhancement and verification, technical advice and engineering solutions, raw materials selection and procurement, quality control, logistic and delivery and after-sale services to our customers in respect of our assembling and production of PCBAs and fully-assembled electronic products.

*Our products.* Our products comprise PCBAs and fully-assembled electronic products that are embedded with our PCBAs primarily produced in-house. PCBAs are produced by assembling, populating and soldering of electronic components onto a bare PCB to form and produce a functional PCBA. Our PCBAs are either sold as stand-alone products or assembled with other product parts and casing (both plastic and metal) and packaging materials to form fully-assembled electronic products under the brands of our customers or the brands of their ultimate customers. Our PCBAs are currently mainly applied for production of electronic products that are used in the banking and finance, telecommunication and smart devices industries. Our fully-assembled electronic products that are embedded primarily with our PCBAs mainly include digital projectors, mPOS, mobile phones and photovoltaic inverters.

The table below sets forth a breakdown of revenue by products during the Track Record Period:

	<b>For the year ended 31 December</b>					
	<b>2015</b>		<b>2016</b>		<b>2017</b>	
	<i>RMB'000</i>	<i>% of total revenue</i>	<i>RMB'000</i>	<i>% of total revenue</i>	<i>RMB'000</i>	<i>% of total revenue</i>
PCBAs ( <i>Note 1</i> )	79,023	43.2	91,860	34.3	118,169	31.9
Fully-assembled electronic products ( <i>Note 2</i> )	<u>103,902</u>	<u>56.8</u>	<u>176,030</u>	<u>65.7</u>	<u>251,993</u>	<u>68.1</u>
<b>Total</b>	<u><u>182,925</u></u>	<u><u>100.0</u></u>	<u><u>267,890</u></u>	<u><u>100.0</u></u>	<u><u>370,162</u></u>	<u><u>100.0</u></u>

*Notes:*

- (1) These PCBAs are sold as stand-alone products to our customers.
- (2) The PCBAs embedded in these fully-assembled electronic products are primarily manufactured by us with a small portion being manufactured and supplied by our suppliers based on our requirements and specifications.

## BUSINESS

---

*Our customers.* During the Track Record Period, our customers mainly include manufacturers of electronic products, brand owners, OEMs and trading companies of electronic products such as mobile phones and mPOS which are mainly located in the Guangdong Province and Wuhan city of Hubei Province, the PRC. Most of our customers are in the PRC with a few customers based mainly in Hong Kong, United States and Mexico. For each of the three years ended 31 December 2017, our Group's sales to our top five customers accounted for approximately 75.3%, 76.4% and 80.3% of our total revenue in each of the respective years. For the same periods, our largest customer accounted for approximately 27.0%, 41.1% and 44.9% of our total revenue, respectively.

*Our production facilities.* Apart from (i) a small portion of the fully-assembled electronic products which were incorporated with the PCBAs supplied by our suppliers based on our requirements and specifications and (ii) the mobile phones, tablets and other telecommunication devices produced by independent third party companies in Hong Kong engaged by Eternity Technology for oversea customers, all our production activities are carried out at our production plant, namely, the Shenzhen Production Plant, in Shenzhen, the PRC. Our Shenzhen Production Plant has a gross floor area of approximately 12,000 sq.m. and is equipped with a range of automated machinery and equipment for assembling PCBAs. As at the Latest Practicable Date, we had ten SMT assembly lines and two DIP assembly lines. These assembly lines are all interchangeable and can be adjusted according to our production schedules and product specifications. Our annual available production capacity for PCB assembly as at 31 December 2017, calculated based on machine hour, amounted to approximately 69,573 hours.

Our subsidiary, namely, Shenzhen Hengchang Sheng, has been accredited with the ISO 9001 certification on quality management system, and ISO 14001 certification on environmental management system, in respect of the processing of PCB, since 2005 and 2009, respectively.

*Our suppliers.* Our suppliers (including suppliers of raw materials and subcontractors performing assembling works of our fully-assembled electronic products) are mainly located in the PRC with a few in Hong Kong, South Korea and Taiwan. For each of the three years ended 31 December 2017, our top five suppliers accounted for approximately 24.4%, 40.7% and 34.6% of our total cost of purchases and subcontracting fees, respectively while our purchases from our largest supplier accounted for approximately 7.0%, 11.5% and 12.0% of our total cost of purchases and subcontracting fees, respectively.

*Our growth.* During the Track Record Period, we recorded a revenue of approximately RMB182.9 million, RMB267.9 million and RMB370.2 million, respectively, and profit attributable to our Shareholders of approximately RMB14.0 million, RMB22.1 million and RMB28.5 million, respectively.

*Outlook of our Group.* Going forward, we view our growth to be driven primarily by the corresponding growth in the industries involving the use of (i) our PCBAs for onward production of various kinds of electronic products, including banking and finance, telecommunication and smart device industries; and (ii) our fully-assembled electronic products for different industries; and the continuing trend that electronic product manufacturers or brand owners are becoming more accustomed to outsourcing their manufacturing activities to EMS providers, like our Group.

## **BUSINESS**

---

### **COMPETITIVE STRENGTHS**

Our Directors believe that our Group's success to date and our potential for future growth are attributed to our competitive strengths set out below:

#### **We offer vertically integrated EMS solutions for rendering both PCB assembly services and full electronic product assembly services to our customers with turnkey EMS capabilities**

The process of PCBA assembling effectively joins and mounts separate and distinct electronic components with different functions together on a PCB, which enable a PCB to function in the way it is specifically designed. PCBA is used as an electronic circuit interconnecting medium and a mechanical mounting substrate which is a vital part of the electronic products and the design and quality of which would directly affect the quality and functioning of the ultimate electronic products.

Through our vertically integrated EMS solution platform, we provide EMS solutions to our customers on a turnkey basis whereby we are involved in almost every stage of product development process up to the delivery of the finished products, i.e. PCBAs or fully assembled electronic products. Our turnkey EMS capabilities include design enhancement and verification, selection and sourcing of material components, offering of technical advice and engineering solutions, assembling and production, inspection, quality control, warehousing and logistics. To achieve design enhancement and verification, we would try to understand the intended functions of individual products and look at the initial design specifications of a PCB in order to ascertain if there is any design flaw which would lead to any malfunction of the PCBA and the electronic end products. Once the assembly process of the PCBA has started, we would oversee the entire process and conduct quality control checking, including visual checks, AOI and x-ray inspection, on both semi-finished products and the finished products. After the soldering step of the PCBA process is finished, we test the PCB for its functionality, which puts the PCB through its paces, simulating the normal circumstances in which the PCB will operate. Our customers would also seek our technical advice or input to their design and/or engineering solutions for their new electronic products or the PCBAs thereof, which we believe, have differentiated us from other EMS providers in the PRC. Our customers can therefore enjoy a smooth PCBA manufacturing experience and full electronic product assembly services with minimal overhead and infrastructure costs. Our turnkey capabilities also offer greater flexibility and savings to our customers as we can handle the sourcing of components, localisation of purchases, materials handling and planning.

Our Group is committed to implementing high standard quality control measures in raw materials procurement, production processes and finished products. Our Group had been accredited with both the ISO 9001 certification of quality management system and ISO 14001 certification of environmental management system, in respect of our production and assembling of PCB and certain fully assembled electronic products, since 2005 and 2009, respectively. Our PCBAs are generally adopted and used by a number of electronic product manufacturers or brand owners for onward production of their electronic products under their brands in the PRC.

With respect to our fully-assembled electronic products, we have received the "CCC" certification in the PRC. As part of our value-added services, our Group has also assisted our customers to obtain international product quality and safety certifications in compliance with FCC to facilitate the onward sales of our fully-assembled electronic products under their brands in North America and South American countries.

## **BUSINESS**

---

### **We have strong research and development capabilities and has been granted the status of High and New Technology Enterprise\* (高新技術企業)**

We place a great emphasis on research and development to keep in pace with technology innovations and advances, which, we believe, will enable us to stay competitive, continually provide high-quality services to our customers and enhance our efficiency and productivity. Over the years, we have accumulated a certain level of technology experience in the provision of PCB assembly services and full electronic product assembly services. Leveraging our experience and knowledge in these areas, we developed a research and development team focusing on developing (i) electronic circuits; and (ii) cabinet parts and other related mechanical assembly parts for the provision of PCB assembly services and full electronic product assembly services to our customers on an EMS basis. Our research and development team engages in discussion with our customers and turn the customers' conceptual design or idea into deliverable and commercialised electronic products aiming to improve their product designs in terms of the products' PCBAs, casing and packaging and recommend the proper and suitable raw materials for production and testing of the products. Our research and development team also provides design enhancement and verification services to our customers.

As at 31 December 2017, we were supported by a dedicated team of 45 research and development staff, of whom 27 are engineering staff, including electronics, mechanical, software and testing engineering staff who place a strong focus on product realisation, commercialisation and improvement. They also have extensive experience in the electronics industry in the PRC. For the three years ended 31 December 2017, our expenses related to research and development amounted to approximately RMB7.3 million, RMB7.4 million and RMB12.4 million, respectively, which was composed of the remunerations paid to these staff, depreciation expenses, materials and service fee payable to third parties for product development.

Up to and including the Latest Practicable Date, we obtained nine utility model patents and 16 software copyrights in the PRC with respect to the enhancement of our efficiency in rendering assembly services and the quality of our services. We focus mainly on the development of patented technologies concerning the assembly process of PCBAs and full electronic end products and the quality control of our services.

As a result of our research and development capabilities, initiatives and achievements, in 2016 our Group was granted the status of "High and New Technology Enterprise\* (高新技術企業)" by the relevant PRC governmental authorities and has since been enjoying a preferential EIT of 15%. While our certificate of "High and New Technology Enterprise\* (高新技術企業)" will expire in 2018, given that (i) we have completed the necessary filings for examination of our status as a "High and New Technology Enterprise\* (高新技術企業)" with the relevant authorities in August 2016; (ii) there has been no major change to the laws and regulations relating to the certification since the last certification; and (iii) our corporate status and research and development credentials, have together been enhanced since the last certification, our Directors believe that we will continue to be qualified as a "High and New Technology Enterprise\* (高新技術企業)" and be granted the preferential EIT treatment upon re-examination of our status as a "High and New Technology Enterprise\* (高新技術企業)", which is expected to be completed by the relevant authorities.

## **BUSINESS**

---

### **We fully optimise the functions of our automated machinery and equipment to enable us to achieve efficient and cost-effective production of PCBAs and fully-assembled electronic products**

Our machinery and equipment for our provision of PCB assembly services are automated and operated by the SMT method, which can produce PCBAs with various specifications for incorporation into different kinds of electronic products. Attributed to our research and development team's expertise and experience, we are able to make adjustments on the parts and components of our machinery and equipment to optimise their functions to cater for specific production requirements of PCBAs with different specifications.

Our research and development team deploys its expertise to enhance our efficiency in production and maximise utilisation of our production capacity by planning our production schedule ahead and making adjustments on the parts and components of our machinery and equipment. Its expertise can also minimise time lag between disassembling and restructuring the production steps to cater for different product types. It can also shorten the time lag between each production step and optimise production speed, which in turn would reduce the production cost per unit of our PCBAs. Owing to our ability to make adjustments on the parts and components of our machinery and equipment to optimise their functions to suit our specific production requirements and schedule, we can diversify our product types with high volumes and short time lag.

As the electronic product market is dynamic and fast-changing, the availability of advanced and effective machinery and equipment coupled with our ability to optimise both their functions and utilisation is the key to our success as it renders the production process of our PCBAs more efficient and flexible.

Apart from the machinery and equipment for production of PCBAs, our automated machinery and equipment such as the wireless communication analyzers and automated testing machines, etc. enable us to perform quality control and testing on both the raw materials and the final products in the course of our provision of full electronic product assembly services to our customers.

As to the geographical location of our Shenzhen Production Plant in which all our machinery and equipment are installed, it enables us to achieve economies of scale through bulk procurement of raw materials from the suppliers in the vicinity. Our immediate access to different kinds of raw materials also allows us to shorten the lead time for the assembly of PCBAs and fully-assembled products.

### **We have an experienced management team**

Our Group's performance and success is, to a significant extent, attributable to the expertise and experience of our key management personnel. Our Group's core management team is led by Mr. Ma, who is our founder and has over 16 years' of experience in the EMS industry. Such experience has enhanced his knowledge and understanding of the EMS markets in the PRC. He is responsible for formulating the overall corporate strategies and handling the day to day operation and production management of our Group. On the other hand, our two other executive Directors, namely, Ms. Chen and Mr. Cheng, have joined our Group since 2007 and 2009, respectively. Our management team's long and stable working relationship with our Group demonstrate that their continued commitment to our Group.

## **BUSINESS**

---

Our Directors believe that the extensive experience of our Group's management team and their industry knowledge and in-depth knowledge and experience in the market enhances our capability to meet the expectations and changing demands of our customers from time to time. For further biographical details of our Company's management team, please refer to the section headed "Directors and Senior Management" of this document.

### **We have established long-term and stable relationships with our major customers**

We believe cultivating and maintaining customer loyalty is crucial to our continued success. We maintain long term business relationships with our customers from different provinces in the PRC and regions around the globe, including mainly Hong Kong, United States and Mexico. As at the Latest Practicable Date, our Group maintained business relationships ranging from approximately two years to nine years with our top five major customers. Our customers mainly includes local manufacturers of electronic products, brand owners, OEMs and trading companies of various kinds of electronic products. We believe that we are well-equipped with a number of highly-competitive qualities which include good quality control, flexibility in designs, competitive pricing and short lead times.

For PCBAs, our Group's major customers during the Track Record Period included manufacturers of ATM of certain popular brands in the PRC, and manufacturers of electronic products. Concerning our full electronic product assembly services, our customers are mainly OEMs or owners of certain electronic product brands, mobile phones and mPOS. Our Group seeks to establish and maintain long-term and stable business relationships with our customers by participating in their product development, new product rolling-out cycles and thereafter providing them with one-stop solutions from research and development to after-sales services. We provide them with quality products and after-sales services including product warranty and technical support. Our Group's stable customer relationships enable us to (i) obtain a stable flow of orders from our customers and maintain a stable production volume; (ii) openly interact and discuss with our customers; (iii) keep abreast of the latest technology; and (iv) acquire the necessary industry knowledge in developing our products with market appeal. We believe that the length of our business relationships with our customers is also an indication of their recognition of the quality of our products, which is a key factor attributable to our success.

Our Directors believe that our understanding on our customers' changing needs, our ability to offer vertically integrated EMS solutions and consistently deliver quality products to our customers at competitive prices and produce customised PCBAs and full electronic product assemblies of varying types, sizes and specifications to cater for the different requirements of our customers have all together been key factors leading to our Group's success in keeping stable customer relationships. As such, our Directors believe that we are also well positioned to develop new relationships with prospective customers.

## BUSINESS

---

### BUSINESS STRATEGIES

Our goal is to achieve sustainable growth in our current business and strengthen our production capacity to secure more business opportunities by implementing the following business strategies:

#### **Expand our production capacity and enhance our production efficiency**

*Industry outlook:* According to the Frost & Sullivan Report, the PRC has overtaken the United States as the world's largest electronic product market in terms of sales value since 2015. The sales value of electronic product market in the PRC grew from USD369.7 billion in 2012 to USD453.7 billion in 2016 with a CAGR of 5.3%. It is forecast that the sales value of electronics product market in the PRC will reach USD549.3 billion in 2021 with a CAGR of 3.9% from 2017 to 2021, and the PRC will account for 25.7% of the entire global market in terms of sales value. Furthermore, with the booming domestic demand for electronic products, advances in manufacturing technology and the offering of more value-add services, the market size of EMS industry in the PRC will continue to grow at a CAGR of 8.1% from 2017 to 2021 and reach RMB1,851.0 billion in 2021.

*Our current production capacity and its utilisation rate:* In respect of the production of our PCBAs, for each of the three years ended 31 December 2017, the utilisation rate of our SMT assembly lines was approximately 90.2%, 90.0% and 91.0%, respectively. A SMT assembly line generally includes SMT machine(s), reflow oven and AOI machine, etc. and the combination of which to form a SMT assembly line is subject to adjustment and modification to cater for the production of different types of electronic products. The production capacity for our SMT assembly lines decreased from approximately 80,850 hours in 2015 to approximately 69,573 hours in 2017 due to the decrease of our number of SMT assembly lines from 13 (inclusive of two SMT assembly lines leased from third party lessors on a short-term basis) as at 31 December 2015 to ten as at 31 December 2017 (inclusive of one SMT assembly line leased from third party lessor). The reduction in the number of our SMT assembly lines was due to our cessation of the short-term leases of two SMT assembly lines and our re-structuring of the combination of our SMT assembly lines with our then existing machinery and equipment to cater for the production of different types of electronic products.

*The increasing rental expenses for machinery:* In addition, in order to cope with the increasing demand of our EMS during the Track Record Period, we have entered into various short term leases of machinery for our SMT assembly lines and testing machines (with a duration of approximately one to 12 months) from time to time, and the rental expenses incurred in relation thereto increased from approximately RMB4.2 million for the year ended 31 December 2015 to approximately RMB8.7 million for the year ended 31 December 2017.

## BUSINESS

---

*The condition of our machinery:* As at the 31 December 2017, out of the ten SMT assembly lines set up in our Shenzhen Production Plant, nine of them were owned by our Group and one was leased from a third party lessor, and the average age of these nine SMT assembly lines was approximately 7.1 years. Among these nine SMT assembly lines, the average age of three of them is more than eight years, and the SMT machines in these three SMT production lines have been used by us for approximately ten to 12 years.

Taking into account the industry outlook of the EMS industry in the PRC, the average age of our SMT assembly lines, increasing rental expenses for machinery and our production volume having reached the existing designed production capacity, our Directors take the view that it is imperative for us to enhance our production capacity in order to cope with the simultaneous growth of the electronic product market in the PRC and to capture the business opportunities to, therefore, optimise our profitability. Our expansion plan includes both upgrading and enhancing our existing machinery and equipment and acquiring new machinery and setting up two additional SMT assembly lines and four additional automated testing lines in the premises of approximately 6,700 sq.m. near our Shenzhen Production Plant (the "**New Premises**") to be leased by us.

*Acquiring new machinery, upgrading three SMT assembly lines and setting up two additional assembly lines and four additional automated testing lines.* Based on the preliminary quotations obtained by us, we estimate that the capital expenditure for the acquisition of new machinery and equipment will be approximately HK\$[REDACTED] million, which will be financed from the [REDACTED] of the [REDACTED]. Also, we expect to utilise approximately HK\$[REDACTED] million from the [REDACTED] of the [REDACTED] to hire four additional workers to operate the four additional automated testing lines.



**BUSINESS**

Particulars of additional machinery and equipment we intend to acquire for production of PCBAs and electronic products are as follows:

<b>Additional machinery and equipment</b>	<b>Number of units</b>	<b>Estimated costs (HK\$'000)</b>
<i>(a) For upgrading three SMT assembly lines (Note)</i>		
Back to back configurable momentum printer	3	[REDACTED]
Three-dimensional solder paste printing inspection machine (double track)	3	[REDACTED]
AOI Inspector	6	[REDACTED]
Double track reflow oven	3	[REDACTED]
High-speed multi-function modular placing machine (2M III base)	9	[REDACTED]
High-speed multi-function modular placing machine (4M III base)	6	<u>[REDACTED]</u>
Sub-total		[REDACTED]
<i>(b) For setting up two additional SMT assembly lines</i>		
Back to back configurable momentum printer	2	[REDACTED]
Three-dimensional solder paste printing inspection machine (double track)	2	[REDACTED]
AOI inspector	4	[REDACTED]
Double track reflow oven	2	[REDACTED]
High-speed multi-function modular placing machine (2M III base)	6	[REDACTED]
High-speed multi-function modular placing machine (4M III base)	4	<u>[REDACTED]</u>
Sub-total		[REDACTED]
<i>(c) For setting up four additional, automated testing lines</i>		
ICT (in-circuit test) machine	4	<u>[REDACTED]</u>
		<u>[REDACTED]</u>

*Note:* As at 31 December 2017, the average age of the three SMT assembly lines to be upgraded was approximately 8.3 years.

Assuming the three SMT assembly lines are upgraded, the two additional SMT assembly lines and four additional automated testing lines are delivered, installed and available for production in accordance with the implementation plan set out in the paragraphs headed "Implementation plan" in the section headed "Future Plans and [REDACTED]" in this document, our Directors estimate that the depreciation charge for these additional machinery and equipment will be approximately RMB0.7 million and RMB5.9 million for the year ending 31 December 2018 and 2019, respectively.

## BUSINESS

---

*Projected increase of our production capacity.* We expect that after completion of the upgrade of three SMT assembly lines and the set-up of two additional SMT assembly lines and four additional automated testing lines, our production capacity for our SMT assembly lines will increase by approximately 7,665 hours and 13,440 hours by the end of 2019 and 2020, respectively.

Our Directors believe that the projected increase in the production capacity for our PCBAs could satisfy our future production needs in the next five years. As such, our Directors are of the view that following the successful implementation of our business strategies, despite the additional production overheads, the direct labour costs to be incurred and the depreciation charge for these additional machinery and equipment, it will not cause any material adverse impact on our financial performance as these additional machinery and equipment would enlarge our production capacity, enabling us to take up more purchase orders from our customers, especially during the anticipated steady growth of the electronic product market in the PRC from 2017 to 2021 with a CAGR of 3.9% and thus, offsetting the additional costs incurred or arisen from the purchase of additional machinery and equipment.

### **Expand our Shenzhen Production Plant, convert our existing warehouse into an intelligent warehouse and set up an additional intelligent warehouse**

Since our Shenzhen Production Plant had been running nearly at full capacity for our PCBA assembling and full electronic product assembling, respectively, our ability to take on new orders is therefore limited by the space therein. In order to expand our production capacity, it is necessary for us to expand our Shenzhen Product Plant. Hence, we plan to lease the New Premises, which will accommodate the additional SMT assembly lines, automated testing lines and warehousing. We choose to lease the New Premises due to its close proximity to our Shenzhen Production Plant and our customers in the Guangdong Province, the PRC, which will enable us to work more closely and effectively with our customers in terms of product design, provision of advice and after-sale services, and substantially shorten the delivery time to our customers.

Our expansion plan includes the lease of the New Premises, renovating the New Premises to house the two additional SMT assembly lines and four additional automated testing lines mentioned above, and recruiting additional staff. We expected to enter into a preliminary lease agreement with the landlord by the end of March 2019. Our expansion plan on our Shenzhen Production Plant is expected to commence in or around the second quarter of 2019 and is expected to be completed by the end of 2019.

*Renovation works:* We expect to receive approval from the Environmental Protection and Water Supplies Department of Pingshan District of Shenzhen City\* (深圳市坪山區環境保護和水務局) to carry out renovation works in the New Premises for our expansion plan. The renovation work is expected to complete in the second quarter of 2019 and we expect to obtain the opinion for completion inspection of the environmental protection for production process from the Environmental Protection and Water Supplies Department of Pingshan District of Shenzhen City\* (深圳市坪山區環境保護和水務局) (the "Completion Inspection Opinion") by the end of 2019.

## BUSINESS

---

*Setting up intelligent warehouse and converting our existing warehouse to be an intelligent warehouse:* We intend to set up an intelligent warehouse in the New Premises and convert and upgrade our existing warehouse with an area of approximately 3,000 sq.m. to be an intelligent warehouse by dividing it into six storage areas, and 10,000 sections for storage of different kinds of raw materials based on the sales orders on hand from time to time. The intelligent warehouse will be installed with automate conveying belts and other facilities.

We expect to utilise approximately HK\$[REDACTED] million to expand our Shenzhen Production Plant; of which approximately HK\$[REDACTED] million and HK\$[REDACTED] million from the [REDACTED] of the [REDACTED] will be utilised for rental of the New Premises and setting up an additional warehouse therein, and conversion of our existing warehouse, respectively; and approximately HK\$[REDACTED] million from the [REDACTED] of the [REDACTED] will be utilised to hire one additional technical staff to operate and maintain the intelligent warehouse.

### **Further strengthen our research and development capabilities**

As an EMS provider, we are distinguished from conventional OEMs by providing a wide range of services and solutions in addition to the mere PCBA or full electronic product assembling services, including design enhancement and verification, provision of technical advice and engineering solutions, raw materials selection and procurement, assembling services, quality control, logistic and delivery and after-sale services. As such, our research and development capabilities play a pivotal role in the success of our business. We intend to further strengthen our research and development capabilities in the following ways: -

- (i) *Seeking to conduct new product development and introducing products that address prevailing and expected changes in electronic product market.* Our research and development department will continue to research the latest technologies to deliver PCBAs that can be applied to innovative electronic products and provide technological solutions to our customers. In view of the increase in amount of revenue contributed by the provision of our EMS to the production of electronic products for banking and finance industry, we will continue to devote more resources to product development for such industry. Also, we have a few pipeline products on hand for new customers, including through our vertically integrated EMS solution platform, developing PCBAs of vibration chairs and smart products.
- (ii) *Recruiting more talent.* We plan to strengthen our research and development capability our research and development department by recruiting more engineers and technicians. In this connection, we plan to recruit an addition of six skilled research technicians;

## BUSINESS

---

- (iii) *Continuing to improve our research and development capacities on the dual fronts.* One being (i) product quality, design and diversity, for instance, by tapping into the latest trends and technological advances that can enable us to provide a wider range of products tailored to our customers' needs; and two, (ii) production efficiency for improving the assembling process and reducing costs. Furthermore, to further augment our research and development capabilities, we plan to cooperate with our customers and/or engage third party research and development solution companies to develop innovative products and solutions. We will also seek to improve our product design and engineering, and to develop and implement more cost-effective production procedures such as adopting more advanced processing technologies, enhancing the automation level of our production process and reducing production costs; and
- (iv) *Striving to expand the usage of our PCBAs to other electronic products.* We plan to explore more business opportunities so that our PCBAs can be incorporated into more electronic products in terms of their usage.

We expect to utilise approximately HK\$[REDACTED] million from the [REDACTED] of the [REDACTED] for recruitment of six skilled research technicians.

### **Upgrade our ERP system and enhance our capabilities in information technology**

We believe that an advanced enterprise resource system ("ERP") is essential for us to enhance the efficiency of our operation. With an advanced ERP system, we can collect, store, manage and interpret data from our business activities as it provides an integrated and continuously updated view of our core business processes using common databases maintained by our database management system. An upgraded ERP system can track our business resources, including cash, raw materials, production capacity and the status of business commitments, for instance, our sales orders, purchase orders and payrolls in a timely manner. The applications that make up the upgraded ERP system share data across various departments (manufacturing, purchasing, sales, finance and accounting, etc.) that provide the data. As such, this is useful for us to plan and iron out our business expansion plan. In light of the above, we intend to upgrade our existing ERP system which runs on a variety of computer hardware and network configurations using database, which will commence in or around March 2019 and complete the trial period by December 2019.

We expect to utilise a sum of approximately HK\$[REDACTED] million from the [REDACTED] of the [REDACTED] for this purpose of which approximately HK\$[REDACTED] million will be used to upgrade our ERP system; and approximately HK\$[REDACTED] million will be used to recruit three additional technical staff for operation and maintenance of the ERP system.

## BUSINESS

---

### OUR BUSINESS MODEL

We offer integrated manufacturing services including the provision of design enhancement and verification, offering of technical advice and engineering solutions, raw materials selection and procurement, quality control, logistic and delivery and after-sale services to our customers in respect of our assembling and production of PCBAs and fully-assembled electronic products.

#### Our EMS business

With the objective to further consolidate our customer base, we provide full-fledged value-added solutions to our customers across various stages of product development and manufacturing. Our EMS business aims at specialising in large economies of scale in manufacturing, raw materials procurement and pooling together resources, industrial design expertise as well as other value-added services such as warranty and after-sale services. This can help free up our customers who do not need to manufacture and keep huge inventories of products by themselves.

For the provision of vertically integrated EMS solution platform, we provide the following services:

- Design enhancement and verification — Our research and development team together with our production team will discuss with our customers the specification of the PCBAs and/or fully-assembled electronic products in accordance with our customers' initial design and specifications, the intended functions of individual products and/or product prototypes to ascertain if there is any design flaw, offer technical advice and engineering solutions to our customers in order to help them transform their concept or initial design into PCBAs or fully-assembled products, and provide technical advice and engineering solutions to our customers assure seamless production of the products. We will also make recommendations on the raw materials to be used for their products. Depending on the specifications provided by our customers, we would provide suggestions to our customers on the modifications of a given design and their specifications for the purpose of, among others, cost saving, efficiency enhancement or design enhancement. Based on the design approved by our customers, we will select and procure the necessary raw materials for production or simply procure the raw materials according to customers' instructions from their designated suppliers;
- Raw materials selection and procurement — Our customers may provide the raw materials to us or may request us to purchase the raw materials from their designated suppliers or from our own source. We also assist our customers to source and procure raw materials, control and negotiate with the suppliers for better prices and seek alternative suppliers to achieve better cost savings for our customers;
- Assembling services — We offer an extensive range of customised assembly services of both PCBAs and fully-assembled electronic products:
  - (i) *PCB assembly*: PCB assembly is a process of assembling, populating and soldering of electronic components (such as capacitors, resistors, integrated circuits, magnetic heads, transistors, diodes and semi-inductors) onto a PCB (which is used for both

## BUSINESS

---

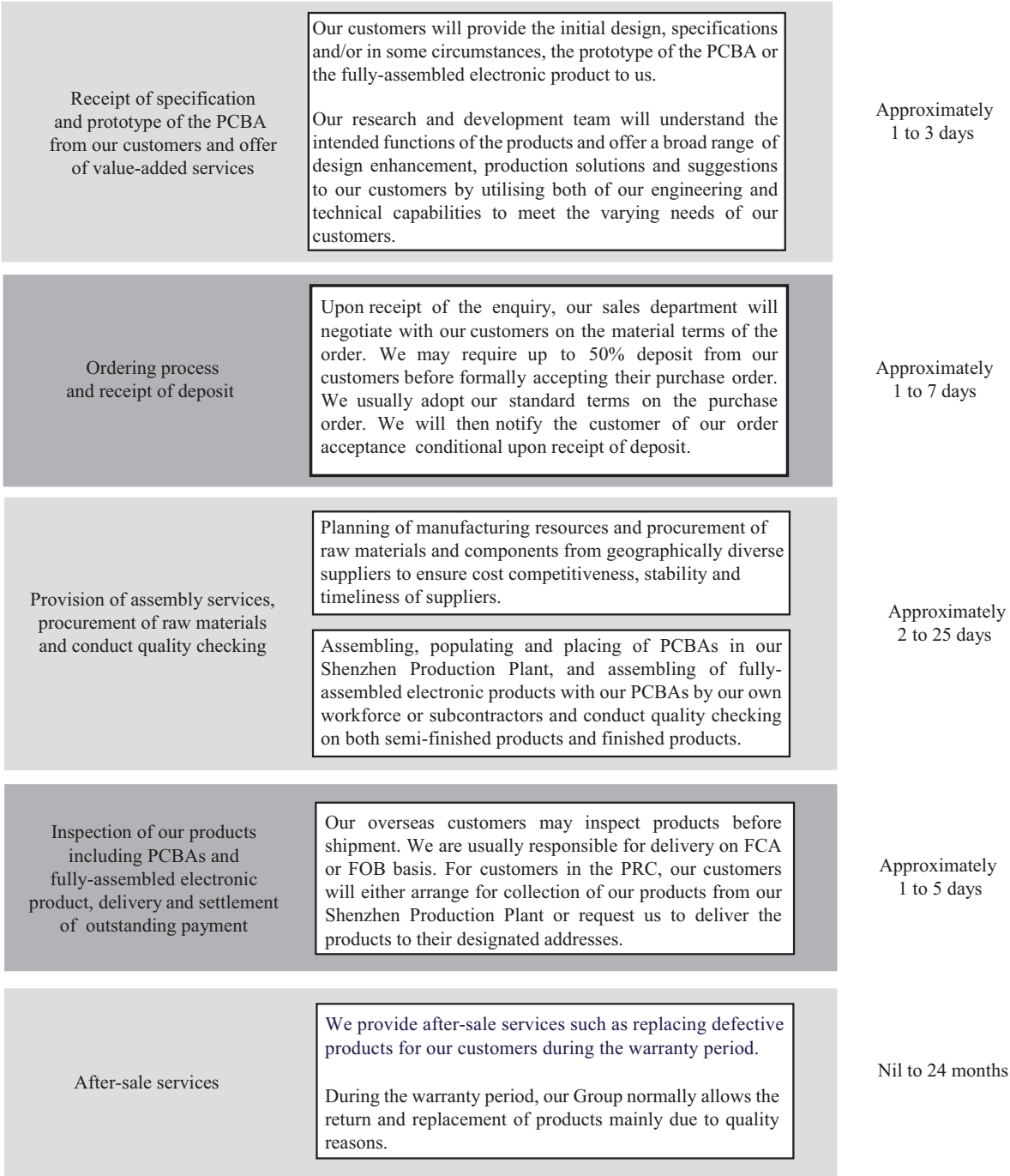
electronic circuits interconnecting medium and mechanical mounting substrate) to form and produce a functional PCBA. Our PCBAs are either sold as stand-alone products or embedded with our fully-assembled electronic products. Our PCBAs are mainly applied for production of electronic products that are used in the banking and finance, telecommunication, and smart devices industries.

- (ii) *Full electronic product assembly*: Full electronic product assembly involves the assembly of our PCBAs (or the PCBAs manufactured by our suppliers) and the structural parts, casing (plastic or metal), screens and packaging materials according to the product design and specifications to form and produce a fully-assembled electronic product. During the Track Record Period, we purchased a small amount of PCBAs from our suppliers for incorporating into our fully-assembled products on a need basis taking into account our then capacity to produce PCBAs, the design of the products or requirements of individual customers. While we subcontract most of the labour intensive and manual assembling services in respect of our fully-assembled products to our subcontractors, who undertake the subcontracted work under our supervision, we upheld the core and integral part of our EMS, in order to ensure that our fully-assembled electronic products can meet our customers' requirements. Our fully-assembled electronic products include mPOS, mobile phones, digital projectors and photovoltaic inverters, which are under the brand of our customers or the brands of their ultimate customers.
- Quality control — We have implemented a series of quality control procedures on the selection and testing of raw materials, semi-finished products and the finished products throughout the production process to ensure the quality of our products. For details, please refer to the paragraph headed "Quality control" in this section.
  - Logistics and delivery — For PRC customers, our customers will either arrange for collection of our products from our Shenzhen Production Plant or request us to deliver the products to their designated addresses, which are usually in the vicinity of our Shenzhen Production Plant. For customers outside the PRC, we deliver the products on (i) FCA basis by loading and delivering the products to the place in Hong Kong as designated by our customers and our duties would then be discharged and the risk of loss of the products is transferred to the customer; or (ii) FOB basis under which the title and risk of goods are transferred to our customers when our products arrived on board; and
  - After-sale services — We offer a warranty ranging from nil to 24 months from the date of the delivery of our products. We provide after-sale services such as replacing defective products for our customers during the warranty period. We endeavour to respond to all customer support inquiries within 24 hours to ensure that we are able to address our customers' needs efficiently. During the warranty period, our Group normally allows the return and replacement of products mainly due to quality reasons. We did not encounter any significant product return and replacement during the Track Record Period and up to the Latest Practicable Date.

**BUSINESS**

Our EMS business model is well-supported by a pool of experienced in-house research and development talents, our ability to develop new assembly technologies and our extensive reach across the electronic product supply chain. We prioritise and devote more of our research and development resources into the development of technologies and method with higher efficiency, which our Directors believe would in turn maintain our profit margin. Our ability to provide value-added solutions to our customers differentiates us from the majority of the market’s OEM manufacturers currently operating in the PRC.

The following diagram illustrates our current EMS business model:

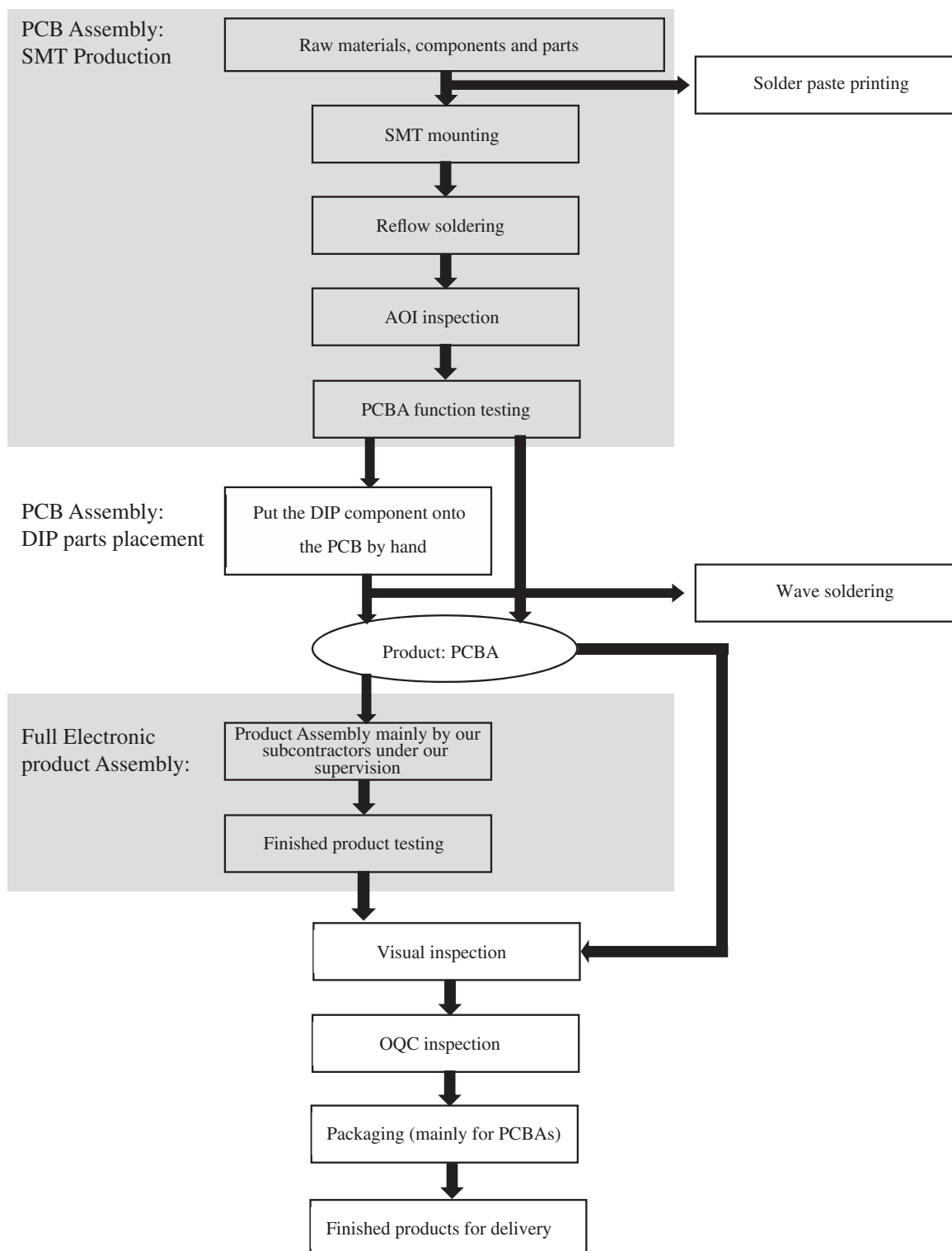


## BUSINESS

### OUR PRODUCTION

#### The Production Process

The following chart shows the major steps generally involved in our PCB assembly and full electronic product assembly process:





## **BUSINESS**

---

### **PCB Assembly**

PCB assembly is the process of assembling, populating and placing of various kinds of electronic components (such as capacitors, resistors, integrated circuits, transistors and diodes and inductors) onto a PCB to form a functional PCBA. All of our PCBAs undergo the PCB assembly and populating process.

Set forth below is a brief description of each major step involved in the PCB assembly:

#### **Raw materials, components and parts**



We procure all or part of the raw materials, components and parts required for assembly such as (i) electronic components and ancillary materials (including PCBs, semiconductors, ICs, batteries and magnetic heads); and (ii) casing (plastic and metal parts), packaging materials, LCD screens and consumables, from our own source or the suppliers designated by our customers; or obtaining the same from our customers.

#### **Solder paste printing**



Solder paste, which is essentially powdered metal solder suspended in a thick medium flux, is applied onto the PCB. Solder paste is printed on the PCB by automated printer prior to assembly. At times, based on our customer's requirements or product specifications, automated optical inspection (AOI) and/or visual inspection will be performed to ensure solder paste has been properly applied. This step is important to ensure that we apply solder paste only to the right parts of the PCB and mounting components have sufficient solder paste for good soldering after the PCBs are assembled.

## **BUSINESS**

---

### **SMT mounting**



The automated mounters pick up components including chips, ICs, connectors by vacuum placement heads and place them on the PCB. Mounting time per chip ranges from 0.1 second to 0.3 second with high precision ranging from 0.01 mm to 0.05 mm. After placement, we will conduct visual inspection to check if components are properly placed according to our customer's requirements or product specifications.

### **Reflow soldering**



After mounting, PCB is transferred by conveyor belt to pass through a re-flow oven for soldering the components. In the reflow oven, solder paste applied on the board is heated and melted to keep the IC in place, and then the molten solder paste is cooled to keep the IC attached to the PCB. This step is to solidify and adhere the electronic components onto the PCB.

### **Inspection and Quality control**



An AOI of PCB manufacture where a camera autonomously scans the device under test for both catastrophic failure (e.g. missing component) and quality defects (e.g. fillet size or shape or component skew). It is commonly used in the manufacturing process because it is a non-contact test method. Machine vision systems optically scan the surface of the PCB to spot defects. Apart from AOI, we also conduct visual checking on our semi-finished and finished products. X-ray inspection, which allows us to see through layers and visualise lower layers of the PCBA to identify any hidden flaw of our PCBAs, is carried out for more complex or layered PCBs.

## **BUSINESS**

---

### **PCBA Function testing**



The overall quality of the product will be checked by our staff or by the automated testing machines and ensure that it conforms to the required standards of both our Group and our customers, by means of testing on all of the work-in progress, immediate defect analysis and timely repair analysis. The test on finished product include visual checking and putting the PCB through its paces, simulating the normal circumstances in which the PCB will operate to check the PCB's functionality and conformity to its design.



### **DIP parts placement**



Depending on the design of the PCBA, which may include other electronic components that cannot be placed on the PCB by SMT. For instance, ICs which exceed 75mm x 74mm x 25.4mm cannot be inserted by SMT. Before the manual insertion, leads of the components have to be bent by our worker using bending tools. Then, the components with bent leads will be inserted manually into the through hole of component locations on the PCB. Visual inspection will be conducted to ensure that components are correctly inserted thereafter before wave soldering.

We assemble the mainboard PCB with our SMT lines, while we assemble the PCB which is used to convert AC to DC and control the voltage level of the ultrasonic devices with our DIP line.

## **BUSINESS**

---

### **Full Electronic Product Assembly**

Concerning the production process of our fully-assembled electronic products, we mainly outsource the assembling of the products to our subcontractors who incorporate mainly the PCBA manufactured by us in-house into the structural parts, casing, screens and other parts of the products including the packaging materials to form and produce a fully-assembled electronic product. As such, in respect of its production process, we focus on and undertake the quality control on the raw materials, semi-finished products and finished products by our quality control staff by way of visual inspection and with the assistance of machinery and equipment. Staff from both of our engineering team and quality control team are assigned to the production plant of our subcontractors to supervise the entire production process of our fully-assembled electronic products. We make use of machinery such as wireless communication analyzers to test the finished products' functionality and ascertain whether they conform to our customers' design. Upon the completion of the quality control procedures, we arrange for delivery of the finished products to our customers. The production lead time of our fully-assembled products varies by product. Generally, it is approximately 5 to 40 days.

### **OUR PRODUCTS**

Our products comprise PCBAs and fully-assembled electronic products that are primarily embedded with the PCBAs produced by us in-house.

Based on the usage of the final electronic products which embedded with our PCBAs, our PCBAs can be broadly applied to electronic end products for three principal industries, namely, banking and finance, telecommunication and smart device.

Our fully-assembled electronic products mainly include mobile phones, tablets, digital projectors, mPOS, photovoltaic inverters and tablets embedded with the PCBAs primarily manufactured by us and are under the respective brands of our customers or the brands of their ultimate customers.

**BUSINESS**

The following table shows the revenue breakdown by products during the Track Record Period:

	For the year ended 31 December					
	2015		2016		2017	
	RMB'000	% of total revenue	RMB'000	% of total revenue	RMB'000	% of total revenue
<b>PCBAs (Note 1)</b>						
Banking and finance	19,221	10.5	50,657	18.9	62,084	16.7
Smart device	5,530	3.0	16,289	6.1	42,547	11.5
Telecommunication	53,612	29.3	24,247	9.1	12,844	3.5
Others (Note 2)	660	0.4	667	0.2	694	0.2
<b>Fully-assembled electronic products (Note 3)</b>						
mPOS	33,615	18.4	110,283	41.2	202,177	54.6
Tablets	—	—	—	—	12,185	3.3
Mobile phones	62,548	34.2	50,973	19.0	8,307	2.3
Digital projectors	5,586	3.0	6,432	2.4	3,478	0.9
Photovoltaic inverters	919	0.5	3,311	1.2	487	0.1
Others (Note 4)	1,234	0.7	5,031	1.9	25,359	6.9
<b>Total</b>	<b>182,925</b>	<b>100.0</b>	<b>267,890</b>	<b>100.0</b>	<b>370,162</b>	<b>100.0</b>

Notes:

- (1) These PCBAs are sold as stand-alone products to our customers for their onward production of various kinds of electronic products in the industries set out below.
- (2) Others mainly includes PCBAs for medical devices.
- (3) The PCBAs embedded in these fully-assembled electronic products are primarily manufactured by us with a small portion being manufactured and supplied by our suppliers based on our requirements and specifications.
- (4) Others mainly include signal amplifiers, remote controllers for home appliances and street light controllers.

We generally assemble and manufacture PCBAs or full electronic products after receiving a purchase order from our customers. Depending on the requirements of individual customers, we procure all or part of the raw materials, components and parts required for assembly from the suppliers designated by our customers or our own source; or obtaining the same from our customers.

## BUSINESS

---

### PCBAs

Our PCBAs are either sold to our customers as stand-alone products or be used for our in-house onward production of fully-assembled electronic products under the respective brands of our customers or their ultimate customers. We have experience in many methods of assembling PCBAs, from DIP to customised fine pitch SMT, depending on the complexity of the PCBAs and/or the fully-assembled electronic products that use our PCBA in production. Our PCBAs will go through a thorough circuit board test and inspection process that may include solder paste printing inspection ("SPI"), AOI, functional testing, and manual inspection. During the Track Record Period and up to the Latest Practicable Date, we had developed and manufactured various types of market specific PCBAs applicable to electronic end products catered for three principal industries, namely, banking and finance, smart device and telecommunication.

#### *PCBA for banking and finance related devices*

We assemble PCBAs for ATM machines and mPOS. In relation to the ATM machines, we have developed and manufactured PCBAs with varying specifications with functions to (i) control the dispatch and deposit of cash notes from the ATM machines; (ii) control the display screen and the lighting system of the ATM machines to indicate its operating status; (iii) handle user authentication, data encryption and decryption and data transmission processes; and (iv) convert AC to DC and keep the voltage level of the ATM machines at a preset or appropriate level. For the PCBA embedded in mPOS, we assemble the mainboard PCB and its functions are to (i) control the display screen of the mPOS to indicate its operating status; and (ii) handle credit card or ATM card verification, data encryption and decryption and data transmission processes.

#### *PCBA for smart devices*

A smart device is an electronic device, generally connected to other devices or networks via different wireless protocols such as bluetooth, Wi-Fi, 3G, etc., that can, to some extent, operate interactively and autonomously. We mainly assemble mainboard PCBAs and the PCBAs which are used to convert AC to DC and keep the voltage level of the smart devices such as sweeping robot main boards (掃地機主板), sweeping robot inductors (掃地機感應器), IOT modules (物聯網模塊) and smart cups.

#### *PCBA for telecommunication devices*

We assemble PCBAs for telecommunication modules (通訊模件), routers and signal amplifiers (信號放大器). Our PCBAs are generally applied to mobile phones, routers and driving recorders, and are used to control the communication between the devices and the transmitting stations. While the PCBAs are generally designed by our customers, we also offer simple PCB layout and PCBA design services upon our customers' requests.

#### *Others*

During the Track Record Period, we also developed and manufactured PCBAs for other devices such as medical devices. We offer medical PCBAs to our customers for their onward production of ultrasonic devices (超聲波機主機板), and the PCBAs for these medical devices are mainly designed by our customers.

## BUSINESS

---

Our automated machinery and equipment are capable of assembling PCBAs for medical devices and applications, which require a high level of accuracy.

### **Fully-assembled electronic products**

As part of our vertically integrated EMS solutions provided to our customers, we also provide full electronic product assembly services to our customers, including PCBA casing, design, raw material selection and procurement, provision of technical advices and engineering solutions, assembly of the complete unit and packaging. The products that are fully assembled by us mainly include digital projectors, mPOS, mobile phones, photovoltaic inverter and tablet that use the PCBAs primarily manufactured by us. After manual insertion, visual inspection will be conducted to check all components are properly and accurately mounted and assembled.

#### *Digital projector*

We developed and manufactured fully-assembled digital projector on an EMS basis for brand-owners and OEMs under the brand of our customers or the brand owners. These digital projectors are small sized and used for many applications such as conference room presentations and home cinemas.



#### *mPOS products*

In view of the increasing mobile payment demand and need for transaction security and personal information protection in the PRC, we developed and manufactured fully-assembled mPOS products since 2015 on an EMS basis for various reputable mPOS product manufacturers in the PRC. The mPOS products are card reading devices that may be connected to smart devices such as smartphones to allow such smart devices to process payment transactions and function as mobile cash registers. The mPOS products provide a secure way to read information from credit and debit cards, and to

## **BUSINESS**

---

perform functions similar to the larger and generally more expensive stationary POS terminals at retailers. The full mPOS products developed and manufactured by us are pocket-sized, handy and portable, to be used by ultimate end users such as retailers salespersons for secure and convenient mobile payment collection in anywhere.



### *Mobile phones*

During the Track Record Period, we provided full electronic product assembly of mobile phones and smartphones. A smartphone is a mobile device which combines the function of a mobile phone and a conventional personal computer with functionality beyond making phone calls and sending text messages. A smartphone runs on an operating system which provides configuration options for the user to install and use various third-party applications. We design and offer mobile phones and smartphones with a wide range of technical specifications and functions to meet our customers' needs in different parts of the world.



**BUSINESS**

Our mobile phones and smartphones adopted various mobile communication standards including 3G (the third generation of mobile communication standard that allows mobile phones, computers, and other portable electronic devices to access the internet wirelessly defined by the International Telecommunications Union) and 4G (the fourth generation of a mobile communications standard intended to replace 3G, allowing wireless internet access at a much higher speed) in GSM, WCDMA and LTE, etc. with different operating frequency applicable to different countries and regions.



## BUSINESS

---

### *Photovoltaic inverter*

Our photovoltaic inverters can convert the variable direct current (DC) output into an alternating current (AC) that can be fed into a commercial appliance. Also, it can handle high power and can be applied in outdoor inverters due to its corrosion-resistant characteristic.



### *Tablet*

Our tablet is a small, portable personal computer with a touch screen as the basic input device. It runs on an operating system which provides configuration options for the user to install and use various third party function. For example, our tablets have been installed in taxis in Mexico to show the fastest route to any chosen destination and to provide information to passengers.



## BUSINESS

### SALES AND CUSTOMERS

As at 31 December 2017, our sales and marketing team comprised 19 staff members. Our sales and marketing team is responsible for formulating our Group's overall sales strategies, collecting and analysing market data and negotiating and finalising sales terms with our customers. Our sales and marketing team, along with our production team, provides sales and after-sale services to our customers.

For each of the three years ended 31 December 2017, our PRC sales accounted for approximately 79.6%, 81.8% and 90.1%, respectively, of the total revenue of our Group and our overseas sales accounted for approximately 20.4%, 18.2% and 9.9% of the total revenue of our Group, respectively.

#### Customers

During the Track Record Period, our Group provided vertically integrated EMS solutions by offering customised PCBAs and fully-assembled electronic products to our customers, including local electronic product manufacturers, brand owners, OEMs and trading companies of various kinds of electronic products in the PRC, Mexico, United States and Hong Kong.

The following table sets forth the information about our revenue by geographical location of our customers during the Track Record Period:

	For the year ended 31 December					
	2015		2016		2017	
	RMB'000	%	RMB'000	%	RMB'000	%
The PRC	145,676	79.6	219,183	81.8	333,650	90.1
Mexico	—	—	—	—	16,502	4.5
United States	6,340	3.5	37,488	14.0	6,828	1.8
Hong Kong	8,962	4.9	3,898	1.5	38	0.1
Others ( <i>Note</i> )	21,947	12.0	7,321	2.7	13,144	3.5
Total	<u>182,925</u>	<u>100.0</u>	<u>267,890</u>	<u>100.0</u>	<u>370,162</u>	<u>100.0</u>

*Note:* Others mainly include South Korea, Spain, Austria and Taiwan and each of such regions accounted for a nominal percentage of our total revenue ranging from approximately nil to 12.0%, nil to 2.7% and nil to 2.8% for each of the three years ended 31 December 2017, respectively.

## BUSINESS

### Top five customers

For each of the three years ended 31 December 2017, our Group's sales to our top five customers accounted for approximately 75.3%, 76.4% and 80.3% of our total revenue in each of the respective years. In the corresponding periods, sales to our largest customer accounted for approximately 27.0%, 41.1% and 44.9% of our total revenue. None of our Directors, their respective associates, and existing Shareholders who hold more than 5% of the issued share capital, had any interest in our five largest customers during the Track Record Period.

The tables below set forth the basic information of our Group's top five customers during the Track Record Period:

For the year ended 31 December 2015

Customers	Products sold to the customer	Principal business activities	Revenue generated from the sale (RMB'000)	% of our total revenue	Credit period	The calendar year in which the customer first started to have business relationship with our Group
Customer A	Mobile phones and PCBAs of telecommunication devices	Customer A consists of two PRC companies whose parent company is listed on the Shanghai Stock Exchange and is engaged in the development, production and sale of mobile phones for several renowned mobile phone brands and sale of mPOS in the PRC	49,307	27.0%	30 days after the date of sales invoice	2011
Customer B	mPOS	A company listed on the ChiNext Board and is engaged in the research, development, production and distribution of various kinds of smart cards and payment-related terminals and related application systems	31,169	17.0%	30% down payment and the remaining 70% payable within 30 days after the date of sales invoice	2014
Customer C	Mobile phones	A Spanish company engaged in the development and sale of mobile phones	21,947	12.0%	No credit term	2014
Customer D	PCBAs of banking and finance related devices	Customer D consists of a PRC company and its branch company, which are engaged in the development and production of ATMs and their parts and accessories in the PRC	19,066	10.4%	30 days after monthly statement	2015
Customer E	Mobile phones and PCBAs of telecommunication devices	Being a subsidiary of a company listed on the Shanghai Stock Exchange and is engaged in the development, production and sale of mobile phones for several renowned mobile phones brands in the PRC	16,242	8.9%	60 days after monthly statement	2013

**BUSINESS**

For the year ended 31 December 2016

Customers	Products sold to the customer	Principal business activities	Revenue generated from the sale (RMB'000)	% of our total revenue	Credit period	The calendar year in which the customer first started to have business relationship with our Group
Customer B	mPOS	A company listed on the ChiNext Board and is engaged in the research, development, production and distribution of various kinds of smart cards and payment-related terminals and related application systems	110,019	41.1%	50% down payment and the remaining 50% payable within 30 business days after the date of sales invoice	2014
Customer D	PCBAs for banking and finance related devices	Customer D consists of a PRC company and its branch company, which are engaged in the development and production of ATMs and their parts and accessories in the PRC	48,066	17.9%	30-60 days after monthly statement	2015
Customer F	Mobile phones	An U.S. company engaged in the development, production and sale of mobile phones	29,737	11.1%	No credit term	2016
Customer G	PCBAs of smart devices	Customer G consists of a PRC company and its parent company in Austria, which are engaged in development, production and sales of sweeping robots	8,871	3.3%	30% down payment and the remaining 70% payable within two weeks after delivery	2015
Customer E	PCBAs of telecommunication devices	Being a subsidiary of a company listed on the Shanghai Stock Exchange and is engaged in the development, production and sale of mobile phones for several renowned mobile phones brands in the PRC	7,908	3.0%	60 days after monthly statement	2013

## BUSINESS

For the year ended 31 December 2017

Customers	Products sold to the customer	Principal business activities	Revenue generated from the sale (RMB'000)	% of our total revenue	Credit period	The calendar year in which the customer first started to have business relationship with our Group
Customer B	mPOS	A company listed on the ChiNext Board and is engaged in the research, development, production and distribution of various kinds of smart cards and payment-related terminals and related application systems	166,057	44.9%	50% down payment and the remaining 50% payable within 30 business days after the date of sales invoice	2014
Customer D	PCBAs of banking and finance related devices	Customer D consists of a PRC company and its branch company, which are engaged in the development and production of ATMs and their parts and accessories in the PRC	61,544	16.6%	30-60 days after monthly statement	2015
Customer A	Mobile phones, PCBAs of telecommunication devices and banking and finance related devices	Customer A consists of two PRC companies whose parent company is listed on the Shanghai Stock Exchange and is engaged in the development, production and sale of mobile phone for several renowned mobile phone brands and sale of mPOS in the PRC	36,120	9.8%	30 days after the date of sales invoice	2011
Customer G	PCBAs of smart product	Customer G consists of a PRC company and its parent company in Austria, which are engaged in development and production and sales of sweeping robots	20,328	5.5%	30 days after delivery	2015
Customer H	PCBAs of telecommunication and smart devices	A company listed on the National Equities Exchange and Quotations System in the PRC and is engaged in the development and production of communication products and provision of IOT solutions	12,841	3.5%	30 days after monthly statement	2009

During the Track Record Period and up to the Latest Practicable Date, our Group did not have any material disputes with our major customers.

## BUSINESS

---

### *Principal contractual terms with our customers*

We set out below the typical terms contained in our customers' cooperation agreements and purchase orders:

Product specification	<p>Our customers will provide us with the specifications on the PCBAs and the prototype of the PCBAs including the PCB sizes, specifications and functions with respect to the ultimate products.</p> <p>For some customers, the purchase orders may give a brief outline or concept of the design and functions to be achieved only.</p>
Quantity	<p>The cooperation agreement might specify the minimum quantity per purchase order per month. Also, the customers might be required to provide demand forecast to facilitate our provision of EMS.</p>
Credit terms	<p>Save for new customers who are required to make full payment to us before we deliver the products to them, we generally grant credit periods to our customers varying from 30 to 120 days, depending on the creditworthiness of individual customers, which is determined on a case-by-case basis with reference to the customers' scale of operation, track record and length of business relationship with us.</p>
Unit Price	<p>The purchase orders from our customers usually set out the unit price of the products.</p>
Quality and acceptance	<p>Different cooperation agreements or purchase orders have different quality and acceptance standards, such as (i) sampling checks before delivery against individual customers' requisite passing rate of sampling checks; (ii) compliance with the international certification standard; (iii) compliance with the product specifications as mutually agreed between the customers and us in advance before production commences; or (iv) compliance with individual customers' internal quality control standards.</p>
Delivery	<p>For PRC customers, our customers will usually (i) arrange for collection of our products from our Shenzhen Production Plant; or (ii) request us to deliver the products to their designated addresses. For customers outside the PRC, the purchase orders will usually specify the basis under which the delivery shall be made (such as FCA or FOB basis). Some purchase orders specify that in case of delay in delivery, we shall pay compensation at an agreed percentage of the entire value of the relevant purchase order to the customers.</p>

## BUSINESS

---

Warranty	We offer a warranty ranging from nil to 24 months from the date of delivery of our products in respect of the quality standards specified in the cooperation agreement or purchase orders. Such quality standards may include warranties that our products are in compliance with (i) the sample provided to the customer; (ii) the specified international certification standards; (iii) the product specifications as mutually agreed between the customers and us in advance; and (iv) individual customers' internal quality control standards.
Product return	We allow product returns and replacements due to the breach of our warranties in respect of the quality of the products if the requests for product return are made within the prescribed time set out in the cooperation agreements or purchase orders.

### Sales

#### *Payment methods*

Our customers in the PRC usually settle payment by way of telegraph transfer, bank transfer or bank acceptance bills. As to the latter, we would accept bank acceptance bills if we have confirmed with the suppliers and they would allow us to settle our payment with them by endorsing the bank acceptance bills we received from our customers. The maturity of the bills receivables generally does not exceed six months. For each of the three years ended 31 December 2017, approximately 26.1%, 20.3% and 34.0% of the revenue received from our customers was paid by bank acceptance bills for settlement and the purchase of our products, respectively.

During the Track Record Period, we experienced delays in receiving our trade and bill receivables. We have implemented a number of internal control procedures to enhance our management of our trade and bills receivables. For details, please see the paragraph headed "Risk Management" in this section.

#### *Delivery and logistics*

For PRC customers, our customers will either arrange for collection of our products from our Shenzhen Production Plant or request us to deliver the products to their designated addresses, which are usually in the vicinity of our Shenzhen Production Plant. Delivery of our products to customers is made via road or sea shipment. For products delivered via road within the PRC, our Group generally delivers the products by our own motor vehicles or engages third-party logistic service providers to deliver the products from our Shenzhen Production Plant to the destinations specified by the customers. Depending on the relevant contract terms, the delivery costs will be borne either by us or our customers. The risks of the products remain with our Group until the products are duly delivered to our customers' designated destinations. For each of the three years ended 31 December 2017, our total delivery costs were approximately RMB0.9 million, RMB1.6 million and RMB2.1 million, respectively. For our export sales to overseas customers, our products are delivered to the place or carrier designated by our customers on either FCA basis or FOB basis.



## BUSINESS

---

### *Products return policy and after-sale services*

*Product return policy:* We offer a warranty ranging from nil to 24 months from the date of delivery of our products. During the warranty period, our Group normally allows the return and replacement of products mainly due to quality reasons. We generally categorise the product defects into technical defects and non-technical defects. Any technical defect found will be referred to our engineering team while all non-technical defects for instance, defects found on the surface of the product's packaging, will be handled by our sales and marketing team together with other relevant teams. We endeavour to respond to all customers' inquiries regarding any product defect within 24 hours to ensure that we are able to address any issue efficiently. During the Track Record Period, our Group had not experienced any significant product return and replacement owing to any quality issue, which would have caused any material and adverse impact on the financial condition and operating results of our Group.

*After-sale services:* The staff members of our sales and marketing team regularly pay visits to and communicate with our customers to collect their feedback on the quality, preferences, improvements and market demands of our products. Our sales and marketing team will share this information with our production team and research and development team in order to improve the existing products.

*Complaint handling:* Our sales and marketing team is responsible for handling customers' complaints. If a customer has lodged a complaint on the quality of our products and/or made a written request to return and replace a product, our sales and marketing team will pass the matter to our production team and quality control team to inspect the products under complaint. If the complaint and/or the request for product return and replacement is genuine, we will arrange for the replacement to be sent to customer.

### **CUSTOMER CONCENTRATION**

For each of the three years ended 31 December 2017, our Group's sales to our top five customers accounted for approximately 75.3%, 76.4% and 80.3% of our total revenue, respectively. In the corresponding periods, sales to our largest customer accounted for approximately 27.0%, 41.1% and 44.9% of our total revenue, respectively. Please refer to the section headed "Risk factors — Our Group had a concentration of customers during the Track Record Period and any decrease or loss of business from these major customers could adversely and substantially affect our operations and financial conditions" in this document for the customer concentration risk.

#### **Reasons for our customer concentration**

Our Directors consider that our customer concentration during the Track Record Period is contributed by a combination of the following key factors:

- (i) Our Group is able to maintain a stable relationship with our major customers. As at the Latest Practicable Date, our Group maintained business relationship ranging from approximately two years to nine years with our top five major customers. Furthermore, our Directors believe that our major customer tends to engage EMS providers with proven high-quality work and on-time delivery track record, like our Group. During the Track Record Period and up to the Latest Practicable Date, we had not experienced any material

## BUSINESS

---

product returns from our top five customers. Also, we did not have any material dispute with any of them. In addition, our Group has also received a number of awards from our top five customers in recognition of our service quality. For details, please refer to the paragraph headed "History, Development and Reorganisation — Our business development" in this document; and

- (ii) During the Track Record Period, we have obtained various utility model patents and software copyrights which had been applied on our PCBAs sold to our major customers. In particulars, one copyright have been applied specifically on the PCBAs of sweeping robots sold to Customer G, and two patents and one copyright have been applied specifically on the PCBAs of ATMs sold to Customer D. As such, our Directors believe that our possession of a range of utility model patents and software copyrights has caused our services more favourable to our major customers, and hence, it would be more difficult for them to switch to other EMS providers.

Our Directors believe that our Group's business model is sustainable despite such customer concentration due to the following factors:

- (i) *Our integrated and value-added services help strengthening our business relationship with our existing customers and bring in new customers*

Some of our major customers had long-standing business relationship with us. We maintain our long-term business relationship with our customers by, among others, working together with them as a co-creation team or quasi partners in their development of new products by offering value-added integrated EMS to them at various stages of their product development and production. Our quality products, capability and research and development ability enable us to meet the requirements of different customers not only restricted to our top five customers but other existing and potential customers. We offer a wide range of PCBAs and fully-assembled products with different specifications to cater for our customers' needs. Attributed to the experience and expertise of our research and development team and our engineering team, we are able to provide design enhancement and verification services and technical advices and engineering solutions to them at the early stage of their development of a particular product. We allow these customers to send their representatives to our Shenzhen Production Plant to oversee the production process of their products if they find it necessary, which would facilitate a timely communication and exchange of ideas and feedbacks between our customers and us. Therefore, if any of our top five customers ceases to place orders to us and provided that we will have spare production capacity, our Group could serve other existing customers and new customers by re-allocating our production capacity. Therefore, our Directors are of the view that if there is diminishing volume of orders from the top five customers, we are still able to secure alternative orders from existing customers and solicit new customers to replenish our order book.

We will continue to endeavour to secure new business from our existing customers, which will enhance our profit-earning ability and industry recognition and thus would increase our competitive edge in securing new customers in the future and benefit our Group's profitability in the long run.

On the other hand, the ranking of our top five customers for each of the three financial years during the Track Record Period was different. This suggests that we did not place undue reliance on any particular customer among our top five customers throughout the Track Record Period for revenue generation. For the year ended 31 December 2017, our Group had started business relationships with

## BUSINESS

---

new customers such as a company carries in the business of sale and purchase of computer equipment and peripherals in Mexico and a company engaged in the provision of smart street lighting and smart lighting solutions in the PRC which accounted for 3.3% and 1.7% of our revenue, respectively. As such, our Directors believe that our Group has reduced our reliance on our major customers.

(ii) *Our expansion to new industry(ies) where our PCBAs can be applied*

We are actively expanding the application of our PCBAs through developing PCBAs that are applicable to electronic end products for other industries. We are striving to strategically increase our level of participation in the product development of customers in other industry(ies) to enhance our industry reputation and recognition, diversify our source of revenue and bring more earnings to our Group. By doing so, our reliance on a particular customer or any particular electronic end products in a particular industry would be reduced.

### RELATIONSHIP WITH CUSTOMER B

#### Background of Customer B

Customer B was our second largest customer for the year ended 31 December 2015 and the largest customer for each of the two years ended 31 December 2017. Our relationship with Customer B started in 2014 when we sold fully-assembled electronic products (including mPOS and smart cards reading devices) to it as our customer.

Customer B is a limited stock company listed on the ChiNext Board. It engages in the research, development, production, and distribution of various kinds of smart cards (including communication smart cards, financial integrated circuit cards, city cards, mobile multimedia broadcasting television receiving cards, tax control cards, social insurance cards, gas cards) and payment-related terminals and related application systems such as mPOS, bluetooth reading devices and other products related to mobile internet and payment service. As at the Latest Practicable Date, Customer B has a registered capital and market capitalization of approximately RMB430.1 million and RMB3,457.7 million, respectively. Based on its latest annual report released, Customer B recorded a revenue and net profit attributable to its shareholders of approximately RMB1,627.3 million and RMB19.8 million, respectively, for the year ended 31 December 2016.

#### Sales during the Track Record Period

During the Track Record Period, the revenue generated from our sales to Customer B amounted to approximately RMB31.2 million, RMB110.0 million and RMB166.1 million, representing approximately 17.0%, 41.1% and 44.9% of our total revenue, respectively. The growth was primarily attributable to the increase in Customer B's purchase orders of our mPOS arising from the trend for mobile payment demand and the need for transaction security and personal information protection in the PRC.

#### Stable and sustainable business relationship between Customer B and our Group

Over the three years of cooperation, our management team has accumulated extensive knowledge in the products, operation standard, requirements and procedures of Customer B. Since then, we have maintained a close business relationship with Customer B. Given our turnkey EMS capabilities, we worked closely with Customer B throughout the whole production process and provided valued-added

## BUSINESS

---

services in terms of cost saving, raw material selection procurements from its designated suppliers or our own suppliers and engineering solutions to it in its development of new products. Hence, we believe that Customer B considers us as its valued business partner and we have developed a stable and sustainable business relationship with Customer B.

### **Our reliance on Customer B would not affect our business prospects and sustainability**

Along with maintaining a stable business relationship with Customer B, we have from time to time identified and taken on new customers that need our PCBAs for onward production of their electronic products or our fully-assembled products which meet their requirements in terms of their quality and functions. Our Directors confirmed that our Group has no intention to limit ourselves to focus on providing EMS to Customer B in the future, and having taken into account the following factors and measures taken by our Group, our Directors consider that our reliance on Customer B or the loss of Customer B would not have a significant adverse effect on our business prospects.

*Our experience in serving sizeable customers like Customer B:* Our business relationship with Customer B and track record in selling products to it can be regarded as a credit to our ability to provide quality EMS in both PCBA assembling and full electronic product assembling in the EMS industry in the PRC, which is highly competitive and fragmented. This will in turn attract more electronic product manufacturers and customers with a sizeable scale of operation, which adopt a stringent approach in their selection and sourcing of suppliers in a region, to cooperate with us in their product development and production. In addition, we believe that the development of our business relationship with Customer B enables us to better understand (i) the criteria, requirements and quality standard of sizeable and renowned customers; and (ii) the key elements and strategies for effective customer management and provision of services to these renowned customers, which can be replicated to other customers. We consider our relationship with Customer B to be in line with our Group's strategy to focus on establishing long-term relationships with reputable customers. On the other hand, there is no restrictive covenant in selling our products to Customer B which forbids or restricts our Group to provide EMS or sell our products to other customers. Therefore, we are free to look for other customers in the PRC.

Owing to our experience in providing quality EMS to customers in the PRC, including Customer B, our Directors do not foresee any difficulty for us to look for other customers.

*Transferability of our skills.* In the unlikely event that our current business relationship with Customer B deteriorates or ceases, we shall still be able to avail our capabilities and resources to serve other customers. Our skills can be readily transferred to serve other potential customers to satisfy their needs. Based on our past experience, we foresee that it would not incur significant costs if our Group re-allocates our resources to serve other customers. The preparation works required to serve new brand owners and fulfilling individual customers' requirements are not expected to incur any significant cost. Hence, our Directors are of the view that our Group is able to meet the demands of other customers and thus, the changing market.

*Difficulties faced by Customer B in engaging other EMS providers in the PRC in place of our Group.* To the best knowledge and belief of our Directors after making all reasonable enquiries with Customer B, our Directors note that Customer B, being a technology company listed on the ChiNext Board and engaged in research, manufacture and sale of various kinds of smart cards and related

## **BUSINESS**

---

application systems, the process of identifying and approving a supplier could be time consuming and might result in unforeseen operational problems to Customer B, as Customer B has its own criteria and protocol in its selection of EMS providers. Furthermore, we have a proven record in providing value-added EMS to Customer B in its development of new product.

Given that Customer B will continue to focus on its research and development of new products, in particular, telecommunication devices and financial products, such as mPOS and other mobile phone connected payment devices and systems and it does not have its own production plant for production and assembling of products in the PRC, Customer B is expected to continue to rely on our Group's EMS. Our Directors believe that it would be rather difficult for Customer B to replace our Group with some other EMS providers as we (i) have acquired knowledge of Customer B's corporate culture, quality standard and approval protocol of its products; (ii) provide value-added and customised EMS for the manufacture of its products whereas other electronic product manufacturers will manufacture on the products on OEM basis without providing any input to the products' design and engineering solutions; and (iii) have had over three years of close cooperation with Customer B. It is noteworthy that after the first year of cooperation, Customer B had largely increased its purchase mPOS during the Track Record Period, due to, in our Directors' observation, the quality of our products and our ability to deliver the products to it on a timely basis. Our Directors believe that Customer B has confidence in our ability to closely work together in developing its products.

In addition, our Directors are of the view that it is not easy for Customer B to replace our Group by engaging other EMS providers if it cannot find an EMS provider with a scale of operation comparable to us as (i) it would increase its administrative work and expenses if it has to arrange the manufacture and assembling of its products to a number of EMS providers and monitor or review the performance of these EMS providers at one time; and (ii) the automation level of the production facilities of these new EMS providers may not be able to meet Customer B's standard and requirements from time to time.

On 5 January 2017, China UnionPay Co., Ltd. (中國銀聯股份有限公司) ("**China UnionPay**"), a customer of Customer B, published a UnionPay card acceptance terminal product life cycle safety and quality management guidelines (銀聯卡受理終端產品生命週期安全與質量管理指南) (the "**Guidelines**"), which set out various requirements to provide guidance in relation to the design, the safety of production process and the quality management of the UnionPay card acceptance terminal product, so as to increase the product design and quality management standards of the manufacturers of such products. Upon the request of China UnionPay, a factory review has been conducted at our Shenzhen Production Plant based on the requirement set out in the Guidelines on 9 August 2017. On 27 November 2017, China UnionPay has published a list of compliant terminal enterprise under the Guidances (銀聯卡受理終端產品生命週期安全與質量管理指南合規終端企業名單), whereby Customer B was listed as a compliant enterprise and our Shenzhen Production Plant was the only production plant listed as the compliant production plant of Customer B. Hence, our Shenzhen Production Plant is the only production plant eligible to supply UnionPay card acceptance terminal products to Customer B and Customer B has to rely on our Shenzhen Production Plant to supply such product to China UnionPay.

Further, a material supply and processing agreement has been entered into between Customer B and our Group on 12 February 2018 which set out the basic terms for our provision of EMS to Customer B (including quality requirement, delivery, payment method and credit terms) with a duration of one year.

Taking into account the above factors and observations, our Directors are of the view that it is both difficult and unlikely for Customer B to replace our Group without a material negative impact on its business and operation in the PRC.

## BUSINESS

---

*Continue to identify potential customers to broaden our revenue stream.* Our Group has been providing EMS to different customers, which manufacture and distribute electronic products across different industries. Our success was attributable to our efforts in working closely with our customers in developing their products, the automation level of our Shenzhen Production Plant and our reputation for offering quality EMS to customers. Hence, if we lose Customer B as our major customer, our Group, with our reputation in the industry, production facilities and expertise, can avail our resources to provide EMS to meet the requirements of other customers. In the unlikely event that our current business relationship with Customer B deteriorates or ceases, we believe that with our Directors' experience, reputation and connection to the EMS industry in the PRC would enable us to respond to market challenges and adjust our business direction swiftly to face any new challenge. We plan to diversify our pool of customers and broaden our revenue stream in the long run, and will continue to (i) maintain a close business relationship with Customer B; and (ii) identify potential sizeable customers which look for EMS providers who can offer quality EMS. Our Directors believe that, with our experience and proven track record in the EMS industry, we will be able to replicate our success in the unlikely event that our relationship with Customer B deteriorates or ceases.

*Experienced and dedicated management team.* Our management team has an extensive and in-depth knowledge of the EMS industry in the PRC. Our founder, chairman, executive Director, Mr Ma and our executive Director, Mr. Cheng both have more than 16 years of experience in the EMS industry market in the PRC. We consider that they are important in driving our future business development.

### **Relationship with our five largest customers during the Track Record Period**

None of our Directors, their respective close associates, or any Shareholders who or which own more than 5% of the issued share capital of our Company as at the Latest Practicable Date, had any interest in any of the five largest customers of our Group during the Track Record Period. Our Group had not experienced any major disruption in business due to material delays or defaulting payments by our customers by reason of their financial difficulties. Our Directors further confirm that they are not aware of any of our major customers having experienced material financial difficulties that may materially affect our Group's business.

### **PROVISION OF EMS TO OVERSEAS CUSTOMERS**

In respect of our fully-assembled electronic products, along with our sales to the local customers, we also provide EMS for mobile phones, tablets and other telecommunication devices to a few overseas customers under their brands or the relevant brand owners. Eternity Technology, our subsidiary in Hong Kong, is mainly responsible for initiation and conclusion of sales and purchase transactions with overseas customers. Upon receipt of the purchase orders from our overseas customers, Eternity Technology would place corresponding purchase orders to Shenzhen Hengchang Sheng, which is our major operating subsidiary and provides a full range of EMS to our customers, for the design enhancement and verification (if required), raw materials selection and procurement, assembling services, quality control and after-sale services. However, as a result of reallocation of our overall resources and refinement of our product mix, since 2016, Eternity Technology has started placing corresponding purchase orders with independent third-party companies in Hong Kong other than Shenzhen Hengchang Sheng for outsourcing the production of the fully-assembled mobile phones and tablets embedded with the PCBAs manufactured or provided by these independent companies.

### **Intra-group transactions between Shenzhen Hengchang Sheng and Eternity Technology**

During the Track Record Period, most of our overseas sales orders were concluded by Eternity Technology in Hong Kong with our overseas customers.

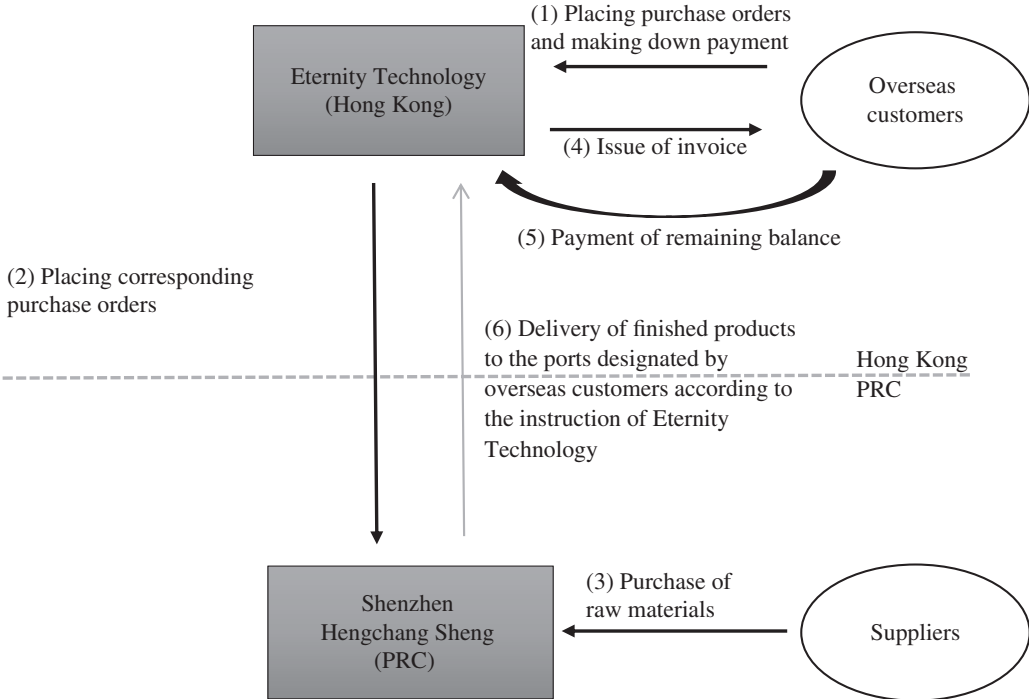
**BUSINESS**

For exports sales, Shenzhen Hengchang Sheng will deliver the finished products to the ports in Hong Kong as designated by Eternity Technology, which is in turn based on the instruction of the overseas customers. The transactions between Shenzhen Hengchang Sheng and Eternity Technology are treated as sales of Shenzhen Hengchang Sheng to Eternity Technology and the selling prices are based on the then prevailing market price of our products. Our Directors confirmed that the relevant intra-group transactions were conducted on normal commercial terms. Notwithstanding that, we may be challenged by the relevant tax authorities on the appropriateness of these transactions and may be subject to possible tax exposure arising from our transfer pricing arrangement. Please also refer to the paragraph headed "Risk Factors — Our operations may be subject to transfer pricing adjustments by competent authorities" in this document. Our Directors confirmed that up to the Latest Practicable Date, our Group had not been subject to any enquiry, audit or investigation by any tax authority in the PRC or Hong Kong with respect to transfer pricing carried out by our Group.

The functions undertaken by Eternity Technology therefore mainly include initiation and contracts conclusion in the name of Eternity Technology. The functions undertaken by Shenzhen Hengchang Sheng include offering PCB assembly services and full product assembly services to our customers based on their ideas and specifications with input to design enhancement and verification, raw materials selection and procurement, assembling services, quality control, logistic and delivery and after-sale services.

**Intra-group transactions**

The flow chart below shows the major steps and parties involved in the intra-group transactions between Eternity Technology and Shenzhen Hengchang Sheng.



## **BUSINESS**

---

### **Stage 1 — Overseas customers place orders with Eternity Technology**

- Most of overseas customers' sales activities are handled by Eternity Technology.
- Eternity Technology is mainly responsible for initiation and conclusion of sales and purchase transactions with overseas customers.
- Eternity Technology also receives the purchase price remitted from our overseas customers.

### **Stage 2 — Provision of EMS by Shenzhen Hengchang Sheng**

- Once Eternity Technology has received purchase orders from overseas customers, it will place the corresponding purchase orders with Shenzhen Hengchang Sheng for the design enhancement and verification, raw materials selection and procurement, assembling services, quality control, logistic and delivery and after-sales services.
- The respective price in the purchase orders from Eternity Technology was based on the prevailing marketing condition.
- Shenzhen Hengchang Sheng procures raw materials from independent third party suppliers.
- Shenzhen Hengchang Sheng is also responsible for quality assurance.

### **Stage 3 — Logistics management**

- Shenzhen Hengchang Sheng is responsible for the whole logistics arrangement for delivering the products from the Shenzhen Production Plant to the location designated by Eternity Technology, which is in turn based on the instructions from the overseas customers on FCA or FOB basis.

During the Track Record Period, the pricing of the sales of finished products between Shenzhen Hengchang Sheng and Eternity Technology was based on the cost-plus basis. We assessed and referenced similar transactions in the market and are of the view that the transactions are carried out under arm's length basis.

In order to assess whether the sales between Shenzhen Hengchang Sheng and Eternity Technology were carried on an arm's length basis, we have engaged an independent tax consultant (the "**Tax Consultant**"), the tax department of one of the largest international auditing, tax and advisory firms, to conduct an analysis of the above transactions by benchmarking the profit margin ranges derived from companies comparable to Eternity Technology during the Track Record Period. Given the functional profile of the parties involved in the transactions, transaction net margin method is selected as an appropriate transfer pricing analysis methodology to test the arm's length nature of the above transactions. The analysis suggested that the transactions between Shenzhen Hengchang Sheng and Eternity Technology can be conducted in accordance with the arm's length principle from Hong Kong and PRC perspectives.



## **BUSINESS**

---

Based on the discussion with the Tax Consultant, our Directors take the view that the above comprehensive assessment basis by reference to similar market transactions and applying the profit margin ranges derived from comparable companies during the Track Record Period complies with the applicable transfer pricing rules and regulations in the PRC and Hong Kong which require related party transactions to be carried out at arm's length basis.

### **Commercial rationale**

Our Directors believe that such transaction enhance the effectiveness of our overall management and operations and allocation of resources, refine our product mix and avoid the concentration of our marketing and production function into a single entity with our Group.

### **Measure to ensure on-going compliance**

Our Group's transfer pricing arrangement is part of a normal trading operation where a transaction price needs to be established. We have implemented a general policy in this area to follow the arm's length principle and to achieve an arm's length outcome. We will regularly review the arrangements between Shenzhen Hengchang Sheng and Eternity Technology, and where necessary, appoint tax consultant to review such transfer pricing arrangements to ensure compliance with the arm's length principle.

As at the Latest Practicable Date, Shenzhen Hengchang Sheng has completed all the relevant tax filings related to its related party transactions in compliance with the relevant PRC laws and regulations and we were not aware of any enquiry, audit or investigation by any tax authority in the PRC or Hong Kong with respect to transfer pricing carried out by our Group.

## **PRICING POLICY**

We determine the prices of our PCBAs and fully-assembled electronic products on a cost-plus basis. Since each product has its own specifications or requirements, the pricing of each product is negotiated and determined on a case by case basis with individual customers in order to maximise the profitability of our Group.

The price of our products is determined by reference to a number of factors including, but not limited to, production costs, costs of raw materials, complexity of the manufacturing process, lead time, packaging requirements and the size of the order.

As a result of the "cost-plus" pricing strategy, our Directors believe that our Group generally passed the risks arising from any fluctuation in the purchase costs of raw materials to customers during the Track Record Period. In this connection, we continuously keep ourselves abreast of changes to the market prices, conduct regular reviews on the pricing policy and pay close attention to responses from customers during the negotiations/quotations stage. Our Group may adjust the pricing policy to ensure our Group is responsive to changes in the market price in a timely manner to avoid any material adverse impact on our market position, competitiveness, performance and financial conditions.

## BUSINESS

For each of the three years ended 31 December 2017, the minimum, maximum and average unit price of our products are as follows:

	For the year ended 31 December								
	2015			2016			2017		
	Min RMB	Max RMB	Average RMB	Min RMB	Max RMB	Average RMB	Min RMB	Max RMB	Average RMB
<b>PCBAs</b>									
Banking and finance	2.9	550.8	55.5	2.9	905.3	74.4	1.4	905.3	85.4
Smart device	0.4	1,495.7	2.7	0.3	672.4	5.1	0.2	1,621.1	5.2
Telecommunication	0.1	85.7	5.8	0.2	176.9	4.4	0.4	601.4	11.8
Others	1.7	2,096.9	22.1	1.5	6,891.9	42.0	1.5	8,131.0	38.2
<b>Fully-assembled electronic products</b>									
mPOS	27.3	61.1	43.2	8.3	237.6	27.4	5.3	597.3	32.3
Tablet	—	—	—	—	—	—	566.9	651.0	600.1
Mobile phones	0.6	1,424.5	17.9	0.5	628.9	82.2	108.7	430.0	193.1
Digital projectors	1.4	250.0	15.2	0.5	845.3	19.3	0.5	479.5	36.1
Photovoltaic inverters	20.0	256.4	50.8	20.0	787.0	78.9	6.3	299.2	56.7
Others	1.0	304.4	21.7	0.2	629.1	18.0	0.4	365.3	57.3

*Note: The pricing of our PCBAs and fully-assembled electronic products is on a cost-plus basis and is also subject to the specifications and requirements provided by our customers. The unit price ranges are prepared by piece, regardless of the product specification, order quantity, raw materials required and other elements which may factor in the pricing of PCBAs and fully-assembled electronic products by order. As a result, there could be significant difference between the minimum and maximum prices of certain products during the Track Record Period.*

### Tax rebate

During the Track Record Period, part of our PCBAs and fully-assembled electronic products were exported to overseas countries mainly to Mexico, United States and Hong Kong from the PRC or via Eternity Technology. For the three years ended 31 December 2017, the revenue generated from our export sales amounted to approximately RMB37.2 million, RMB48.7 million and RMB36.5 million, representing approximately 20.4%, 18.2% and 9.9% of our total revenue, respectively. We were therefore entitled to a rebate of the VAT from the PRC tax authority arising from these export sales at a rate of 17% for our PCBAs and from 5% to 17% for our fully-assembled electronic products. We received export tax rebate in the respective sum of approximately RMB0.1 million, RMB0.8 million and RMB1.7 million for each of the three years ended 31 December 2017, respectively.

The amount of tax rebate is calculated by multiplying the invoiced value of our export sales with the tax rebate rate applicable to the export product type. Application of tax rebate has to be made to the tax authority. Should the PRC tax authority finds the documents submitted in relation to the application of tax rebate in order, the tax rebate will be realised, by way of offsetting the VAT payable or cash settlement, within one month. The purpose of the tax rebate is to refund the VAT incurred on the raw materials we sourced for the production of our products in the PRC, which were subsequently exported to overseas countries.

---

## BUSINESS

---

### PRODUCTION FACILITIES AND UTILISATION

Our Shenzhen Production Plant is located in Pingshan District, Shenzhen, Guangdong Province, the PRC. For details, please refer to the paragraph headed "Property" in this section. All our SMT assembly lines for production of PCBAs for sale as stand-alone products or for our onward production of our fully-assembled electronic products are installed in our Shenzhen Production Plant. Except for (i) a small portion of the fully-assembled electronic products which were incorporated with the PCBAs supplied by our suppliers based on our requirements and specifications and (ii) the mobile phones, tablets and other telecommunication devices produced by independent third party companies in Hong Kong engaged by Eternity Technology for overseas customers, we used our SMT assembly lines in our Shenzhen Production Plant to produce all of our PCBAs (including both the PCBAs be sold as stand-alone products or embedded in our fully-assembled electronic products) during the Track Record Period. Therefore, our SMT assembly lines collectively form an essential component of our production process and the production capacity of our Shenzhen Production Plant is subject to the production capacity of our SMT assembly lines. As such, we calculate our annualised utilisation rate of our Shenzhen Production Plant based on the annual aggregate production capacity of our SMT production lines in term of machine hour. The following table sets out the production capacity and utilisation rate of our Shenzhen Production Plant, based on the available machine hours and productive machine hours of our SMT assembly lines during the Track Record Period:

#### Production capacity and utilisation rate of our SMT assembly lines for production of PCBAs

	For the year ended 31 December		
	2015	2016	2017
Number of SMT lines ( <i>Note 1</i> )	11-13	11-12	10-11
Number of available SMT machine hours (hours) ( <i>Note 2</i> )	80,850	76,818	69,573
Number of productive SMT machine hours (hours) ( <i>Note 3</i> )	72,920	69,153	63,323
Utilisation rate (%) ( <i>Note 4</i> )	90.2	90.0	91.0

*Notes:*

1. The number of SMT lines includes both SMT assembly lines owned by us and leased from third party lessors during the Track Record Period.
2. The number of available SMT machine hours is calculated by multiplying the number of SMT lines by the number of hours in a day and the number of days in a year that our SMT machines are expected to operate. The above calculation is based on the assumptions that our SMT machines operate 21 hours a day, and 323 days, 321 days and 316 days for each of the three years ended 31 December 2017, respectively.
3. The number of productive SMT machine hours refers to the total number of the actual machine hours utilised in production, which includes set-up time but excludes unforeseen maintenance downtime.
4. The utilisation rate is calculated by dividing the number of productive SMT machine hours by the number of available SMT machine hours.

## **BUSINESS**

---

### **Production capacity of our manual workers and simple machinery for production of fully-assembled electronic products**

Owing to the unique nature of different kinds of electronic products where the assembling of which require substantive manual works of the assembling workers with the assistance of small machinery and tools, our Directors consider that it is not feasible nor practicable to quantify and disclose detailed utilisation rate regarding our provision of fully-assembled electronic products due to the following reasons:

- (i) Different fully-assembled electronic products with different product structure, complexity and usage would require different assembling time and different number of skilled workers for carrying out the assembling works. It is therefore not entirely feasible to quantify the capacity of our assembling workers and/or the small machinery and tools used by them;
- (ii) If the assembling workers are left idle at the Shenzhen Production Plant awaiting further orders, we would deploy them to assist in other matters such as the operation of SMT lines or packaging of our products in our Shenzhen Production Plant; and
- (iii) Our fully-assembled electronic products primarily used our in-house PCBAs with a small portion sourced from our suppliers based on our requirements and specifications. Since 2017 and as at the Latest Practicable Date, we had subcontracted most of the manual assembling and packaging of our fully-assembled electronic products to our subcontractors. Our provision of full electronic assembly services therefore mainly includes the provision of input to design enhancement and verification, provision of technical advices and engineering solutions, raw materials selection and procurement, quality control, logistics and delivery and after-sale services, which is difficult and even infeasible to define accurate utilisation rate.

Though we cannot quantify the utilisation rate of our assembling workers and small machinery and tools for our provision of fully-assembled electronic products due to the above reasons, our Directors and management do monitor the overall deployment of our assembling workers and machinery.

**BUSINESS**

**MACHINERY AND EQUIPMENT**

Our Shenzhen Production Plant is equipped with a variety of machinery and equipment for the different stages of assembling the PCBAs and fully-assembled electronic products. SMT is the primary type of machinery and equipment used by our Group for provision of assembling services. We purchased these machinery and equipment from the PRC, Japan, Germany, Malaysia, Netherlands, United States or South Korea. We adopt a straight-line depreciation policy on our machinery for three to ten years, which our Directors believe is in line with industry norm. Notwithstanding that, the machinery and equipment generally have a useful life of approximately ten years. The table below sets out a summary of the principal machinery and equipment owned by our Group for the provision of assembling services as at the Latest Practicable Date:

<b>Name of the machinery and equipment</b>	<b>Quantity</b>	<b>Principal functions</b>	<b>Average age (approximately) (Note 1)</b>	<b>Remaining useful life (approximately) (Note 2)</b>
SMT machine	29	A machine that is used for high speed, high precision placing of broad range of electronic components	7	3
Reflow oven	10	Reflow soldering of surface mount electronic components to PCB	8	2
Automated Optical Inspection (AOI)	12	An automated visual inspection of printed circuit board which scans the device under tests for catastrophic failure (e.g. missing component) and quality defects	6	4
Fully automatic SMT stencil printer	7	A machine that is used for depositing solder paste on the printed wiring boards (PWBs) to establish electrical connections	8	2
3D solder paste inspection machine	6	A machine that is used to monitor and control solder paste deposition in board assembly operations using SMT techniques, inspecting solder paste by offering an automated method for performing in-process inspection on the assembly line	5	5
SMT production line			7.1	2.9

---

**BUSINESS**

---

Name of the machinery and equipment	Quantity	Principal functions	Average age (approximately) <i>(Note 1)</i>	Remaining useful life (approximately) <i>(Note 2)</i>
X-Ray	1	A test machine with real-time high magnification and resolution imaging function using its X-ray capabilities for inspection of our PCBAs	1	9
ICT (in-circuit test) machine	1	A test machine that tests a populated PCB, checking for shorts, opens, resistance, capacitance, and other basic quantities which will show whether the assembly was correctly assembled	4	6
Wireless communication analyzer	88	A machine that is used to test the functions of the communication products	7	3
Automated testing machine	4	A machine that is used to automatically test the functions of the products	—	10
Wave soldering machine	2	For bulk soldering process used in the manufacture of PCBs	4	6

*Notes:*

1. The average age of the machinery and equipment is calculated based on the aggregated age of the machinery divided by the number of units of the machinery and equipment.
2. The remaining useful life of the machinery and equipment is calculated based on the estimated useful life deducted the average age of the machinery and equipment.

Our SMT assembly lines are compatible for assembling (which forms part of the production process) different types of products with slight adjustments. Hence, the same machinery and equipment can be used for production of our PCBA and fully-assembled electronic products. Regular maintenance of our production facilities is generally on a monthly basis and is scheduled to rotate among different machinery and equipment to avoid a complete shutdown of our operation.

*Repair and maintenance*

We implement a series of repair and maintenance procedures for our machinery and equipment. Our production team conducts routine checks on our machinery and equipment on a daily basis and usually cleaning and detailed checks on a monthly basis. Generally, we check the sensors and other major parts of our machinery and equipment on a quarterly basis and conduct thorough cleaning thereof and their power supply systems on an annual basis. We maintain detailed records of maintenance and repair of the machinery and equipment.

## **BUSINESS**

---

We compiled a handbook of the guidelines for the operation and maintenance of our production facilities. The handbook contains the procedures related to the planning and acquisition of new machinery and equipment and details on the repair and maintenance of our machinery and equipment. For each of the three years ended 31 December 2017, our costs incurred for the repair and maintenance of our machinery and equipment was approximately RMB0.2 million, RMB0.1 million and RMB0.1 million, respectively.

### **RAW MATERIALS AND SUPPLIERS**

The raw materials we use for the provision of assembly services can generally be divided into (i) electronic components and ancillary materials (including PCBs, semiconductors, ICs magnetic heads and other consumables); and (ii) casing (plastic and metal parts), packaging materials, LCD screens and consumables. For each of the three years ended 31 December 2017, the cost of raw materials used accounted for approximately 49.7%, 75.4% and 77.3% of our total cost of sales, respectively. Such increase in the cost of new materials used as a percentage of our total cost of sales during the Track Record Period was due to the fact that more customers required us to select and provide raw materials in the course of provision of PCBA assembly services and full products assembly services to them.

Our Group sources raw materials generally from our PRC suppliers and suppliers from South Korea and Taiwan. PCBs are used as critical parts of electrical and electronic products for connecting electronic parts to each other along a circuit pattern designed on a substrate or supporting electronic part, and act as a passive component widely used in various kinds of electronic products. PCBs with electrical components are widely used in the electronic industry in a variety of products including computers, servers, televisions and telecommunication devices.

Semiconductors are small silicon devices which are used to control the passage of electrical currents in electronic devices. Semiconductors can be single discrete devices, such as a single transistor and a resistor, and other more complex devices, which consist of a number of devices manufactured and interconnected on a single semiconductor substrate. Semiconductors can be broadly divided in terms of functions, including discrete, optical semiconductor, sensor, analog, memory, microprocessor and microcontroller.

Our Directors confirm that there had not been any significant fluctuation in the market price of these major types of raw materials during the Track Record Period. We source all our raw materials from PRC suppliers who are Independent Third Parties.

## BUSINESS

The table below shows a breakdown of our Group's purchases by types of materials or products for the three years ended 31 December 2017:

	For the year ended 31 December					
	2015		2016		2017	
	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%
ICs	18,055	19.2	33,517	20.2	50,126	20.1
Casing (both plastics and metal)	7,124	7.6	15,556	9.4	34,827	14.0
PCBs	18,957	20.1	14,813	9.0	29,203	11.7
Magnetic heads	3,390	3.6	13,384	8.1	17,499	7.0
Packaging materials	5,562	5.9	10,997	6.6	15,743	6.3
LCD screens	14,351	15.2	3,393	2.1	12,420	5.0
Tablets	—	—	—	—	9,262	3.7
Semiconductors	2,494	2.7	8,007	4.8	9,018	3.6
Mobile phones ( <i>Note</i> )	—	—	29,997	18.1	3,553	1.4
Other consumables	24,236	25.7	35,866	21.7	67,970	27.2
<b>Total</b>	<b>94,169</b>	<b>100.0</b>	<b>165,530</b>	<b>100.0</b>	<b>249,621</b>	<b>100.0</b>

*Note:* During the Track Record Period, we shifted our product mix towards certain products with better margin, such as mPOS given the increased competition of the mobile phones market that has resulted in a decrease in profit margin of the mobile phones products and our production volume have reached the existing designed production capacity. Since 2016, Eternity Technology has started placing corresponding purchase orders with independent third-party companies in Hong Kong for outsourcing the production of mobile phones.

Our Directors confirm that during the Track Record Period and up to the Latest Practicable Date, we had not encountered any material quality issue on or shortage of the raw materials used for production, which would otherwise have adversely affected our operation and provision of assembly services.

During the Track Record Period, our Group purchased raw materials from over 500 suppliers from a diversified geographical location. We generally have alternative sources to supply the same kind of raw materials and hence, the loss of any single supplier would not have a material impact on our operations. We do not enter into any long-term procurement agreements with any supplier. We do not have any hedging policy against any risk of fluctuation in the raw material costs, but we do closely monitor the market prices of the raw materials.

### Procurement planning

As at 31 December 2017, our procurement and inventory team comprised 47 staff members. To maintain our inventory of raw materials at a minimum level, we typically procure raw materials upon receipt of purchase orders from our customers. During Track Record Period, we purchased raw materials from more than 30 suppliers who were designated by our EMS customers. The remaining



## **BUSINESS**

---

suppliers were selected by us based on our selection criteria. We have not entered into any long-term procurement agreement with our suppliers. During the Track Record Period, we were able to mitigate the risk of an increase in the costs of raw materials by passing the increase to our customers through an increase in the price of their products.

During the Track Record Period, our production team would first place an internal purchase request with our procurement department, based on the customers' confirmed purchase orders. Save for those raw materials to be supplied by the suppliers designated by individual customers at a pre-determined price agreed by the customers, our procurement staff would request for price quotations in advance from our generally three suppliers on our list of approved suppliers.

In selecting the price quotation, we take into account the terms and offers from each of the suppliers each time before placing purchase orders. Such practice will allow us to enhance our bargaining power on price and to avoid over-reliance on a single supplier.

Since our Group did not engage in any hedging activity nor enter into any futures contract or price-lock arrangement to manage any price fluctuation of the raw materials, parts and components during the Track Record Period, and does not plan to engage in any hedging activity in the foreseeable future, our procurement department will closely monitor the price of the raw materials. When our Group anticipates any increase in the price of raw materials or shortage of supply thereof, our Group will adjust its procurement plans accordingly in order to minimise its exposure to fluctuations in prices and supply.

### **Selection of suppliers**

We select our suppliers based on a number of criteria including, but not limited to, their product quality, pricing, supply capability and business track record with our Group. With our extensive experience in providing EMS to our customers who are either notable brand owners, authorised manufacturers or licensees and complying with their stringent quality standards, we understand the importance of material safety and quality, and we are capable of identifying and picking quality materials and suitable suppliers.

Shenzhen and other cities in the Guangdong province are blessed with a number of raw material suppliers and our geographical proximity to the market allows us to source quality materials from a wide range of suppliers at stable and competitive prices with high logistic efficiency. Hence, we do not have to rely solely on a small number of suppliers. For each of the sourcing exercises for a new type of raw material, we would typically pick from a pool of no less than 550 potential suppliers for the same material and request the identified suppliers to provide quotations. We would demand our chosen suppliers comply with relevant international quality control standards and perform quality tests on the supplied materials.

We maintain a list of approved suppliers, whom would be removed from the list should they fail to satisfy our quality and service requirements upon periodic review by our production material control department. We are able to exercise considerable control over our sourcing exercises due to

## **BUSINESS**

---

the vast number of available suppliers operating mainly in Guangdong Province, which allows us to review and easily replace existing suppliers who fail to live up to our expectations from time to time.

Our Directors confirm that as our quality control department closely monitors the quality of the supplied materials from the initial stage, we have not experienced any significant return of raw materials which would cause any material adverse effect to our business operations during the Track Record Period.

### **Salient terms of a typical purchase transaction**

Our Directors do not consider it necessary to enter into any long-term procurement agreement with any supplier, which is in line with industry practice. Instead, our Group places a purchase order to the chosen supplier in any typical purchase transaction.

Instead, our Group would issue a standard purchase order to the supplier, on our list of approved suppliers, in an ordinary purchase transaction. A standard purchase order contains the following terms and conditions:

Specifications of the raw materials	We will specify the raw materials we need and the quality of each type of raw materials required in the purchase order of agreement
Specifications and international or industry standards for raw materials	We will specify in the purchase order of agreement the required standard and whether test reports of the raw materials are required
Delivery	We will specify the date of delivery in the purchase orders. The suppliers are responsible for the delivery of the raw materials to our Shenzhen Production Plant or the place as designated by us or before the date of delivery at their own costs
Quality standard	Upon receipt of the raw materials, we are entitled to conduct inspection of the raw materials based on the said quality control standard and guidelines
Price	We will specify the unit price of each type of raw materials and the total contract sum in the purchase order
Return of defective raw materials	If any defective or sub-standard raw materials are found upon their arrival, we are entitled to request for replacement and the supplier is liable for all the costs and expenses arising therefrom

## **BUSINESS**

---

### **Payment methods**

Our Group is generally required to pay for the raw materials upon their delivery to our warehouse or between 30 to 90 days after the date of the invoices. Sometimes, at the request of the suppliers and subject to the demand and supply conditions of the relevant raw materials, we may need to prepay certain amount of the purchase price in order to secure our purchase of the raw materials. Payment is generally made by bank transfer or bank acceptance bills endorsed to us by our customers and settled in RMB or USD. During the Track Record Period, we had entered into arrangement with the banks or financial institutions with respect to the issue of any bank acceptance bills by ourselves. For more details, please refer to the section headed "Financial Information — Trade and bills receivables" in this document.

Our Directors confirm that, during the Track Record Period and up to the Latest Practicable Date, as our quality control department closely monitors the quality of the supplied materials from initial stage, our Group had not encountered any quality issues on or shortage or delay of raw materials and/or any significant return of defective raw materials, which would have a material adverse effect on the manufacture of our products. For each of the three years ended 31 December 2017, the value of the products returned to suppliers and the suppliers subsequently replaced the defective new materials with the good ones over our total cost of sales was approximately 0.5%, 0.2% and 0.7%, respectively.

### **SUBCONTRACTING**

According to the Frost & Sullivan Report, the average monthly wage of employed persons in manufacturing industry in Guangdong province, the PRC increased from RMB3,476.0 in 2012 to RMB5,198.6 in 2016, representing a CAGR of 10.6% from 2012 to 2016. In view of the increasing labour cost, and in order to minimise the needs to maintain a large work force and increase the flexibility and cost effectiveness of our EMS business, our Directors consider that it would be more cost-effective to subcontract the assembling works of our full product assembly services, which are relatively more labour-intensive, to third party subcontractors under our supervision and at the same time upheld the core and integral part of our full product assembly services, i.e. using primarily the PCBAs manufactured by us, provision of design enhancement and verification, provision of technical advices and engineering solutions, selection and procurement of raw materials, quality control and testing of both semi-finished and finished products.

### **Our arrangement with subcontractors**

We do not enter into long-term contracts with any of our subcontractors. Nevertheless, we maintain long-standing working relationships with them. We generally place purchase orders with our subcontractors, which contain terms with respect to the subcontracting works, the delivery time, the subcontracting costs and payment terms. Attributed to the industry experience of our Directors and their familiarity with the assembly cost as well as the market price, we are therefore able to negotiate with our subcontractors and seek to control the subcontracting cost at a reasonable level. During the Track Record Period, we engaged more than ten third party subcontractors for undertaking the manual assembly works. For each of the three year ended 31 December 2017, the total subcontracting charges amounted to approximately RMB2.5 million, RMB0.6 million and RMB23.0 million, representing approximately 1.7%, 0.3% and 7.4% of our total cost of sales, respectively.

## **BUSINESS**

---

### **Selection of subcontractors**

Pursuant to the contracts with our customers, we generally have to bear the responsibilities in respect of defective products and/or late delivery. As such, our Directors consider that a stringent selection of our subcontractors is of paramount importance. We will regularly review our selection of subcontractors based on a number of factors, including: (i) company background, job reference and their adherence to instructions, if any; (ii) timely delivery of products; (iii) quality of work performed; (iv) safety and environmental compliance; (v) overall performance; and (vi) their locations preferably in the vicinity to our Shenzhen Production Plant, to enable us to supervise both the assembly process and implementation of our quality control measures.

### **Quality control on the subcontracted works**

Our staff have regularly visited the production plant of our subcontractors. When there are any subcontracted works to be carried out, we will designate two staff members from our engineering department, a quality control supervisor together with the quality control personnel to station at the subcontractors' production plant to supervise their production processes, and conduct testing on the semi-finished products and finished products to ensure the products are in compliance with the specifications of our customers. We also require subcontractors to rectify all defects in their works on the spot and after delivery. During the Track Record Period and up to the Latest Practicable Date, we had not experienced any delayed performance by our subcontractors and we had not received any material claims or complaints from our customers for substandard work of our subcontractors.

Our Directors confirm that we had no material dispute with any of our subcontractors during the Track Record Period.

### **Our top five suppliers and subcontractors**

For each of the three years ended 31 December 2017, the total purchases, including the supply of raw materials and subcontracting fees, from our top five suppliers and subcontractors amounted to approximately RMB23.6 million, RMB67.7 million and RMB94.3 million, representing approximately 24.4%, 40.7% and 34.6% of our total cost of purchases and subcontracting fees for the corresponding periods. For each of the three years ended 31 December 2017, our purchases from our largest supplier accounted for approximately 7.0%, 11.5% and 12.0% of our total cost of purchases and subcontracting fees, respectively. Most of our suppliers and subcontractors are based in the PRC with a few in South Korea, Hong Kong and Taiwan.

None of our Directors, their respective associates and existing Shareholders, who own more than 5% of our issued share capital, had any interest in any of our top five suppliers during the Track Record Period. None of our top five suppliers and subcontractors was our customers during the Track Record Period.

**BUSINESS**

The following tables set forth certain information of our top five suppliers and subcontractors during the Track Record Period:

*For the year ended 31 December 2015*

Supplier	Raw materials procured from the suppliers or services provided by the subcontractors	Principal business	Cost of purchases or subcontracting fees (RMB'000)	% of total cost of purchases and subcontracting fees	Credit Period	The calendar year in which the supplier/subcontractor first started to have business relationship with our Group
Supplier A	LCD screens	A PRC company engaged in research and development, manufacturing and sale of electronic communication products, LCD screen, computer software and hardware	6,762	7.0	10% down payment and the remaining payable within 3 days after delivery	2015
Supplier B	LCD screens	A PRC company engaged in research and development, manufacturing and sale of liquid crystal materials, LCD screen and liquid crystal mold	4,495	4.6	30 days after monthly statement	2014
Supplier C	Batteries	A PRC company engaged in research and development, manufacturing and sale of electronic products and components, battery, electronic equipment and electronic automation production equipment	4,287	4.4	30 days after monthly statement	2015
Supplier D	PCBAs	A PRC company engaged in provision of technology development and sale of computer and electronic products, including the PCBAs	4,234	4.4	10% deposit and the remaining payable 15-20 days after delivery	2014
Supplier E	PCBAs	A PRC company engaged in design, development and sale of mobile phones, tablet computers and electronic products, including the PCBAs	3,866	4.0	10% deposit and the remaining payable 15-20 days after delivery	2015

**BUSINESS**

For the year ended 31 December 2016

Supplier	Raw materials procured from the suppliers or services provided by the subcontractors	Principal business	Cost of purchases or subcontracting fees (RMB'000)	% of total cost of purchases and subcontracting fees	Credit Period	The calendar year in which the supplier/subcontractor first started to have business relationship with our Group
Supplier F	Mobile phones	A Hong Kong company engaged in development, manufacturing and sale of mobile phones	19,071	11.5	15%-20% deposit and the remaining 80%-85% payable after delivery	2016
Supplier G	Plastic casing and other consumables	A PRC company engaged in manufacturing and sale of plastics and electronic products	18,804	11.3	30 days after monthly statement	2015
Supplier H	Magnetic heads	A PRC company engaged in manufacturing and sale of electronic components	11,208	6.7	30 days after monthly statement	2015
Supplier I	Mobile phones	A Hong Kong company engaged in development, manufacturing and sale of mobile phones	10,926	6.6	20%-30% deposit and the remaining 70%-80% payable after delivery	2016
Supplier J	ICs	A Korean company engaged in development and sale of electronic products	7,682	4.6	30 days after monthly statement	2015

**BUSINESS**

For the year ended 31 December 2017

Supplier	Raw materials procured from the suppliers or services provided by the subcontractors	Principal business	Cost of purchases or subcontracting fees (RMB'000)	% of total cost of purchases and subcontracting fees	Credit period	The calendar year in which the supplier/subcontractor first started to have business relationship with our Group
Supplier G	Plastic casing	A PRC company engaged in manufacturing and sale of plathetics and electronic products	32,796	12.0	30 days after monthly statement	2015
Supplier K	Provision of assembling services	A PRC company engaged in manufacturing and sale of electronic products	22,899	8.4	30 days after monthly statement	2017
Supplier L	Batteries	A PRC company engaged in sale of batteries, electronic products, and spare parts of mobile phones	13,633	5.0	30 days after monthly statement	2016
Supplier M	Semiconductors and ICs	A PRC company engaged in manufacturing and sale of electronic components	13,338	4.9	30 days after monthly statement	2016
Supplier N	LCD screens	A PRC company engaged in research, design, manufacturing and sale of electronic components and products in relation to Light-Emitting and LCD	11,596	4.3	60 days after monthly statement	2016

**ENTITIES WHO ARE OUR CUSTOMERS AND ALSO OUR SUPPLIERS**

For each of the three years ended 31 December 2017, there were one customer (namely, Customer I), two customers (namely Customer D and Customer J) and six customers (namely Customer D, Customer J, Customer K, Customer G, Customer L, Customer M), were also our suppliers, respectively.

The reasons for which our customers are also our suppliers are as follows:-

1. There are circumstances where our customers are the only suppliers of certain raw materials we find necessary to meet sales orders, such as specific models of IC chips and specific models of coils. Thus we have to purchase such raw materials from our customers;
2. In view of the tight business production schedule at the commencement of our business relationship with Customer K and Customer L in 2017, we purchased the respective raw materials from them as we could not, at that point, identify any other stable source of the required raw materials from suppliers apart from Customer K and L. Such arrangements were only a temporary measure, thus we had no longer purchased raw materials from Customer K and Customer L as at the Latest Practicable Date;

## BUSINESS

3. Customer G required us to incorporate specific IC chips, which were only supplied by Customer G, in their new product models. Thus we made purchases of such raw material from Customer G; and
4. Customer D required us to use a specific type of raw material approved by them, which were only supplied by Customer D, thus we made purchases of such raw material from Customer D.

We will only source raw materials from our customers in order to satisfy their specific needs.

Our sales to these customers amounted to approximately RMB2.4 million, RMB42.7 million and RMB62.8 million, respectively, which accounted for approximately 1.3%, 15.9% and 17.0%, respectively, of our total revenue for the three years ended 31 December 2017. During the same corresponding years, our costs of sales of these customers amounted to approximately RMB2.0 million, RMB35.5 million and RMB52.4 million, respectively, which accounted for approximately 1.4%, 16.1% and 16.9%, respectively, of our total cost of sales. Gross profit for the sales to these customers for each of the three years ended 31 December 2017 was approximately RMB0.4 million, RMB7.1 million and RMB10.4 million, respectively. The gross profit margin for each of the three years ended 31 December 2017 was approximately 18.0%, 16.7% and 16.6%, respectively, whereas our overall gross profit margin for the corresponding year was 18.9%, 17.7% and 16.3%, respectively.

The following table set out the breakdown of gross profit from the entities who are our customers and also our suppliers during the Track Record Period:

	For the year ended 31 December					
	2015		2016		2017	
	Gross profit	Gross profit margin	Gross profit	Gross profit margin	Gross profit	Gross profit margin
	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%
	<i>(approximately)</i>		<i>(approximately)</i>		<i>(approximately)</i>	
Customer D	—	—	7,104	16.9	9,228	18.0
Customer G	—	—	—	—	257	21.9
Others	441	18.0	14	2.3	954	9.3
	<u>441</u>	18.0	<u>7,118</u>	16.7	<u>10,439</u>	16.6
						<i>(Note)</i>
Our Group's overall gross profit and gross profit margin	<u>34,591</u>	18.9	<u>47,530</u>	17.7	<u>60,338</u>	16.3



## **BUSINESS**

---

*Note:* Our Group generally adopts a more competitive approach when negotiating the sale price with our new customers or potential customers. Among these four customers, Customer K, Customer L and Customer M were our new customers in 2017 and our Group have adopted such approach so as to attract and retain them, which caused the price more favourable than those offered to other customers. As a result, the gross profit margin of these customers was relatively lower than the overall gross profit margin of our Group for the year ended 31 December 2017.

### **INVENTORY MANAGEMENT**

The inventory comprises mainly of raw materials and finished products. Our procurement and inventory team, which consists of 47 staff as at the 31 December 2017, closely monitor the inventory level to meet the production requirements, and minimise any waste on inventory or obsolete inventory.

#### **Raw materials**

We purchase most of our raw materials after we have confirmed the purchase orders with our customers and checked the orders against our inventory in order to avoid accumulation of excessive inventories. Hence, on the one hand, we strive to maintain a minimal level of inventory for the raw materials based generally on the purchase orders. On the other hand, we accumulate key raw materials that we frequently use in our production, including PCB and IC, in order to meet our continuous production needs for a period of around 30 days.

As most of our products are produced based on individual orders, there is no significant risk of obsolescence. To facilitate the monitoring of our inventory, we use a standard enterprise resource planning (ERP) system, which provides tools for us to, among other things, keep efficient and effective records used since 2014 of purchase orders placed with our suppliers, and to aid us in maintaining regular inventory levels, as well as commanding a centralised price information system complete with account receivables and account payables to our customers and suppliers. Our Directors believe that implementation of this ERP system has helped us controlling our inventory more effectively. With the assistance of the ERP system:

- once the amounts are confirmed, and with the assistance of our production team, our procurement and inventory team will check the availability of the existing inventory and will then proceed to order the raw materials from suppliers chosen from our approved list of suppliers;
- after our quality control team has inspected the incoming raw materials, such raw materials will be warehoused and we will perform material categorisation and inventory tracking; and
- a full stocktake is performed on a half-yearly basis to ensure the accuracy of stock-in and stock-out information on record. Throughout the year, our Group reviews the stocktaking records and performs inventory aging analysis to ensure that inventories are properly used and that there is no unnecessary accumulation of aged inventories.

We adopt a first-in-first-out approach for the utilisation of the raw materials, and parts and components.

## **BUSINESS**

---

### **Finished products**

Finished products refer to the products which are ready to be delivered to our customers. As our Group commences the production process upon receipt of the purchase orders placed by our customers, there is no significant risk of obsolescence of finished products. Our Group adopts a first-in-first-out approach in utilising the finished products and closely monitors the inventory level of the finished products to minimise the inventory level.

### **QUALITY CONTROL**

Our Group has adopted quality control measures on the selection and testing of raw materials, semi-finished products and end products throughout the assembling process to ensure the quality of our products as well as their adherence to customers' specifications. As at the 31 December 2017, our Group had 35 quality control staff, which include four supervisors, four engineering staff and 27 technicians, responsible for quality control in four aspects, namely, incoming raw materials quality control, SMT control, overall quality control and industrial electronics quality control, of whom seven had completed tertiary education in different disciplines including mechanical engineering, applied electronics engineering and computer sciences and two were university graduates in mechanical engineering. They are in charge of the overall implementation of the relevant quality control measures in the respective aspects at the different production processes and the finished products. Our quality control team is mandated to identify any quality control issues and provide solutions to the production team to address such issues.

For each of the three years ended 31 December 2017, our Group incurred approximately RMB0.8 million, RMB0.7 million and RMB0.8 million, respectively, mainly for the salaries of our quality control staff and the fees paid to external product inspection companies, for the costs of quality control. Our quality control manager is involved in (i) reviewing the implementation of our quality control measures; (ii) meeting with our quality control supervisors to discuss any enhancements in quality control processing; (iii) organising training in quality control for new incoming quality control staff; and (iv) discussing with the head of our procurement team in relation to the selection and quality of raw materials to be purchased and used in the production of our products.

### **Quality control on the incoming raw materials**

Incoming raw materials are subject to inspection by our quality control team on the acceptable quality limit (AQL) and quality standard for production based on our internal guidelines to ensure their conformity with the specifications set out in our design and schematics and requirements of our customers before acceptance. Our quality control personnel prepare a report on the results of the inspection and such report will be reviewed by the head of our quality control department. Upon discovery of any sub-standard or defective raw materials, our quality control personnel will refer the case to the procurement department which will communicate with the relevant suppliers for defect analysis and arrange for the return and replacement of such supplies. AQL is an inspection standard where the maximum number of defects that could be considered acceptable during a random sampling inspection. We have adopted a series of strict quality control measures in the inspection and checking of the incoming raw materials and electronic components before we use the same for production, in order to minimise the risks of producing defective products.

## **BUSINESS**

---

Depending on the nature of the raw materials, the internal guidelines of our Group require the testing and inspection process to cover aspects including appearance, size, mechanical features, electrical testing and geometric features. The raw materials and components which pass the incoming quality check are delivered and stored in the warehouse.

The maximum amount of defective raw materials discovered during random inspections which is considered by us as acceptable is 0.5% of the entire batch of the raw materials under inspection. Though our Group has adopted a strict quality control measures in inspecting the incoming raw materials, there are occasions that the raw materials are found to be sub-standard or defective during the assembling process. If that happens, we will return the defective raw materials to the relevant suppliers and request the suppliers to send a new batch of raw materials to us. Our Directors confirm that due to our stringent policy in selection of suppliers and inspection of raw materials, we had not experienced significant return of raw materials and components which could not pass our incoming quality check to the suppliers for each of the three years ended 31 December 2017.

As PCBs are one of our largest raw materials, which are different in terms of surfaces, angles and structures. We evaluate their circuit board flatness or the microstructures of the board with precise measurement.

### **Quality control on the assembling process**

The quality control personnel test the quality of semi-finished products at several major stages in the assembling process of both PCBAs and full electronic products on a real time basis to ensure the semi-finished products in the course of assembling can meet the required standards and customers' specifications. Apart from visual checking, we also use advanced quality control machinery and equipment including SPI, x-ray inspection, AOI and BGA rework device. Insofar as the assembly services are subcontracted to the third-party subcontractors, two staff members from our engineering department, a quality control supervisor together with other quality control personnel will be assigned to station at the production plant of our subcontractors to supervise the entire assembling process of our fully-assembled electronic products, conduct testing on both semi-finished products and finished products and to ensure that the assembly process is carried out according to our instructions and the final electronic products can meet our customers' requirements and specifications.

If the semi-finished products are found to be defective, such semi-finished products will pass to our laboratory managed by our production department for repair and will return to the quality control department for a re-test. If the defective rate is more than 2.0%, the defective semi-finished products will be passed to the engineering department to identify the problem and make adjustments to the production techniques.

## **BUSINESS**

---

One of our major objectives is to ensure that the overall quality of the semi-finished products conforms to the required standards, by means of testing on all of the work-in progress, immediate defect analysis and timely repair. The semi-finished products that fail to meet quality standards are either repaired or disposed of and are subject to failure analysis, to identify the root cause of the failure to determine what corrective actions need to be taken. Our production personnel and quality control personnel meet regularly to discuss the causes of the quality problems of our products and the corresponding solution to improve and ensure the quality of our products.

### **Quality control on overall quality of the finished products**

It serves as our final control point to ensure that the finished products comply with the customers' requirements and the industry standards. Our Group requires the quality control personnel to conduct random inspection on the physical appearance, level of adherence to our customers' specifications and functional testing on the quality of the finished products. The finished products must pass the final quality test on their functionality which put the product through its paces, simulating the normal circumstances in which the product will operate before packaging. The products that fail to meet quality standards will be subject to additional work and those which meet the requisite standard will be subject to final inspection by the customers, if required. Some of our customers also send their representatives to conduct on-site quality checks on the finished products. After the final inspection, the finished products will be packaged and delivered to the warehouse within our Shenzhen Production Plant to arrange for delivery to our customers or for collection by our customers.

The same quality control procedures are applied to the finished products assembled by our third-party subcontractors after these finished products are delivered to our Shenzhen Production Plant.

### **Industrial electronics quality**

In the provision of accurate assembling services to our customers on EMS basis, we have to comply with the manufacturing processes of our customers, including the guidelines for materials-handling and disposal. We have to ensure that our suppliers throughout the supply chain meet the same strict standards.

This involves the measures to track defects throughout the production process by rapidly and accurately identifying flaws, reasons for failures, and error trends in order to ensure product quality and overall yield — for example, whether or not it is a specific vendor, a certain material or an individual part of the process that has resulted in any defective products. By doing so, we can ensure accurate assemblies of electronic components and keep pace with the short product development cycles for electronic products.

## **BUSINESS**

---

### **Quality certifications and recognition**

We have obtained quality certifications in an effort to ensure our manufacturing system and processes conform with the internationally recognised quality standards. We have obtained the ISO 9001 certification on quality management since 2005 and ISO 14001 certification on environmental management system since 2009.

During the Track Record Period and up to the Latest Practicable Date, there were no material claims for delay in delivery, defective products or sales returns from our customers. Our Directors confirmed that there were no material product recalls nor claims against us in respect of any alleged breach of the intellectual property rights of any third party during the Track Record Period and up to the Latest Practicable Date.

### **RESEARCH AND PRODUCT DEVELOPMENT**

Over the years, we have accumulated a certain level of technology experience on assembling PCBAs and fully-assembled electronic products according to the specifications given by our customers. As at 31 December 2017, we had 45 staff members in our research and development team, out of which (i) three possessed a bachelor degree in engineering or computer application technology; and (ii) 31 possessed a post-secondary-school qualification in the field of applied electronics or other related disciplines in the PRC.

Leveraging our experience and knowledge derived from provision of EMS, our research and development team, which is under our engineering team, focuses on the research and development of technologies for improving the efficiency and effectiveness of the assembling process, quality control enhancement, design and verification of PCBA and full electronic product assembly services to customers; and to reduce their cost of production.

Alongside our provision of assembling services to our customers on EMS basis, our research and development team also participates in the product development stage of our customers' products, which in the opinion of our Directors, would help strengthen our relationship with the customers and ensure that the quality of our products meet customers specifications. Our research and development team also has the capability to verify and develop the conceptual designs from the customers and turn such design concepts into deliverable PCBAs or fully-assembled electronic products by improving the PCBA specifications and design, product designs, recommending the proper and suitable raw materials for assembling and testing of the trial products.

As at the Latest Practicable Date, our Group applied for the registration of various utility model patents (實用新型專利) and software copyrights (軟件著作權). Please refer to the paragraph headed "B. Information about the business — 2. Intellectual property rights of our Group" of Appendix IV to this document for details of the patent under application and the nine utility model patents and 16 software copyrights already registered under the name of Shenzhen Hengchang Sheng.

## **BUSINESS**

---

As a result of our research and development capabilities, initiatives and achievements, since 2016, our Group has been awarded the status of “High and New Technology Enterprise\* (高新技術企業)” by the relevant PRC governmental authorities and has been enjoying a preferential EIT of 15%. While our certificate of “High and New Technology Enterprise\* (高新技術企業)” expired in 2018, given that (i) we have completed the necessary filings for examination of our status as “High and New Technology Enterprise\* (高新技術企業)” with the relevant authorities in August 2016; (ii) there has been no major change to the laws and regulations relating to the certification since the last certification; and (iii) our corporate status and research and development credentials have been enhanced since the last certification, our Directors believe that we will continue to be qualified as a “High and New Technology Enterprise\* (高新技術企業)” and be granted the preferential EIT treatment upon re-examination of our status as “High and New Technology Enterprise\* (高新技術企業)” which is expected to be completed by the relevant authorities.

Our Group incurred approximately RMB7.3 million, RMB7.4 million and RMB12.4 million, respectively, for the expenses related to research and development for each of the three years ended 31 December 2017, which was composed of the remunerations paid to these staff, depreciation expenses, materials and service fee payable to third parties for product development.

### **SEASONALITY AND PRODUCT LIFE CYCLE**

As our PCBAs are mainly applied to the production of the electronic products used in banking and finance, telecommunication and smart devices industries, our Directors consider that the product cycle of our PCBAs would be affected by the pace of technological development and the launching of new electronic products in these industries. With the increase in electronic product consumption, an increasing number of new electronic products spring up, old products are therefore expected to be replaced in the short term, which further increases the demand for PCBAs and full product assemblies.

We generally record lower sales in the first half quarter of the year, which our Directors consider to be generally attributable to the reduced business activities and closure of our Shenzhen Production Plant around the Chinese New Year holidays which fall in January or February of the year in the PRC. On the other hand, we generally record higher demands from our customers in the fourth quarters, which we consider to be attributable to and the purchase patterns of our customers that they generally place their orders around the fourth quarter of the year given that, based on our Directors’ observations, our customers place more purchasing orders with us in that quarter in anticipation of stronger market demands for electronic products for the festive seasons in the fourth quarter of the year and the first quarter of the following year.

### **MARKETING AND PROMOTION**

As at 31 December 2017, our sales and marketing team comprised of 19 staff members who are responsible for the sales activities of our Group and formulating our Group’s overall sales strategies, collecting and analysing market data, communicating with our customers from time to time to collect their feedback on our products and updated market information. Our sales and marketing team, along with our production team, is also responsible for negotiating and finalising sales terms with our customers and handling the return of defective products in a timely manner.

## BUSINESS

### MARKET AND COMPETITION

According to the Frost & Sullivan Report, growing demand from players along the value chain of the EMS industry and the continuous increasing penetration of EMS has driven the EMS market in the PRC. Sales value of EMS industry in the PRC reached RMB1,252.6 billion in 2016, with CAGR of 9.3% from 2012 to 2016. There had been an accelerated growth of EMS market from 2012 to 2014 due to the recovery of global electronic market. However, the growth of the EMS market has slowed down and entered a steady growth since 2015.

According to the Frost & Sullivan Report, in terms of revenue in 2016, top ten companies in the EMS market in the PRC accounted for approximately 51.8% market share, whereas our Group had a market share of approximately 0.02%.

In view of (i) the thriving demand in global electronic products markets; (ii) continuously increasing penetration of EMS; (iii) growing capabilities of EMS providers; and (iv) the PRC government's policies which encourage market growth, the demand of EMS is expected to grow in the future. Our Directors consider that (i) customers' requirement on EMS providers' design and the manufacturing capabilities; (ii) our possession on EMS providers' contract manufacturer certifications; (iii) customers' requirement of supply chain management capabilities; and (iv) large capital investment requirement, are the main entry barrier to the EMS market in the PRC.

### EMPLOYEES

As at the Latest Practicable Date, our Group had 359 employees and 25 dispatched staff. The following table sets forth the number of our Group's employees by job functions as at the date specified:

Function	31 December 2015	31 December 2016	31 December 2017	Latest Practicable Date
Managerial, administrative and accounts	32	34	33	32
Production — SMT	184	127	105	113
Production — assembling services	139	148	80	74
Quality control	51	39	35	33
Procurement and inventory	34	41	47	44
Research and development	51	46	45	45
Sales and marketing	12	17	19	18
<i>Total number of employees</i>	<u>503</u>	<u>452</u>	<u>364</u>	<u>359</u>

---

**BUSINESS**

---

The following table sets forth the number of dispatched staff engaged by our Group as at 31 December 2015, 2016 and 2017 and Latest Practicable Date:

<b>Function</b>	<b>31 December 2015</b>	<b>31 December 2016</b>	<b>31 December 2017</b>	<b>Latest Practicable Date</b>
Production — SMT	213	126	19	10
Production — Assembling services	343	128	12	15
Quality control	53	19	—	—
Procurement and inventory	8	21	—	—
<i>Total number of dispatched staff</i>	<u>617</u>	<u>294</u>	<u>31</u>	<u>25</u>

Our total number of staff and dispatched workers decreased from 1,120 as at 31 December 2015 to 384 as at the Latest Practicable Date. The decrease was mainly due to the following reasons:-

- (1) The number of dispatched staff engaged by our Group had exceeded the regulatory threshold of 10% of the total number of our workers as stipulated in the Interim Provisions on Labour Dispatch (勞務派遣暫行規定) which came into effect on 1 March 2014 during the Track Record Period. To rectify the situation, we had terminated the engagement with the dispatched staff and manpower service company and engaged subcontractors to perform the assembling of our products. Therefore, our Group recorded a decrease in number of dispatched staff from 617 as at 31 December 2015 to 25 as at the Latest Practicable Date; and
- (2) According to the Frost & Sullivan Report, the average monthly salary of workers in manufacturing industry in Guangdong Province has increased from RMB3,476.0 in 2012 to RMB5,198.6 in 2016, representing a CAGR of 10.6%. In view of the increasing labour cost, our Directors consider that it would be more cost-effective to reduce our number of assembly lines and subcontract the assembling works of our full product assembly services which are relatively more labour intensive, to other third party subcontractors. For detail of our subcontracting arrangement, please refer to the paragraph headed "Business — Subcontracting" in this document.

During the Track Record Period, our number of employees responsible for assembling services decreased from 139 as at 31 December 2015 to 80 as at 31 December 2017, while our subcontracting expenses increased from approximately RMB2.5 million for the year ended 31 December 2015 to approximately RMB23.0 million for the year ended 31 December 2017. By subcontracting part of our full product assembly services, our Directors believe that we can (i) focus on offering technical advice and engineering solutions ranging from procurement of raw materials to after-sales service; (ii) minimise our need to employ and maintain a large work force; and (iii) increase flexibility and cost effectiveness in carrying out our EMS.



## **BUSINESS**

---

### **Remuneration**

Our Group's employees are generally remunerated by way of fixed salary. Our Group utilises an appraisal system for our employees and considers the appraisal results of individual employees when conducting their salary reviews, making promotion decisions and determining the amount of bonuses. Our Group's employees are also entitled to a performance-based bonus, paid leave and various subsidies.

### **Relationship with employees and recruitment policies**

Our Directors believe that our Group's management policies, working environment, employee development opportunities and employee benefits have together contributed to good employer-employee relations and successful employee retention. Our Directors confirm that during the Track Record Period and up to the Latest Practicable Date, our Group had not encountered any difficulty in the recruitment and retention of staff for our operation or experienced any disruption in our operation as a result of labour disputes with our employees in all material respects.

We recruit employees based on a number of factors such as their working experience, educational background and vacancy needs.

### **Employee Training**

In order to increase the overall competitiveness of our Group's workforce and to attract and retain existing employees and strengthen their knowledge, skill level and quality, our Group places strong emphasis on training employees. We provide trainings across different operational functions, including induction training for new employees, functional training to provide our employees with the necessary skills and knowledge of their respective work areas and other on-the-job trainings to reinforce functional training and to enhance the employees' knowledge on the safety measures when performing their duties.

### **Social Welfare Scheme and Housing Provident Funds**

According to the Social Insurance Law of the PRC\* (中華人民共和國社會保險法), our PRC subsidiary, Shenzhen Hengchang Sheng is required to make social insurance fund contributions for its employees in the PRC. As at the Latest Practicable Date, Shenzhen Hengchang Sheng maintained a social insurance scheme that covers basic pension insurance, unemployment, work-related injuries, medical and maternity expenses for our PRC employees.

Shenzhen Hengchang Sheng is also required under the Administrative Regulations on the Housing Provident Fund of the PRC\* (住房公積金管理條例) to deposit housing provident funds to its employees in the PRC. Shenzhen Hengchang Sheng set up its housing provident fund account only in March 2017. To rectify such non-compliance, Shenzhen Hengchang Sheng set up a housing provident fund system in March 2017 and has been paying contributions to the housing fund for their employees in accordance with and for the purpose of compliance with the applicable PRC laws and regulations

## **BUSINESS**

---

since May 2017. To prevent the recurrence of such non-compliance, we have implemented a series of internal control measures. In future, we will ensure that all our incoming employees to give consent to set up housing provident fund accounts before they join our Group. For details, please see the paragraph headed "Business — Legal and Compliance" in this document.

### **Dispatch Agencies**

During the Track Record Period, Shenzhen Hengchang Sheng utilised and engaged dispatched staff. Given the relatively high turnover rate of labour in the manufacturing industry, we believe the engagement of dispatched staff for temporary, auxiliary and substituting positions can enhance efficiency and flexibility to cope with the rapid business expansion in recent years.

Pursuant to the Interim Provisions on Labour Dispatch\* (《勞務派遣暫行規定》) which came into effect on 1 March 2014, "if the number of dispatched staff utilised by an employer exceeds 10% of the total number of its workers prior to the effective date of these Provisions, such employer shall develop a scheme for employment adjustments to reduce the proportion to the specified level within two years from the effective date of these Provisions. Shenzhen Hengchang Sheng had engaged 617 and 294 dispatched workers as at 31 December 2015 and 2016, respectively, representing approximately 55.1% and 39.4% of the total number of its workers as at the corresponding date, respectively, which exceeded the regulatory threshold of 10% and constituted a non-compliance incident of the Interim Provisions on Labour Dispatch\* (勞務派遣暫行規定). For details, please refer to the section headed "Business — Legal and Compliance" in this document.

## **ENVIRONMENTAL PROTECTION**

Manufacturing enterprises, like our Group, in the PRC are subject to PRC environmental protection laws and regulations, which include the Environmental Protection Law of the PRC (中華人民共和國環境保護法) and other PRC environmental protection laws and regulations. For further details, please refer to the section headed "Regulatory Overview — PRC Laws and Regulations — Regulations on Environmental Protection" in this document.

Shenzhen Hengchang Sheng obtained the environmental permit statement from the Environmental Protection Bureau of Longgang District of Shenzhen City\* (深圳市龍崗區環境保護局) (the "Environmental Protection Bureau") in relation to our Shenzhen Production Plant in October 2011. Since the commencement of our Group's operations and up to the Latest Practicable Date, it has not been subject to any material penalty or fines imposed by the environmental protection authorities. For each of the three years ended 31 December 2017, the costs incurred by our Group for compliance with the relevant environmental protection laws and regulations were approximately RMB10,000, RMB14,000 and RMB10,000, respectively. Based on the past experience of our Group's management team, the nature of the industry and future developments of the industry, our Directors believe that our Group's current environmental conservation facilities are adequate to satisfy the relevant laws and regulations and do not expect any major or significant expenditure to be incurred in the future.

## **BUSINESS**

---

According to the PRC Legal Advisers, Shenzhen Hengchang Sheng had not received any administrative punishment by the environmental protection department for serious behaviours violating any PRC environmental law and regulation during the Track Record Period. Our Directors also confirmed that our Group has not been subject to any material environmental claims, lawsuits, penalties or administrative sanctions, and the operations of our Group have been in compliance with the relevant environmental laws and regulations in all material respects in the PRC during the Track Record Period and up to the Latest Practicable Date.

### **OCCUPATIONAL HEALTH AND SAFETY**

Our Group has implemented measures in our Shenzhen Production Plant to promote occupational health and safety and to ensure compliance with applicable laws and regulations. We published booklets with occupational health and safety for circulation to our employees to raise awareness of occupational health and safety among our employees. We had established a series of safety guidelines, rules and procedures for different aspects of our production activities, including fire safety, warehouse safety, work-related injuries and emergency and evacuation procedures.

During the Track Record Period, our Group did not experience any accidents or claims for personal or property damage that, individually or in aggregate, had a material effect on our Group's financial condition and results of operations.

As confirmed by our PRC Legal Advisers, our Group had complied with the applicable national and local safety laws and regulations in all material respects during the Track Record Period, and the relevant PRC authorities had not imposed any material sanctions or penalty on us for incidents of non-compliance of any safety laws or regulations in the PRC.

### **RECOGNITIONS AND CERTIFICATIONS**

As at 31 December 2017, our Group had the following major recognitions and certifications:

<b>Year</b>	<b>Recognition or certification</b>	<b>Issuing authority/institution</b>
2017	Certification for China Compulsory Product Certification	China Quality Certification Centre
2016	High and New Technology Enterprise* (高新技術企業)	Science, Technology and Innovation Committee of Shenzhen City* (深圳市科技創新委員會), Finance Commission of Shenzhen Municipality, SAT Shenzhen Municipal Office, Shenzhen Local Taxation Bureau

**BUSINESS**

<b>Year</b>	<b>Recognition or certification</b>	<b>Issuing authority/institution</b>
2015	ISO 9001:2008 Quality management for the processing of PCB (SMT, test and assembly), production of the wireless data termination products (GPRS/CDMA module)	Beijing Standard Certification Centre
2015	ISO14001:2004 Environmental management system for the processing of PCB (SMT, test and assembly), production of the wireless data termination products (GPRS/CDMA module)	Beijing Standard Certification Centre

**PROPERTY**

**Owned property in the PRC**

The table below sets forth the particulars of our owned property:-

<b>Location</b>	<b>Owner</b>	<b>GFA (sq.m)</b>	<b>Usage</b>
Unit 1004, Block 4, Shenye Yuyuan (深業御園), Shenzhen	Shenzhen Hengchang Sheng	135.88	Staff quarters
Unit 604, Block 5, Shenye Yuyuan (深業御園), Shenzhen	Shenzhen Hengchang Sheng	87.73	Staff quarters
Unit 704, Block 5, Shenye Yuyuan (深業御園), Shenzhen	Shenzhen Hengchang Sheng	87.73	Staff quarters
Unit 804, Block 5, Shenye Yuyuan (深業御園), Shenzhen	Shenzhen Hengchang Sheng	87.73	Staff quarters
Unit 904, Block 5, Shenye Yuyuan (深業御園), Shenzhen	Shenzhen Hengchang Sheng	87.73	Staff quarters
Unit 1004, Block 5, Shenye Yuyuan (深業御園), Shenzhen	Shenzhen Hengchang Sheng	87.73	Staff quarters
Unit 1104, Block 5, Shenye Yuyuan (深業御園), Shenzhen	Shenzhen Hengchang Sheng	87.73	Staff quarters
Unit 1204, Block 5, Shenye Yuyuan (深業御園), Shenzhen	Shenzhen Hengchang Sheng	87.73	Staff quarters
Unit 1304, Block 5, Shenye Yuyuan (深業御園), Shenzhen	Shenzhen Hengchang Sheng	87.73	Staff quarters
Unit 1504, Block 5, Shenye Yuyuan (深業御園), Shenzhen	Shenzhen Hengchang Sheng	87.73	Staff quarters

## BUSINESS

As at the Latest Practicable Date, our Group did not have any property interest (as defined by Rule 5.01(2) of the Listing Rules) with a carrying amount of 15% or more of our Group's total assets, and on this basis, our Group is not required by Rule 5.01A of the Listing Rules to include in this document any valuation report. Pursuant to section 6(2) of the Companies (Exemption of Companies and Prospectuses from Compliance with Provisions) Notice (Chapter 32L of the Laws of Hong Kong), this document is exempted from compliance with the requirement of section 342(1)(b) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance in relation paragraph 34(2) of the Third Schedule to the Companies (Winding Up and Miscellaneous Provisions) Ordinance, which requires a valuation report with respect to all of our Group's interests in land or buildings.

### Leased property in the PRC

As at the Latest Practicable Date, our Group leased five properties in the PRC, details of which are set out as follows:

Location	Landlord	GFA (sq.m.)	Our Group's use of the property	Monthly rental (RMB'000) (approximately)	Term
4th Floor, Office Building, Yingzhan Industrial Park Area A, Kengzi Office, Longtian Community, Pingshan New District, Shenzhen (坪山新區坑梓辦事處龍田社區瑩展工業園A區辦公樓4樓房屋)	Yingzhan Electronic Technology (Shenzhen) Limited* (瑩展電子科技(深圳)有限公司)	875	Office	10.5	From 1 April 2014 to 31 March 2021
5th to 7th Floor, Block C2, Yingzhan Industrial Park, Longtian Community, Kengzi Office, Pingshan New District, Shenzhen (坪山新區坑梓辦事處龍田社區瑩展工業園C2棟5-7樓房屋)	Yingzhan Electronic Technology (Shenzhen) Limited	4,953	Staff quarters	49.5	From 1 June 2014 to 31 March 2021
Units 101, 201 and 401, Block A West (now known as Block A2), Yingzhan Electronic Park Area Factory, Longtian Road Office, Pingshan District, Shenzhen (坪山區龍田街道辦事處瑩展電子園區廠房A西棟(現A2棟)101、201、401房屋)	Yingzhan Electronic Technology (Shenzhen) Limited	10,003.3	Shenzhen Production Plant	100.0	From 1 April 2017 to 31 March 2021

## BUSINESS

Location	Landlord	GFA (sq.m.)	Our Group's use of the property	Monthly rental (RMB'000) (approximately)	Term
3th Floor, Block A1, Yingzhan Industrial Park, Longtian Community, Kengzi Road, Pingzhan New District, Shenzhen (坪山新區坑梓街道龍田社區瑩展工業園第A1棟標準結構廠房第三層)	Shenzhen Hetianfu Property Investment Management Co., Ltd* (深圳市和天福物業投資管理有限公司)	1,680	Shenzhen Production Plant	32.0	From 1 June 2017 to 31 May 2018
Room 807-808, 8/F, Qianhai Zhuoyue Financial Center (Phase 1), Unit 2, Guiwan Area, Nanshan District, Shenzhen (南山區桂灣片區二單元前海卓越金融中心(一期)8號樓807, 808)	Shenzhen Qianhai Yufa Technology Company Limited* (深圳市前海宇發科技有限公司) (Note)	397.09	Office	59.6	From 1 February 2018 to 31 January 2021

*Note:* Shenzhen Qianhai Yufa Technology Company Limited is wholly-owned by Mr. Ma. As such, it is a connected person of our Company and the lease will constitute continuing connected transactions for our Company under Chapter 14A of the Listing Rules upon [REDACTED]. For details, please refer to the section headed "Connected Transactions" in this document.

## INSURANCE

Our Group currently maintains social security insurance for our employees, property insurance for our production facilities in the Shenzhen Production Plant and our vehicles. Our Group does not maintain product liability insurance arising from the manufacture and sale of our products. Our Directors confirm that our Group's insurance coverage is adequate for our operations and is in line with industry practice. As at the Latest Practicable Date, our Group had not made, nor been the subject of, any material insurance claim. There had been no product liability claims against us during the Track Record Period.

**BUSINESS**

**INTELLECTUAL PROPERTY**

Up to the Latest Practicable Date, we also obtained nine utility model patents (實用新型專利) and 16 software copyrights (軟件著作權) in the PRC, details of which are set forth in the table below:

Authorised patent and description	Registered owner	Registration number	Date of application	Date of authorisation	Patent duration (from the date of application)
PCB electronic pneumatic testing fixture (PCB電子氣動測試治具)	Shenzhen Hengchang Sheng	ZL201620365232.1	27 April 2016	21 September 2016	10 years
Test system for PCBA boards for portable electronic products (一種用於便攜式電子產品PCBA板的測試系統)	Shenzhen Hengchang Sheng	ZL201620389391.5	29 April 2016	12 October 2016	10 years
A sensor testing device (一種傳感器測試裝置)	Shenzhen Hengchang Sheng	ZL201620339634.4	20 April 2016	12 October 2016	10 years
A camera module auto-motion testing device (一種攝像頭模塊自動移動測試裝置)	Shenzhen Hengchang Sheng	ZL201620362362.X	26 April 2016	12 October 2016	10 years
Testing device for the bank card sensor (銀行卡感應器的測試裝置)	Shenzhen Hengchang Sheng	ZL201620356096.X	25 April 2016	12 October 2016	10 years
Printing machine vacuum base (一種印刷機真空底座)	Shenzhen Hengchang Sheng	ZL201620362508.0	26 April 2016	12 October 2016	10 years
A kind of constant temperature and humidity chamber with infrared temperature measurement (一種具有紅外測溫的恆溫恆濕試驗箱)	Shenzhen Hengchang Sheng	ZL201620356471.0	26 April 2016	12 October 2016	10 years
A mobile phone or tablet automated testing device (一種手機或平板自動檢測裝置)	Shenzhen Hengchang Sheng	ZL201620396246.X	3 May 2016	30 November 2016	10 years
A new type sweeping machine (一種新型掃地機)	Shenzhen Hengchang Sheng	ZL201720044146.5	13 January 2017	23 January 2018	10 years

Authorised Copyright	Registered owner	Registration number	Date of first publication	Expiry date
Hengchang Sheng mobile phone elderly auxiliary function system V1.0 (恒昌盛手機老人輔助功能系統軟件V1.0)	Shenzhen Hengchang Sheng	2015SR155331	26 September 2013	31 December 2063
Hengchang Sheng phone SMS backup a key recovery function system V1.0 (恒昌盛手機短信備份一鍵恢復功能系統軟件V1.0)	Shenzhen Hengchang Sheng	2015SR154964	17 April 2014	31 December 2064

**BUSINESS**

<b>Authorised Copyright</b>	<b>Registered owner</b>	<b>Registration number</b>	<b>Date of first publication</b>	<b>Expiry date</b>
Hengchang Sheng mobile phone test data timely upload data system V1.0 (恒昌盛手機測試數據適時上傳數據系統V1.0)	Shenzhen Hengchang Sheng	2015SR154842	25 February 2015	31 December 2065
Hengchang Sheng Mobile screen saver global time difference clock function automatically setting system V1.0 (恒昌盛手機屏保全球時差時鐘功能自動設置系統軟件V1.0)	Shenzhen Hengchang Sheng	2015SR155086	16 October 2014	31 December 2064
Hengchang Sheng mobile download security early warning system (恒昌盛手機下載安全預警系統V1.0)	Shenzhen Hengchang Sheng	2015SR154969	13 May 2015	31 December 2065
Hengchang Sheng Mobile phone voice dialing function system V1.0 (恒昌盛手機語音撥號功能系統軟件V1.0)	Shenzhen Hengchang Sheng	2015SR155295	21 August 2014	31 December 2064
Hengchang sheng mobile terminal two dimensional code scanning information upload management system V1.0 (恒昌盛移動終端二維碼掃描信息上傳管理系統V1.0)	Shenzhen Hengchang Sheng	2015SR154396	16 April 2015	31 December 2065
Hengchang Sheng mobile phone backup T card function software V1.0 (恒昌盛手機電話本備份T卡功能系統軟件V1.0)	Shenzhen Hengchang Sheng	2015SR155430	18 March 2015	31 December 2065
Hengchang Sheng multifunctional projector machine control system V1.0 (恒昌盛多功能投影儀機器管控系統 V1.0)	Shenzhen Hengchang Sheng	2017SR461586	14 June 2017	31 December 2067
Hengchang Sheng sweeper intelligent control system V1.0 (恒昌盛掃地機智能管控系統 V1.0)	Shenzhen Hengchang Sheng	2017SR468542	13 June 2017	31 December 2067



## BUSINESS

Authorised Copyright	Registered owner	Registration number	Date of first publication	Expiry date
Hengchang Sheng IOT smart home remote management and control system V1.0 (恆昌盛物聯網智能家居遠端管控系統 V1.0)	Shenzhen Hengchang Sheng	2017SR462744	13 June 2017	31 December 2067
Hengchang Sheng inverter power detection system V1.0 (恆昌盛逆變器電源檢測系統 V1.0)	Shenzhen Hengchang Sheng	2017SR460711	24 June 2017	31 December 2067
Hengchang Sheng ATM machine advertising automatic promotion platform V1.0 (恆昌盛ATM機廣告自動推廣平台 V1.0)	Shenzhen Hengchang Sheng	2017SR461565	20 June 2017	31 December 2067
Hengchang Sheng automatic mobile phone intelligent optimization system V1.0 (恆昌盛全自動手機智能優化系統 V1.0)	Shenzhen Hengchang Sheng	2017SR461556	14 June 2017	31 December 2067
Hengchang Sheng POS terminal control system V1.0 (恆昌盛POS機終端操控系統 V1.0)	Shenzhen Hengchang Sheng	2017SR461571	13 June 2017	31 December 2067
Hengchang Sheng wireless router connection configuration management system V1.0 (恆昌盛無線路由器連接配置管控系統 V1.0)	Shenzhen Hengchang Sheng	2017SR461576	13 June 2017	31 December 2067

For details of our Group's registered patents, copyrights and domain names, please refer to the paragraph headed "B. Information about the business — 2. Intellectual property rights of our Group" in Appendix IV to this document.

As at the Latest Practicable Date, our Group is the owner of the following domain names which are considered by our Directors, are material to the business of our Group:

Domain name	Registrant	Registration date	Expiry date
szeternity.com	Shenzhen Hengchang Sheng	12 August 2011	12 August 2020
szeternity.com.cn	Shenzhen Hengchang Sheng	3 June 2006	3 June 2020

Save as set above, as at the Latest Practicable Date, we did not have any material intellectual property rights (whether registered or pending registrations) that are significant to our business operations or financial positions. Our Directors confirmed that during the Track Record Period and up to the Latest Practicable Date, our Group had not engaged in or been threatened with any claim for infringement of any intellectual property rights which would have a material financial and operational impact on us, either as claimant or as respondent.

## BUSINESS

---

### LICENCES, APPROVALS AND PERMITS

Based on the advice of the PRC Legal Advisers, our Group has obtained all necessary licences, approvals and permits from the relevant governmental authorities for our Group's business operations in the PRC.

### RISK MANAGEMENT

Key risks relating to our business are set out in the section headed "Risk factors" in this document. The following sets out the key measures adopted by our Group under our risk management and internal control systems for managing the more particular operational and financial risks relating to our business operation:

- (i) *Customer concentration risk*: Please refer to the paragraphs headed "Customers — Customer concentration" and "Customer — Relationship with Customer B" in this section.
- (ii) *Risk of potential inaccurate costs estimation and cost inflation*: Please refer to the paragraph headed "Pricing strategy" in this section.
- (iii) *Risk relating to suppliers' and subcontractors' performance*: Please refer to the paragraph headed "Raw materials and suppliers — Selection of suppliers" and "Subcontracting — Selection of subcontractors" in this section.
- (iv) *Quality control system*: Please refer to the paragraph headed "Quality control" in this section.
- (v) *Risk of possible failure, damage or loss of machinery*: Please refer to the paragraph headed "Machinery and equipment — Repair and maintenance" in this section.
- (vi) *Health and safety system*: Please refer to the paragraph headed "Occupational health and safety" in this section.

### LEGAL AND COMPLIANCE

Set out below is a summary of incidents of our non-compliance with applicable regulations during the Track Record Period. Based on the advice of our PRC Legal Advisers, our Directors and the Sole Sponsor consider that none of the legal and compliance matters as mentioned below will have any material operational or financial impact on our operations. Having considered the facts and circumstances leading to the non-compliance incidents as disclosed in this section, our Directors' integrity, our Group's internal control measures to avoid recurrence of the non-compliance incident, and the preventive measures mentioned below, our Directors and the Sole Sponsor are of the view that we now have adequate and effective internal control procedures in place in accordance with the requirements under the Listing Rules, and the past non-compliance incidents will not affect the

**BUSINESS**

suitability of the Directors to act as directors of a listed issuer under Rules 3.08, 3.09 and 8.15 of the Listing Rules, and the suitability for [REDACTED] of our Company under Rule 8.04 of the Listing Rules. Save as disclosed below, we have obtained and currently maintain all necessary permits and licences that are material to our business operations, and, during the Track Record Period and up to the Latest Practicable Date, we have been in compliance with the applicable PRC laws and regulations relating to our business operations in all material respects.

Non-compliance incident and reason	Legal consequences, potential maximum penalties and other potential future impact on our operations and financial condition	Remedial actions and status as of the Latest Practicable Date	Enhanced internal control measures to prevent recurrence of non-compliance
<p>Pursuant to the Interim Provisions on Labour Dispatch* (勞務派遣暫行規定) which came into effect on 1 March 2014, "if the number of dispatched staff utilised by an employer exceeds 10% of the total number of its workers prior to the effective date of these Provisions, such employer shall develop a scheme for employment adjustments to reduce the proportion to the specified level within 2 years from the effective date of these Provisions."</p> <p>Shenzhen Hengchang Sheng engaged 617 dispatched staff and 294 dispatched staff as at 31 December 2015 and 2016, respectively, representing approximately 55.1% and 39.4% of our total number of workers at the corresponding date, which exceeded the regulatory threshold of 10%, and constituted a non-compliance incident of the Interim Provisions on Labour Dispatch* (勞務派遣暫行規定).</p>	<p>According to our PRC Legal Advisers, if the employers violate the Interim Provisions on Labour Dispatch* (勞務派遣暫行規定), the labour authorities shall order the employer to rectify such violation within a prescribed time limit, if the employers fail to do so at the prescribed time limit, may impose a fine ranging from RMB5,000 and RMB10,000 per person.</p> <p>Our Directors confirm that during the Track Record Period and up to the Latest Practicable Date, Shenzhen Hengchang Sheng has not received any notice of rectification from the labour administrative department.</p> <p>According to the letter issued by the Human Resources and Social Security Bureau of Shenzhen City (the "Bureau") on 15 January 2018, from 1 January 2012 to 31 December 2017, the Bureau had not imposed any administrative penalty on Shenzhen Hengchang Sheng in respect of labour dispatch.</p> <p>As of the Latest Practicable Date, Shenzhen Hengchang Sheng has not received any notice of rectification from the labour administrative departments, and it has obtained the certificate issued by relevant competent department in charge of labour affairs, proving that Shenzhen Hengchang Sheng has not been penalised for violation of labour laws and regulations during the Track Record Period and has completed the rectification for such non-compliance. Our PRC Legal Adviser opined that the likelihood that Shenzhen Hengchang Sheng will be exposed to the risk of being penalised by labour administrative department is minimal.</p> <p>Mr. Ma, our Controlling shareholder, has undertaken to indemnify the Group for any loss resulting from the dispatched staff non-compliance.</p>	<p>To rectify the situation, we signed employment contracts with the dispatched staff or engaged more subcontracting staff to replace the dispatched staff</p> <p>The number of dispatched staff engaged by Shenzhen Hengchang Sheng had been reduced to below the regulatory limit, respectively, as of 31 December 2017</p>	<p>Our Group has adopted internal policies to require our human resources department to calculate the ratio of dispatched staff to total number of workers on a monthly basis.</p> <p>Such ratio shall be reviewed by the head of the human resources department to ensure compliance with the relevant regulatory requirements in the PRC of dispatched staff.</p>

**BUSINESS**

Non-compliance incident and reason	Legal consequences, potential maximum penalties and other potential future impact on our operations and financial condition	Remedial actions and status as of the Latest Practicable Date	Enhanced internal control measures to prevent recurrence of non-compliance
<p><b>Housing provident fund contribution</b></p> <p>According to the Regulations on the Administration of Housing Provident Fund* (住房公積金管理條例) and other relevant regulations, we are required to provide our employees with housing funds and housing benefits.</p> <p>Shenzhen Hengchang Sheng did not set up a housing provident fund account until March 2017 and pay housing provident fund contributions for all employees in accordance with the applicable PRC laws and regulations until May 2017.</p> <p>During the Track Record Period, Shenzhen Hengchang Sheng did not make adequate contribution to housing provident fund for our employees.</p> <p>For each of the three years ended 31 December 2017, the amount of unpaid housing provident fund contributions for the employees was approximately RMB1.4 million, RMB1.3 million and RMB0.8 million, respectively.</p> <p>As confirmed by the Directors, Shenzhen Hengchang Sheng did not apply for the registration of housing provident fund or pay for the housing provident fund contributions for the other employees because such employees refused to make their own housing provident fund contributions, for which Shenzhen Hengchang Sheng would be required to make matching contributions.</p>	<p>According to Regulations on the Administration of Housing Provident Fund* (住房公積金管理條例), employers failing to (i) undertake the housing provident fund payment and deposit registration within 30 days after the establishment, or (ii) register housing provident fund accounts for the employees within 30 days after employment, may be ordered to make such registration within a prescribed time limit, where failing to do so at the expiration of that time limit, a fine ranging from RMB10,000 to RMB50,000 will be imposed; (iii) pay housing provident fund contributions in full or on time after employment may be ordered to make outstanding contributions in a prescribed time limit, where failing to do so at the expiration of that time limit, the relevant housing provident fund authority may apply to the PRC courts for enforcement of such payments.</p> <p>Therefore, in addition to the payment of outstanding contributions, we would be subject to a potential maximum fine of RMB50,000.</p> <p>Mr. Ma, our Controlling shareholder, has undertaken to indemnify the Group for any loss resulting from the housing provident fund non-compliance.</p>	<p>Shenzhen Hengchang Sheng has set up a housing provident fund account and has been paying contributions to the housing fund to our employees.</p> <p>We had also liaised with the relevant housing provident fund authorities in Shenzhen City, PRC. We received confirmation letters from the relevant housing provident fund authorities on 8 January 2018, confirming that we had never been penalised by them for any breach of the relevant PRC laws and regulations relating to the housing provident funds from February 2017 to December 2017.</p> <p>As advised by our PRC Legal Advisers, in light of the confirmation letters issued by the relevant and competent PRC government authorities, the likelihood that we will be penalised by the relevant housing provident fund authority is low.</p> <p>Notwithstanding the above, we have made provisions for the underpaid housing fund contributions in the sum of RMB2.1 million as at 31 December 2017.</p>	<p>Since March 2017, we have adopted the following measures:</p> <p>(i) adopting internal policies to ensure compliance with all regulatory requirements in the PRC, including the procedures to require our human resources department to review periodically the total number of employees who are required to make housing provident fund contributions, and our administration department to review and check against the total number of employees before making payment for the contribution.</p> <p>(ii) to the extent that their places of origin were located in the relevant urban areas and as far as practicable for these non-urban employees, all incoming employees are required to provide us with their respective housing provident fund registration information. These are mainly employees whose places of origin are located in the relevant urban areas.</p> <p>(iii) we will ensure that all our incoming employees whose respective places of origin are in the relevant urban areas would give consent to set up housing provident fund accounts before they join our Group. As for incoming employees whose respective places of origin are outside of the relevant urban areas, we will persuade them to set up housing provident fund accounts upon joining our Group. If such employees refuse to set up housing provident fund accounts, we will arrange for them to sign waiver letters immediately to confirm their voluntary renunciation of their rights to the housing provident funds when they sign their employment contracts. At the same time, our administration department will complete all formalities regarding cessation of payment of housing provident fund contribution for all outgoing staff insofar as they have paid housing provident fund contribution;</p>

**BUSINESS**

Non-compliance incident and reason	Legal consequences, potential maximum penalties and other potential future impact on our operations and financial condition	Remedial actions and status as of the Latest Practicable Date	Enhanced internal control measures to prevent recurrence of non-compliance
			<p>(iv) enhancing the awareness of our employees with respect to the importance of participation in housing provident fund schemes by regularly reminding them to make their part of contributions;</p> <p>(v) to the extent to those employees who are willing to pay housing provident fund contributions, conducting internal checking from time to time to ensure that we have paid housing provident fund contributions in accordance with the relevant PRC laws and regulations; and</p> <p>(vi) seeking advice from external legal advisers on the latest requirements of applicable laws and regulations of the PRC.</p>

**BUSINESS**

Non-compliance incident and reason	Legal consequences, potential maximum penalties and other potential future impact on our operations and financial condition	Remedial actions and status as of the Latest Practicable Date	Enhanced internal control measures to prevent recurrence of non-compliance
<p><b>Social insurance fund</b></p> <p>According to the Social Insurance Law of the PRC (中華人民共和國社會保險法) and other relevant regulations, we are required to provide our employees with welfare schemes covering social insurance.</p> <p>During the Track Record Period, Shenzhen Hengchang Sheng did not make adequate contribution to social insurance fund for our employees.</p> <p>During the relevant periods, contributions to the social insurance fund were handled by our human resources department. The staff at our human resources department was not familiar with the requirements of the social insurance fund. As such, the staff of our human resources department did not make adequate contribution to the social insurance fund for our employees.</p> <p>For each of the three years ended 31 December 2017, the amount of unpaid social insurance fund for the employees was approximately RMB1.4 million, RMB1.1 million and RMB2.0 million, respectively.</p>	<p>Under the relevant PRC laws and regulations, the relevant governmental authority may require the company to make the outstanding contribution with an additional late payment fee at a daily rate of 0.05% of the outstanding contribution from the due date within a given period and, if the company fails to do so, may impose a fine on the company ranging from one to three times of the total amount of the outstanding contribution. According to the aforementioned provisions, we may be required by the relevant governmental authority to make the outstanding contribution within a given period and an additional late payment fee at a daily of 0.05% of the outstanding contribution from the due date incurred and accrued.</p>	<p>We obtained a confirmation letter dated 5 January 2018 from the Social Insurance Fund Management Bureau of Shenzhen City* (深圳市社會保險基金管理局), the competent governmental authorities, confirming that, from 1 January 2012 to 31 December 2017 Shenzhen Hengchang Sheng had not been subject to any penalty, with respect to our payment of social security insurance contribution.</p> <p>Our PRC Legal Advisers are of the view that, since we received the above confirmation letter from the competent governmental authority, the likelihood that the relevant authority would impose fines or penalties on us in this regard should be remote.</p> <p>Our Directors believe that, in view that the likelihood of being fined or penalised is low, no provisions for the fine or penalty to the social insurance fund are required.</p> <p>We have commenced making payments of social insurance fund since April 2017.</p> <p>Up to the Latest Practicable Date, we have not received any request for making up the outstanding contribution nor have we been imposed any punishment as a result of such non-compliance.</p> <p>Our Controlling Shareholders have agreed to indemnify us for all claims, costs, expenses and losses incurred by us if we are asked to make up for the difference in payment of social insurance contribution.</p> <p>Notwithstanding the above, we have made provisions for the shortfall of the social insurance fund contributions in the sum of RMB3.1 million as at 31 December 2017.</p>	<p>According to the relevant PRC laws and regulations, employees are mandatorily required to participate in the social insurance fund. We have established internal control procedures to prevent possible deviation in calculation of our social insurance contribution, including: (i) human resources manager is responsible to seek advice from our legal advisers on yearly basis to ensure the accuracy of the calculation of social insurance fund contribution, (ii) an experienced human resources staff has been designated to handle matters in relation to social insurance fund, (iii) the calculation of social insurance contribution will be reviewed by the human resources manager on monthly basis, (iv) manager of general affairs office will review the compliance of social insurance fund contribution on yearly basis and (v) we will retain PRC legal advisers to advise on and to provide training on the relevant PRC laws and regulations in relation to the social insurance fund to human resource department on yearly basis so as to keep abreast of these areas.</p>

## **BUSINESS**

---

### **LITIGATIONS**

As at the Latest Practicable Date, Shenzhen Hengchang Sheng is involved in an ongoing civil litigation in relation to a fatal traffic accident happened in August 2017. The plaintiffs therein a claim in November 2017 at the Shenzhen Longgang District People's Court (深圳市龍崗區人民法院) against, among others, Shenzhen Hengchang Sheng for an amount of approximately RMB762,420 and litigation costs on the basis that our employee, being the driver at the material time, was liable for the accident. The hearing is fixed to be held on 6 March 2018. As confirmed by the insurance loss adjuster, the traffic accident fell within the coverage of the relevant insurance policies maintained by Shenzhen Hengchang Sheng. As such, no provision has been made to cover our potential liability under the claim. Our Directors believe that such legal proceeding would not have a material adverse effect on our financial position or results of operations.

Save as otherwise disclosed in this document, during the Track Record Period and as at the Latest Practicable Date, no member of our Group was engaged in any litigation, claim or arbitration of material importance and no litigation, claim or arbitration is known to the Directors to be pending or threatened against any member of our Group which would have a material adverse effect on our financial position or results of operations.

### **Indemnity given by our Controlling Shareholders**

Our Controlling Shareholders have entered into the Deed of Indemnity whereby our Controlling Shareholders have agreed to indemnify our Group, subject to the terms and conditions of the Deed of Indemnity, in respect of, among others, any claim to which our Group may be subject to in respect of any disputes, arbitrations or legal proceedings occurring on or before the [REDACTED]. Further details of the Deed of Indemnity are set out in the paragraph headed "D. Other information — 2. Tax and other indemnities" in Appendix IV to this document.

### **INTERNAL CONTROL**

To streamline the current internal control procedure, we engaged the Internal Control Consultant in February 2017 to review the adequacy and effectiveness of our internal control procedures, systems and controls. The Internal Control Consultant is a professional firm specialising in providing corporate governance, internal audit and internal control review services to new listing applicants and listed companies.

The objective of the internal control review is to assess and identify significant weakness in relevant procedures, systems and controls as established by our Group. A detail evaluation was done by our Internal Control Consultant. Through an initial review during March, April, June and November 2017, our Internal Control Consultant identified some weaknesses and deficiencies in our internal control system and recommended certain measures on the area including staff management, budget and risk management, information and communication system and internal audit function to improve our internal control system.

## **BUSINESS**

---

The Internal Control Consultant has identified the following key findings and our Group has taken the following remedial actions based upon the Internal Control Consultant's recommendations:

### **KEY FINDINGS**

Our Group had no compliance manual, which includes a compliance system in relation to the Listing Rules and laws and regulations on anti-bribery, antidiscrimination and privacy of personal information.

Our Group did not require all applicants to submit academic certificates or work experience reference documents to support their job application.

When recruiting staff of managerial grades, our Group did not require applicants to disclose their potential conflict with our Group.

Our Group did not prepare any profit forecast.

Our Group did not have any formal procedure for reporting connected transactions and related party transaction.

### **REMEDIAL ACTION TAKEN**

Our Group adopted a compliance manual with compliance system in relation to the Listing Rules, and laws and regulations on anti-bribery, antidiscrimination and privacy of personal information.

Our Group required job applicants to provide supporting documents in relation to their academic qualifications and working experience since May 2017.

Our Group has requested job applicants to disclose his/her potential conflict of interest with our Group when recruiting staff of managerial grade or above since February 2017.

Our financial controller has prepared the profit forecast memorandum and cash flow forecast memorandum.

Our Group has adopted a compliance manual with a compliance system in relation to helping our Group in identifying connected transaction and related party transactions.

### **Internal control measures to improve corporate governance**

Our Directors recognise the importance of up-keeping adequate internal control and risk management systems. In order to continuously improve our Group's corporate governance, our Group has implemented and will implement the following measures:

- Our Group will engage a PRC legal adviser to provide legal services to it in relation to future compliance with the PRC laws and regulations in all respects;
- Our Group has arranged for our Directors and senior management to attend a training program on the relevant applicable laws and regulations, including the Listing Rules, provided by our Company's Hong Kong legal advisers prior to the [REDACTED]. Our Group will continue to arrange various training programs on an annual basis to be provided by its legal advisers in Hong Kong and the PRC and/or any appropriate accredited institution to update our Directors, senior management and relevant employees on the relevant laws and regulations. In addition, specific training programme(s) in relation to updates on relevant applicable laws and regulations will also be held when necessary;



## **BUSINESS**

---

- Our Company has appointed Dakin Capital Limited as our compliance adviser to advise on regulatory compliance with the Listing Rules;
- When necessary, we will engage external professional, including auditors, internal control consultant, and external legal advisers to render professional advice as to compliance with statutory and regulatory requirements, as applicable to our Group from time to time. Our Group intended to retain PricewaterhouseCooper as the auditor for the consolidated financial statements of the Group after [REDACTED];
- Our Group has provided trainings for our employees on compliance matters in order to develop a corporate culture and to enhance their compliance perception and responsibility and to enhance their knowledge to manage our operation risks. For example, road safety trainings (involving traffic accidents' cause analysis and traffic regulations update) has been provided to our staff of the logistic department, and our Directors take the review that such trainings together with other internal control measures (such as our vehicle maintenance policy) are adequate to ensure our compliance with internal motor vehicle management policy and relevant driving behavior regulation in the PRC. Our Group plans to provide training to employees of managerial level on an annual basis and ad hoc training to all relevant employees when our Group finds it necessary; and
- On [●], we established an Audit Committee which will implement formal and transparent arrangements to apply financial reporting and internal control principles in accounting and financial matters to ensure compliance with the Listing Rules and all relevant laws and regulations, including timely preparation and laying of accounts. It will also periodically review our compliance status with the Hong Kong laws after the [REDACTED]. The Audit Committee will exercise its oversight by:
  - (i) reviewing our internal control and legal compliance;
  - (ii) discussing the internal control systems with the management of our Group to ensure that the management has performed its duty to have an effective internal control system; and
  - (iii) considering the major investigation findings on internal control matters as delegated by the Board or on its own initiative and the management's response to these findings.

Based on the above, our Directors are of the view that the above internal control measures could adequately and effectively ensure that our Group has implemented a proper internal control system and maintained good corporate governance practices.