THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

If you are in any doubt about this circular or as to the action to be taken, you should consult your stockbroker, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all your shares in China Literature Limited, you should at once hand this circular to the purchaser or transferee or to the bank, stockbroker or other agent through whom the sale was effected for transmission to the purchaser or transferee.

This circular appears for information purposes only and does not constitute an invitation or offer to acquire, purchase or subscribe for the securities.

CHINA LITERATURE LIMITED
阅文集团

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 772)

(1) MAJOR AND CONNECTED TRANSACTION
(2) CONSIDERATION ISSUE UNDER SPECIFIC MANDATE
AND
NOTICE OF EXTRAORDINARY GENERAL MEETING

Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders

SOMERLEY CAPITAL LIMITED

A notice convening the Extraordinary General Meeting of China Literature Limited to be held at Niccolo Room, Level 25, The Murray, Hong Kong, a Niccolo Hotel, 22 Cotton Tree Drive, Central, Hong Kong at 3:00 p.m. on Wednesday, December 9, 2020 is set out on pages EGM-1 to EGM-3 of this circular. A form of proxy for use at the Extraordinary General Meeting is also enclosed. Such form of proxy is also published on the websites of The Stock Exchange of Hong Kong Limited (www.hkexnews.hk) and the Company (http://ir.yuewen.com). Whether or not you are able to attend the Extraordinary General Meeting, you are requested to complete the form of proxy in accordance with the instructions printed thereon and return it to the Hong Kong share registrar of the Company, Computershare Hong Kong Investor Services Limited, at 17M Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong as soon as possible but in any event not less than 48 hours before the time appointed for the holding of the Extraordinary General Meeting or any adjournment thereof. Completion and return of the form of proxy will not preclude shareholders from attending and voting in person at the Extraordinary General Meeting (or any adjournment thereof) if they so wish.

PRECAUTIONARY MEASURES FOR THE EXTRAORDINARY GENERAL MEETING

In order to prevent the spread of COVID-19 pandemic and to safeguard the health and safety of Shareholders, the Company will implement the following precautionary measures at the EGM:

- compulsory body temperature checks
- compulsory wearing of surgical face masks
- no provision of refreshments and corporate gifts

Any person who does not comply with the precautionary measures may, to the extent permitted under applicable laws, be denied entry into the venue of the EGM. All attendees are requested to wear surgical face masks at all times at the venue of the EGM. **Shareholders are reminded to exercise their voting rights at the EGM by appointing the chairman of the EGM as proxy to attend and vote on the relevant resolutions at the EGM instead of attending the EGM in person.**

November 10, 2020

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In view of the ongoing COVID-19 pandemic and recent requirements for prevention and control of its spread, the Company will implement the following precautionary measures at the EGM to protect attending Shareholders, staff and other stakeholders from the risk of infection:

(i) compulsory body temperature checks will be conducted on every attending Shareholder, proxy and other attendees at the entrance of the EGM venue. Any person found to be suffering from a fever or otherwise unwell will be denied entry into the EGM venue or be required to leave the EGM venue;

(ii) all attendees are requested to wear surgical face masks at the EGM venue at all times, and to maintain a safe distance with other attendees; and

(iii) no refreshments and corporate gifts will be provided.

To the extent permitted under applicable laws, the Company reserves the right to deny entry into the EGM venue or require any person to leave the EGM venue in order to ensure the safety of the attendees at the EGM.

In the interest of all stakeholders' health and safety and in response to the recent guidelines on prevention and control of COVID-19 pandemic, Shareholders are reminded that **physical attendance in person at the EGM is not necessary for the purpose of exercising voting rights. As an alternative, by completing form of proxy in accordance with the instructions printed thereon, Shareholders may appoint the chairman of the EGM as proxy to attend and vote on the relevant resolutions at the EGM instead of attending the EGM in person.**

In this circular, unless the context otherwise requires, the following expressions shall have the following meanings:

"Adjustment Amount"	has the meaning as defined in the paragraph headed "(ii) Additional condition and adjustment of the New Earn Out Consideration"
"Amendment Deeds of Lock-up Undertaking"	the amendment deeds to be executed by each of the Holders in favour of the Company in relation to the 2018 Lock-up Undertakings
"Amendment Deeds of Non-Competition"	the amendment deeds to be executed by the Founder, Ms. Qu and each key employee of New Classics Media and its subsidiaries in favour of the Company in relation to the 2018 Deeds of Non-Competition
"associate(s)"	has the meaning ascribed to it under the Listing Rules
"Board"	the board of Directors
"Business Day(s)"	the days on which commercial banks are open for business in Hong Kong, the Cayman Islands and PRC (excluding Saturdays, Sundays, public holidays and any weekday on which Typhoon Signal No. 8 or higher is hoisted or a black rain storm warning is given in Hong Kong at any time during 9:00 a.m. to 5:00 p.m.)
"Company"	China Literature Limited (阅文集团), an exempted company incorporated in the Cayman Islands with limited liability on April 22, 2013, whose shares are listed on the main board of the Stock Exchange with stock code 772
"Consideration Shares"	an aggregate of 153,936,541 new Shares issued and/or to be issued by the Company pursuant to the 2018 NCM Share Purchase Agreement, where a maximum of 15,119,815 new Shares remains to be outstanding for issue by the Company as New Earn Out Shares to the Management Vendors to satisfy part of the New Earn Out Consideration
"Director(s)"	the director(s) of the Company

"Executive SPV"	X-Poem Limited, a company incorporated with limited liability in the British Virgin Islands, whose registered office is at Craigmuir Chambers, Road Town, Tortola, VG 1110, British Virgin Islands and is owned as to 43.63% by the Founder
"Extraordinary General Meeting" or "EGM"	the extraordinary general meeting of the Company to be held at Niccolo Room, Level 25, The Murray, Hong Kong, a Niccolo Hotel, 22 Cotton Tree Drive, Central, Hong Kong at 3:00 p.m. on Wednesday, December 9, 2020, or any adjournment thereof and notice of which is set out on pages EGM-1 to EGM-3 of this circular
"Founder"	Mr. Huayi Cao, a non-executive Director and a founder of New Classics Media
"Founder Non-Compete and Leaver Amount"	has the meaning as defined in the paragraph headed "(iii) Founder Non-Compete and Leaver Amount"
"Founder SPV"	C-Hero Limited, a company incorporated with limited liability in the British Virgin Islands, the entire share capital of which is held by the Founder
"Group"	the Company and its subsidiaries and consolidated affiliated entities from time to time
"HK$"	Hong Kong dollars, the lawful currency of Hong Kong
"Holders"	the parties to the Revised Deed of Lock-up Undertaking, including the Founder, the Founder SPV, Ms. Qu, the Qu SPV, the Executive SPV, and each key employee of New Classics Media and its subsidiaries (being individual shareholders of the Executive SPV)
"Hong Kong"	the Hong Kong Special Administrative Region of the People's Republic of China
"Independent Board Committee"	the independent committee of the Board, comprising Ms. Yu Chor Woon Carol, Ms. Leung Sau Ting Miranda and Mr. Liu Junmin, being all the independent non-executive Directors, established for the purpose of, among other things, advising the Independent Shareholders in respect of the Transaction Documents

"Independent Financial Adviser" or "Somerley"	Somerley Capital Limited, a corporation licensed to carry on type 1 (dealing in securities) and type 6 (advising on corporate finance) regulated activities as defined under the SFO, which has been appointed as the independent financial adviser to the Independent Board Committee and the Independent Shareholders in respect of the Transaction Documents and the transactions contemplated thereunder
"Independent Shareholders"	the Shareholders other than the Management Vendors and its associates
"Issue Price"	the price at which the Consideration Shares issued, being HK$80 per Share
"Last Trading Day"	August 27, 2020
"Latest Practicable Date"	November 5, 2020, being the latest practicable date prior to the printing of this circular for the purpose of ascertaining certain information contained in this circular
"Listing Committee"	the Listing Committee of the Stock Exchange
"Listing Rules"	the Rules Governing the Listing of Securities on the Stock Exchange, as amended, supplemented or otherwise modified from time to time
"Management Member(s)"	the Founder, Ms. Qu and the individual shareholders of the Executive SPV
"Management Vendor(s)"	the Founder SPV, the Qu SPV and the Executive SPV
"Ms. Qu"	Yaqian Qu, a citizen and resident of the PRC
"Net Profit"	for any fiscal year of New Classics Media, the consolidated profit after tax (excluding certain items as set out in the 2018 NCM Share Purchase Agreement) of New Classics Media
"New Classics Media" or "NCM"	New Classics Media Holdings Limited (previously known as "Qiandao Lake Holdings Limited"), a company established in Cayman Islands on May 18, 2018 and whose subsidiaries are principally engaged in production and distribution of television series
"New Earn Out Consideration"	the relevant consideration payable by the Company to a Management Vendor under the New Earn Out Mechanism under the Revised NCM Share Purchase Agreement

"New Earn Out Mechanism"	an adjustment mechanism if the Net Profit of New Classics Media in respect of any New Earn Out Year does not meet a certain benchmarked level as set out in the Revised NCM Share Purchase Agreement
"New Earn Out Year(s)"	the fiscal year(s) of New Classics Media ending December 31, 2020, 2021, 2022, 2023 and 2024
"Original Earn Out Consideration"	the relevant consideration payable by the Company to a Management Vendor under the Original Earn Out Mechanism under the 2018 NCM Share Purchase Agreement
"Original Earn Out Mechanism"	the earn out mechanism as stipulated in the 2018 NCM Share Purchase Agreement, under which the total consideration payable by the Company to each of the Management Vendors was subject to a downward-only adjustment mechanism if the Net Profits of New Classics Media fall below a certain benchmarked level for the three years ending December 31, 2020
"PRC" or "China"	the People's Republic of China, but for the purposes of this circular only, excluding Hong Kong, Macau Special Administrative Region and Taiwan
"Qu SPV"	Ding Dong-D Limited, a company incorporated with limited liability in the British Virgin Islands, the entire share capital of which is held by Ms. Qu
"Relevant Shares"	the existing Shares held by the Holders or the future Shares to be issued to the Holders as part of the Consideration Shares and any other Shares attributable to or derived from such existing Shares or future Shares (as the case may be) as a result of a bonus issue, scrip dividend, consolidation or subdivision by the Company
"Revised Deed of Non-Competition"	the 2018 Deed of Non-Competition to be amended, supplemented and revised by the Amendment Deeds of Non-Competition
"Revised Lock-up Undertaking"	the 2018 Lock-up Undertakings to be amended, supplemented and revised by the Amendment Deeds of Lock-up Undertaking
"Revised NCM Share Purchase Agreement"	the 2018 NCM Share Purchase Agreement as amended, supplemented and revised by the Supplemental SPA Deed

"RMB"	Renminbi, the lawful currency of the PRC
"SFO"	Securities and Futures Ordinance, Chapter 571 of the Laws of Hong Kong, as amended from time to time
"Share(s)"	ordinary share(s) in the share capital of the Company with a par value of US$0.0001 each
"Shareholder(s)"	the holder(s) of the Share(s)
"Specific Mandate"	the specific mandate proposed to be sought from the Independent Shareholders at the Extraordinary General Meeting for the allotment and issue of the 15,119,815 Consideration Shares under the New Earn Out Mechanism
"Stock Exchange"	The Stock Exchange of Hong Kong Limited
"subsidiary(ies)"	has the meaning ascribed to it under the Listing Rules
"Supplemental SPA Deed"	the supplemental deed entered into between the Company, the Founder, the Founder SPV, Ms. Qu, the Qu SPV and the Executive SPV dated August 27, 2020 in relation to, among others, the amendment of the 2018 NCM Share Purchase Agreement
"Transaction Documents"	the Supplemental SPA Deed, the Amendment Deeds of Lock-up Undertaking and the Amendment Deeds of Non-Competition
"2018 Deed(s) of Non-Competition"	the deed of non-competition provided by each of the Founder, Ms. Qu and each key employee of the Group on October 31, 2018 in favour of the Company
"2018 Lock-up Undertaking(s)"	the deed of lock-up undertaking provided by each of the Management Vendors and each of the Management Members on October 31, 2018 in favour of the Company
"2018 NCM Share Purchase Agreement"	the share purchase agreement entered into, among others, the Company, the Founder, the Founder SPV, Ms. Qu, the Qu SPV and the Executive SPV dated August 13, 2018 in relation to the acquisition of the entire equity interest of New Classics Media
"%"	per cent

阅文集团

CHINA LITERATURE LIMITED

阅文集团

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 772)

Executive Directors:
Mr. Cheng Wu
Mr. Hou Xiaonan

Non-Executive Directors:
Mr. James Gordon Mitchell
Mr. Wu Wenhui
Mr. Cao Huayi
Mr. Cheng Yun Ming Matthew

Independent Non-Executive Directors:
Ms. Yu Chor Woon Carol
Ms. Leung Sau Ting Miranda
Mr. Liu Junmin

Registered office:
The offices of Maples Corporate Services Limited
PO Box 309, Ugland House
Grand Cayman KY1-1104
Cayman Islands

Head office and principal place of business in China:
Block 6, No. 690 Bi Bo Road
Pudong XinQu
Shanghai
People's Republic of China

Principal place of business in Hong Kong:
Room 1503-04, ICBC Tower
3 Garden Road
Central
Hong Kong

November 10, 2020

To the Shareholders

Dear Sir or Madam

MAJOR AND CONNECTED TRANSACTION
CONSIDERATION ISSUE UNDER SPECIFIC MANDATE
AND
NOTICE OF EXTRAORDINARY GENERAL MEETING

A. INTRODUCTION

The purpose of this circular is to give you the notice of Extraordinary General Meeting and the following proposals to be put forward at the Extraordinary General Meeting: (a) approving the Transaction Documents and the transaction contemplated thereunder and (b) approving the issue of the Consideration Shares under the New Earn Out Mechanism, and to provide you with, among other things, (a) details of the Transaction Documents; (b) the letter from the Independent Board Committee; and (c) the letter from the Independent Financial Adviser.

Reference is made to:

(i) the announcement of the Company dated August 27, 2020 in respect of the entering into of the Supplemental SPA Deed in relation to, among others, the amendment of the 2018 NCM Share Purchase Agreement;

(ii) the announcements of the Company dated August 13, 2018, October 19, 2018 and October 31, 2018 and the circular of the Company dated September 28, 2018 in respect of, among others, the acquisition of the entire equity interest of New Classics Media, which was completed on October 31, 2018; and

(iii) the announcements of the Company dated March 18, 2019 and March 17, 2020 in respect of, among others, the adjustment results under the Original Earn Out Mechanism for the year ended December 31, 2018 and 2019.

B. 2018 NCM SHARE PURCHASE AGREEMENT

Under the 2018 NCM Share Purchase Agreement, the maximum consideration payable to the Management Vendors is approximately RMB10,210.1 million (50% by cash and 50% by Consideration Shares), subject to the adjustment under the Original Earn Out Mechanism). The table below sets out:

(i) the maximum amount and the mode of settlement of Consideration payable under the 2018 NCM Share Purchase Agreement;

(ii) the amount of Consideration paid (A) at completion of the 2018 NCM Share Purchase Agreement, (B) for the year ended 31 December 2018 and (C) for the year ended 31 December 2019 under the 2018 NCM Share Purchase Agreement; and

(iii) the maximum amount of Consideration payable for the year ending 31 December 2020 under the 2018 NCM Share Purchase Agreement.

Management Vendors	Total consideration payable *(RMB million) (approximate)*	Method of payment *(approximate)*	Initial consideration paid upon completion *(approximate)*	Original Earn Out Consideration paid for 2018[(1)] *(approximate)*	Original Earn Out Consideration paid for 2019[(2)] *(approximate)*	Total consideration paid *(approximate)*	Original Earn Out Consideration payable for 2020 *(approximate)*
Founder SPV	6,200.6	Cash of RMB3,100.3 million	RMB930.1 million	RMB721.3 million	RMB620.1 million	RMB2,271.5 million	RMB620.1 million
		45.9 million Shares	23.0 million Shares	Nil	2.1 million Shares	25.0 million Shares	9.2 million Shares
Qu SPV	2,787.0	Cash of RMB1,393.5 million	RMB418.1 million	RMB324.2 million	RMB278.7 million	RMB1,021.0 million	RMB278.7 million
		20.6 million Shares	10.3 million Shares	Nil	0.9 million Shares	11.3 million Shares	4.1 million Shares
Executive SPV	1,222.4	Cash of RMB611.2 million	RMB183.4 million	RMB142.2 million	RMB122.2 million	RMB447.8 million	RMB122.2 million
		9.1 million Shares	4.5 million Shares	Nil	0.4 million Shares	4.9 million Shares	1.8 million Shares
Total	**10,210.1**	**Cash of RMB5,105.5 million**	**RMB1,531.5 million**	**RMB1,187.8 million**	**RMB1,021.0 million**	**RMB3,740.3 million**	**RMB1,021.0 million**
		75.6 million Shares	**37.8 million Shares (equivalent to RMB1,403.0 million)[(3)]**	**Nil**	**3.4 million Shares (equivalent to RMB96.3 million)[(4)]**	**41.2 million Shares (equivalent to RMB1,499.3 million)**	**15.1 million Shares**

Notes:

(1) The total Original Earn Out Consideration payable for the year ended December 31, 2018 to the Founder SPV, the Qu SPV and the Executive SPV was reduced by approximately RMB854.2 million (comprising approximately RMB343.7 million cash and approximately 7.6 million shares), as the actual Net Profit in 2018 (being RMB324.3 million) fell below the corresponding reference Net Profit benchmark under the Original Earn Out Mechanism.

(2) The total Original Earn Out Consideration payable for the year ended December 31, 2019 to the Founder SPV, the Qu SPV and the Executive SPV was reduced by approximately RMB788.4 million (comprising approximately 11.7 million shares), as the actual Net Profit in 2019 (being RMB537.8 million) fell below the corresponding reference Net Profit benchmark under the Original Earn Out Mechanism.

(3) Based on the closing price of HK$41.20 per Share as quoted on the Stock Exchange on October 30, 2018, being the business day immediately prior to the issue of the Consideration Shares of completion.

(4) Based on the closing price of HK$31.05 per Share as quoted on the Stock Exchange on April 6, 2020, being the business day immediately prior to the issue of the Consideration Shares for setting the Original Earn Out Consideration for the year ended December 31, 2019.

(5) The above figures are rounded to the nearest 0.1 million and may not add up due to rounding.

C. SUPPLEMENTAL SPA DEED

The Board announces that, on August 27, 2020, the Company entered into the Supplemental SPA Deed with the Founder, the Founder SPV, Ms. Qu, the Qu SPV and the Executive SPV, pursuant to which the parties agreed to amend the terms of the 2018 NCM Share Purchase Agreement, under which (i) the Original Earn Out Mechanism and the Original Earn Out Consideration applicable to the year ending December 31, 2020 as set out in the 2018 NCM Share Purchase Agreement are revised; (ii) parties to the 2018 Lock-up Undertakings will enter into the Amendment Deeds of Lock-up Undertaking to revise the terms thereunder; and (iii) parties to the 2018 Deeds of Non-Competition will enter into the Amendment Deeds of Non-Competition to revise the terms thereunder.

Major terms of the amendments are set out as follows:

(i) Amendment of the Original Earn Out Mechanism

The Original Earn Out Mechanism under the 2018 NCM Share Purchase Agreement for the year ending December 31, 2020 has been revised, under which the Original Earn Out Consideration payable by the Company for the year ending December 31, 2020 under the Original Earn Out Mechanism (being 15,119,815 Consideration Shares and approximately RMB1,021.0 million in cash) has been apportioned into five tranches and allocated to cover the five financial years of New Classics Media ending December 31, 2024.

(1) Original Earn Out Mechanism

Under the Original Earn Out Mechanism, the amount of Original Earn Out Consideration payable by the Company for the year ending December 31, 2020 is subject to a downward-only adjustment mechanism if the Net Profit of New Classics Media for the year ending December 31, 2020 falls below RMB900 million.

(a) if the Net Profit of New Classics Media for the year ending December 31, 2020 is equal to or more than RMB900 million

If the actual Net Profit of New Classics Media for the year ending December 31, 2020 is not less than RMB900 million, the Original Earn Out Consideration payable by the Company to the relevant Management Vendor for that earn out year shall be the instalment amount for that earn out year. The instalment amount for December 31, 2020 is 20% of the total consideration, of which half will be settled in cash (being approximately RMB1,021.0 million in total to all Management Vendors) and half in Consideration Shares (being 15,119,815 Consideration Shares in total to all Management Vendors).

(b) if the Net Profit of New Classics Media for the year ending December 31, 2020 is less than RMB900 million

If the actual Net Profit of New Classics Media for the year ending December 31, 2020 is less than RMB900 million, the Original Earn Out Consideration payable by the Company to the relevant Management Vendor for that earn out year shall be the instalment amount for that earn out year (as set out in paragraph (a) above) as reduced by such a deduction amount as determined in accordance with the formula below:

$$\text{Deduction amount} = \frac{\text{Reference Net Profit benchmark for the year ending December 31, 2020 (RMB900 million)} - \text{actual Net Profit of NCM for the year}}{\text{Total reference Net Profit benchmark (RMB2,100 million)}} \times \text{Total consideration payable to the relevant Management Vendor (as if there is no adjustment under the 2018 NCM Share Purchase Agreement)}$$

* If the actual Net Profit of New Classics Media in any relevant earn out year is a negative figure, for the purpose of the formula as set out above, the amount of Net Profit of New Classics Media for that relevant earn out year shall be regarded as zero.

The deduction amount shall be applied towards the deduction of Original Earn Out Consideration for that earn out year in the manner following the order of priority below:

(a) first, the portion of Original Earn Out Consideration being settled by issue of Consideration Shares; and

(b) thereafter, the portion of Original Earn Out Consideration being settled by cash.

For the avoidance of doubt, if the instalment amount is less than the deduction amount (if any) for an earn out year, the amount of Original Earn Out Consideration payable by the Company to that Management Vendor in that earn out year shall be zero, and such shortfall will be subject to a roll-over mechanism, overall final adjustment and return of consideration as set out in the paragraph headed "(iv) Removal of Roll-over Mechanism, Overall Final Adjustment and Return of Consideration" below.

(2) New Earn Out Mechanism

Under the New Earn Out Mechanism, the amount of New Earn Out Consideration payable by the Company in a particular New Earn Out Year will depend on whether the Net Profit for the corresponding New Earn Out Year is less than, or equal to or more than the Reference Minimum Net Profit for the relevant New Earn Out Year as set out below:

New Earn Out Year ending	**Reference Minimum Net Profit** *(RMB in millions)*
December 31, 2020	200
December 31, 2021	300
December 31, 2022	300
December 31, 2023	300
December 31, 2024	300

(a) if the Net Profit for the relevant New Earn Out Year is less than the Reference Minimum Net Profit

No New Earn Out Consideration will be payable by the Company for the relevant New Earn Out Year.

(b) if the Net Profit for the relevant New Earn Out Year is equal to or more than the Reference Minimum Net Profit

The Company shall settle the New Earn Out Consideration in cash ("**Cash Amount**") and by issuing new Consideration Shares ("**New Earn Out Shares**") in accordance with the following formula:

(1) the Cash Amount:

$$\textit{Cash Amount} = \frac{\textit{Net Profit for that New Earn Out Year}}{\textit{Reference Maximum Net Profit for that New Earn Out Year}} \times \textit{Maximum Cash Amount} - \textit{Adjustment Amount (cash portion) for that New Earn Out Year}$$

(2) the New Earn Out Shares:

$$\textit{New Earn Out Shares} = \frac{\textit{Net Profit for that New Earn Out Year}}{\textit{Reference Maximum Net Profit for that New Earn Out Year}} \times \textit{Maximum New Earn Out Shares} - \frac{\textit{Adjustment Amount (Share portion) for that New Earn Out Year}}{\textit{Issue Price}}$$

where,

(w) the Reference Maximum Net Profit for the New Earn Out Years are set out as follows:

New Earn Out Year ending	Reference Maximum Net Profit *(RMB in millions)*
December 31, 2020	400
December 31, 2021	500
December 31, 2022	500
December 31, 2023	500
December 31, 2024	500

(x) the Maximum Cash Amount and the Maximum New Earn Out Shares applicable to each of the Founder SPV, the Qu SPV and the Executive SPV for each New Earn Out Year shall be:

	Founder SPV	Qu SPV	Executive SPV
Maximum Cash Amount	RMB124,012,531.8	RMB55,740,417.2	RMB24,448,155
Maximum New Earn Out Shares	1,836,470 Consideration Shares	825,446 Consideration Shares	362,047 Consideration Shares

The Maximum Cash Amount and the Maximum New Earn Out Shares for each of the five New Earn Out Years was determined by apportioning the maximum Original Earn Out Consideration payable by the Company for the year ending December 31, 2020 evenly over five years. For the avoidance of doubt, the amount of the Maximum New Earn Out Shares was rounded down to the nearest whole number and the fractional amounts of the Consideration Shares (being 2 Shares in total) will be disregarded and not be issued to the relevant Management Vendor.

(y) if the Net Profit for a New Earn Out Year is greater than the Reference Maximum Net Profit for that New Earn Out Year, the Net Profit for that New Earn Out Year will be the Reference Maximum Net Profit for that corresponding New Earn Out Year.

(z) under no circumstances shall the Cash Amount and number of New Earn Out Shares for the relevant Management Vendor be less than zero or exceed the Maximum Cash Amount and Maximum New Earn Out Shares (as set out above) respectively for that Management Vendor for any New Earn Out Year.

(ii) Additional condition and adjustment of the New Earn Out Consideration

The New Earn Out Consideration applicable to the Founder SPV, the Qu SPV and the Executive SPV shall be subject to an additional adjustment ("**Adjustment Amounts**"). In the event that (a) in the case of the Founder SPV, certain selected employee(s) of New Classics Media other than the Management Members, (b) in the case of the Qu SPV, Ms. Qu, or (c) in the case of the Executive SPV, all shareholders of the Executive SPV who are also employees of New Classics Media and/or its subsidiaries:

(1) breaches his/her Revised Deed of Non-Competition in a New Earn Out Year (the "**Non-Compete Trigger Event**"); and/or

(2) ceases or terminates his/her employment relationship(s) with the Group in a New Earn Out Year by reason of resignation, dismissal or otherwise (other than certain exclusions as set out in the Revised NCM Share Purchase Agreement), (the "**Leaver Trigger Event**" and together with the Non-Compete Trigger Event, the "**Trigger Events**"),

an agreed amount determined with reference to the positions held by such employees shall be an Adjustment Amount and shall be deducted from the New Earn Out Consideration applicable to the Founder SPV, the Qu SPV and the Executive SPV for each Trigger Event in that New Earn Out Year and each New Earn Out Year thereafter. 50% of the Adjustment Amounts will be deducted from the Cash Amount and the remaining 50% will be deducted from the New Earn Out Shares.

The Adjustment Amount applicable to each selected employee was determined in accordance with that employee's contribution to the success of the business of New Classics Media. In determining an employee's contribution to New Classics Media, the Company took into account the following factors:

(a) the seniority, position, qualifications and experience of that employee;

(b) the length of service of that employee;

(c) the work performance of that employee; and

(d) how critical that employee is to New Classics Media.

The maximum aggregate Adjustment Amounts applicable to the Management Vendors during a New Earn Out Year is RMB8 million, of which half (being RMB4 million) is allocated to the Non-Compete Trigger Event and the remaining half to the Leaver Trigger Event. The aggregate Adjustment Amounts were determined after arm's length negotiations between the Company and the Management Vendors, taking into account the remaining consideration payable to the Qu SPV (comprising RMB278.7 million and 4,127,230 Consideration Shares) and the Executive SPV (comprising RMB122.2 million and 1,810,235 Consideration Shares) which is directly related to the majority of the key employees' interests as the ultimate individual shareholders of the Executive SPV. The Board believes that the newly added Adjustment Amounts (which is significantly more than the Controlled Account Amount under 2018 NCM Share Purchase Agreement) could deter key employees from leaving New Classics Media and/or breaching the non-competition undertakings.

(iii) Founder Non-Compete and Leaver Amount

In the event that the Founder (a) breaches his non-compete undertaking and/or (b) ceases or terminates his employment relationship with the Group by reason of resignation, dismissal or otherwise (other than as a result of death, physical or mental disability or unlawful dismissal as adjudicated by a court of competent authority) at any time during any New Earn Out Year, the Founder SPV must return to the Company an amount on a one-time basis ("**Founder Non-Compete and Leaver Amount**") equal to the shortfall between the deduction amount and the instalment amount for the Founder SPV for the year ending December 31, 2020 under the Original Earn Out Mechanism and in accordance with the return of consideration under the Original Earn Out Mechanism. In particular, the Founder Non-Compete and Leaver Amount is determined in accordance with the following formula:

$$\begin{array}{c}\text{Founder}\\\text{Non-Compete}\\\text{and Leaver}\\\text{Amount}\end{array} = \frac{\begin{array}{c}\text{Net Profit}\\\text{Shortfall for}\\\text{the year ending}\\\text{December 31, 2020}\\\text{under the Original}\\\text{Earn Out Mechanism}\end{array}}{\begin{array}{c}\text{Total Reference}\\\text{Net Profit under the}\\\text{Original Earn Out}\\\text{Mechanism}\\\text{(RMB2,100 million)}\end{array}} \text{ x } \begin{array}{c}\text{RMB6,200,626,591}\\\text{(being the total consideration}\\\text{applicable to the Founder}\\\text{SPV for the acquisition of}\\\text{New Classics Media}\\\text{by the Company)}\end{array} - \begin{array}{c}\text{2020 Founder}\\\text{Initial Instalment}\\\text{Amount}\end{array}$$

where the 2020 Founder Initial Instalment Amount equals to RMB1,240,125,318 (being the instalment amount payable by the Company to the Founder SPV for the year ending December 31, 2020 under the Original Earn Out Mechanism).

The Founder Non-Compete and Leaver Amount shall not be less than zero nor exceed a cap equal to the total consideration actually received by the Founder SPV from the Company.

(iv) Removal of Roll-Over Mechanism, Overall Final Adjustment and Return of Consideration

Under the Original Earn Out Mechanism:

(a) *Roll-over mechanism*: if the instalment amount in the Original Earn Out Mechanism is less than the deduction amount in the Original Earn Out Mechanism (if any) for an earn out year, such shortfall shall be carried forward to and shall be applied to deduct the instalment amount of the subsequent earn out year(s) (for the avoidance of doubt, such deduction will be in addition to any further deduction amount incurred in the relevant earn out year(s)), until the total instalment amount(s) for the remaining earn out year(s) is/are reduced to zero.

(b) *Overall Final Adjustment*: in the event that the actual Net Profit for each of the three earn out years ending December 31, 2020 is no less than 90%, 75% and 100% of the reference Net Profit benchmark respectively, the net profit shortfall (if any) in an earn out year ended on December 31, 2018 and/or 2019 (being the first and/or second earn out year under the Original Earn Out Mechanism) shall be set off (in the order of firstly the Net Profit shortfall (if any) of such first earn out year, and then that of such second earn out year) by any net profit surplus incurred in any subsequent (but not preceding) earn out year(s). Following the adjustment above, the Company shall pay to the relevant Management Vendor an amount equal to the deduction amount(s) already deducted from the instalment amount which arise(s) from the net profit shortfall so set off above.

(c) *Return of Consideration*: if, following the roll-over mechanism above and overall final adjustment above, there remains any outstanding deduction amount which have not yet been applied for deduction, the relevant Management Vendor shall pay to the Company such remaining amount in the manner following the order of priority below until the remaining amount has been fully settled by the relevant Management Vendor:

   (i) by returning to the Company all the cash received by it under the 2018 NCM Share Purchase Agreement;

   (ii) by returning to the Company the Consideration Shares or the proceeds of the Consideration Shares by the manner prescribed in the 2018 NCM Share Purchase Agreement.

Notwithstanding any other clauses in the 2018 NCM Share Purchase Agreement, the remaining amount of each Management Vendor shall be subject to a cap equal to the consideration received by such Management Vendor under the 2018 NCM Share Purchase Agreement.

Under the New Earn Out Mechanism:

(a) the above roll-over mechanism, and overall final adjustment are removed and no such adjustment will be applied towards the New Earn Out Consideration due to the different methodologies used to calculate the Original Earn Out Consideration under the Original Earn Out Mechanism and the New Earn Out Consideration under the New Earn Out Mechanism; and

(b) the above return of consideration is, to the extent it relates to the Founder SPV, amended in accordance with the Founder Non-Compete and Leaver Amount (set out above) and, to the extent it relates to the Qu SPV and the Executive SPV, removed.

Under the Original Earn Out Mechanism, a 'top-down' methodology was applied. If New Classics Media's actual Net Profit for a certain earn out year is less than the reference Net Profit benchmark under the Original Earn Out Mechanism, certain agreed amount of consideration will be deducted from the Original Earn Out Consideration for that earn out year, and the above roll-over mechanism, overall final adjustment and return of consideration would be applicable to the Original Earn Out Consideration. Under the New Earn Out Mechanism, a 'bottom-up' methodology is applied such that only if New Classics Media's actual Net Profit for a certain New Earn Out Year is higher than the Reference Minimum Net Profit for that New Earn Out Year can the Management Vendors start to receive New Earn Out Consideration based on the formula set out in this circular, and if the actual Net Profit is equal to or higher than the Maximum Reference Net Profit for that New Earn Out Year, the Management Vendors can only receive the Maximum Cash Amount and the Maximum New Earn Out Shares, subject to an additional adjustment, rendering the above roll-over mechanism and overall final adjustment clauses no longer applicable.

For the same reasons set out in the paragraph above, the return of consideration is no longer applicable to the "bottom-up" methodology under New Earn Out Mechanism. Instead, the return of consideration mechanism is used for a different purpose, which is to deter the Founder from breaching his Revised Deed of Non-Competition and/or ceasing or terminating his employment with the Group (as set out in the Founder Non-Compete and Leaver Amount above). A separate Adjustment Amounts mechanism (whereby an agreed amount is allocated to selected employees) is used to deter the selected employees from triggering the Non-Compete Trigger Event and/or the Leaver Trigger Event.

(v) Removal of Controlled Account

Pursuant to the 2018 NCM Share Purchase Agreement, the Management Vendors have agreed to place part of the instalment cash amount for the year ending December 31, 2020 (the "**Controlled Account Amount**") into escrow. The Management Vendors shall be deemed as giving up all their rights, title and interests in their respective Controlled Account Amount if:

(a) (i) the Founder (in respect of the Founder SPV's Controlled Account Amount); (ii) Ms. Qu (in respect of the Qu SPV's Controlled Account Amount); and/or (iii) any of the individual shareholders of the Executive SPV (in respect of the Executive SPV's Controlled Account Amount) triggers a Leaver Trigger Event at any point in time before March 31, 2023; or

(b) any of the cooperation agreement(s) entered into between him/her on one side and the Company and/or its subsidiaries on the other side is/are terminated or materially breached (other than as a result of expiry of the term of such cooperation agreement).

Please see the circular of the Company dated September 28, 2018 for further details.

Under the Revised NCM Share Purchase Agreement, the New Earn Out Consideration will not be placed into escrow or any controlled account. Instead, if Ms. Qu or the selected employees triggers a Leaver Trigger Event during a New Earn Out Year, the New Earn Out Consideration for the relevant Management Vendor for that New Earn Out Year will be adjusted by way of the Adjustment Amounts mechanism. If the Founder triggers a Leaver Trigger Event during a New Earn Out Year, the Founder SPV must return to the Company the Founder Non-Compete and Leaver Amount. Therefore, the Controlled Account clause is no longer necessary.

(vi) Amendment of 2018 Lock-up Undertakings

Pursuant to the Amendment Deeds of Lock-up Undertaking, the Consideration Shares issued or to be issued to the Management Vendors will be subject to disposal restrictions from:

(a) in respect of the Consideration Shares already issued to the Management Vendors as at the date of the Amendment Deeds of Lock-up Undertaking, the date of the Amendment Deeds of Lock-up Undertaking to April 1, 2025 (excluding the last date) and such Consideration Shares will be released from such restrictions in tranches; and

(b) in respect of the Considerations Shares to be actually issued to the Management Vendors in respect of each New Earn Out Year, the issue date of such Consideration Shares, to April 1, 2025 (excluding the last date) and such Consideration Shares will be released from such restrictions in tranches.

(vii) Amendment of 2018 Deeds of Non-Competition

The non-competition undertakings given by the Founder, Ms. Qu and each key employee of NCM and its subsidiaries (each a "**Covenantor**") will be extended to the latest of (a) December 31, 2024; (b) three years from the termination of all employment relationships between the relevant Covenantor and the Group; and (c) the date on which the relevant Covenantor holds, directly or indirectly through a controlled entity, less than 1% of the issued share capital of the Company.

(3) Conditions precedent

The amendment of the 2018 NCM Share Purchase Agreement under Supplemental SPA Deed shall take effect from the date falling on the next day immediately after the conditions precedent below are satisfied or waived:

(i) **Independent Shareholders' Approval:** the approval of the independent Shareholders of the Company having been obtained at an extraordinary general meeting of the Company by way of a poll in relation to the entering into of the Supplemental SPA Deed and the performance of all transactions contemplated under the Supplemental SPA Deed, including the allotment and issue of the Consideration Shares, in accordance and in compliance with the Listing Rules;

(ii) **Listing Approval:** the Listing Committee of the Stock Exchange having granted or having agreed to grant the listing of, and permission to deal in, the Consideration Shares on the Stock Exchange;

(iii) **Amendment Deeds of Non-Competition:** the due execution of the Amendment Deeds of Non-Competition by the parties thereto;

(iv) **Amendment Deeds of Lock-up Undertaking:** the due execution of the Amendment Deeds of Lock-up Undertaking by the parties thereto; and

(v) **Certified copy of minutes:** the delivery by each of the Management Vendors and the Company certified copy of the minutes of their respective board of directors approving the Supplemental SPA Deed and consummation of the transactions contemplated thereunder.

The Company may at any time waive the above conditions precedents (iii) and (iv) in relation to the execution of the Amended Deeds of Non-Competition and Amendment Deeds of Lock-up Undertaking. As of the Latest Practicable Date, none of the conditions precedent above has been satisfied.

D. THE CONSIDERATION SHARES

Pursuant to the Revised NCM Share Purchase Agreement, the Consideration Shares to be issued will be subject to the New Earn Out Mechanism at the time of allotment.

The Consideration Shares has been and will be issued at a price of HK$80 per Consideration Share. The Issue Price was determined after arm's length negotiations among the parties taking into account, among other things, the prevailing market performance of the Shares. The Directors consider that the Issue Price is fair and reasonable under the present market conditions.

The Issue Price represents:

(i) a premium of approximately 65.80% over the same price to the closing price of the Shares of HK$48.25 per Share as quoted on the Stock Exchange on the Last Trading Day;

(ii) a premium of approximately 64.74% over the average closing price of the Shares of approximately HK$48.56 per Share as quoted on the Stock Exchange for the five consecutive trading days up to and including the Last Trading Day;

(iii) a premium of approximately 72.95% over the average closing price of the Shares of approximately HK$46.26 per Share as quoted on the Stock Exchange for the ten consecutive trading days up to and including the Last Trading Day;

(iv) a premium of approximately 59.05% over the average closing price of the Shares of approximately HK$50.30 per Share as quoted on the Stock Exchange for the thirty consecutive trading days up to and including the Last Trading Day; and

(v) a premium of approximately 24.71% over the closing price of the Shares of approximately HK$64.15 per Share as quoted on the Stock Exchange as at the Latest Practicable Date.

As of the Latest Practicable Date, a total of 3,444,870 Consideration Shares have been issued under the Original Earn Out Mechanism. Under the New Earn Out Mechanism, a maximum of 15,119,815 new Consideration Shares remains to be outstanding for issue by the Company to the Management Vendors to satisfy part of the New Earn Out Consideration.

A maximum of 15,119,815 Consideration Shares, if issued, represent:

(i) approximately 1.49% of the entire issued share capital of the Company as of the Latest Practicable Date; and

(ii) approximately 1.47% of the entire issued share capital of the Company as enlarged by the allotment and issue of such Consideration Shares under the New Earn Out Mechanism.

The 15,119,815 Consideration Shares that remain outstanding to be issued under the New Earn Out Mechanism will be allotted and issued pursuant to a specific mandate to be sought by the Company at the Extraordinary General Meeting. The Consideration Shares, when allotted and issued, will rank pari passu in all respects among themselves and with the Shares in issue. An application will be made by the Company to the Stock Exchange for the approval for the listing of, and permission to deal in, the 15,119,815 Consideration Shares to be issued under the New Earn Out Mechanism.

(i) Effect of the Issue of Consideration Shares on the Shareholding Structure

For illustration purpose only, set out below is the shareholding structure of the Company (i) as at the Latest Practicable Date; (ii) immediately upon the issuance of all the Consideration Shares under the New Earn Out Mechanism under the Revised NCM Share Purchase Agreement, assuming that all the Reference Maximum Net Profit are met and no adjustment will be made pursuant to the Revised NCM Share Purchase Agreement:

	As at the Latest Practicable Date		Immediately upon the issuance of all Consideration Shares[1]	
Shareholders	**Number of Shares**	**Appro. % of issued Shares**	**Number of Shares**	**Appro. % of issued Shares**
Founder SPV	25,047,972	2.47%	34,230,322	3.32%
Qu SPV	11,258,413	1.11%	15,385,643	1.49%
Executive SPV	4,810,165	0.47%	6,620,400	0.64%
Tencent Holdings Limited	601,126,564	59.18%	601,126,564	58.31%
Other connected persons[2]	15,950,546	1.57%	15,950,546	1.55%
Other public Shareholders	357,588,056	35.20%	357,588,056	34.69%
Total	1,015,781,716	100%	1,030,901,531	100%

Note:

(1) For the purpose of illustration only, the table represents the shareholding structure of the Company upon issuance of all the Consideration Shares under the New Earn Out Mechanism and assumes that the Reference Maximum Net Profit for each New Earn Out Year is met and the maximum number of Consideration Shares (being 15,119,815 Consideration Shares) is issued under the New Earn Out Mechanism and without any additional adjustment under the Revised NCM Share Purchase Agreement.

(2) The 15,950,546 Shares comprise the Shares held by Mr. Wu Wenhui, Mr. James Gordon Mitchell, Mr. Cheng Yun Ming Matthew and Mr. Cheng Wu, all being the Directors and the connected person of the Company.

(3) For further details of the Shares held by the connected persons, see "Appendix II – 6. Disclosure of Interests."

(ii) No Change of Control

The issuance of Consideration Shares by the Company will not result in a change of control of the Company.

E. REVISED DEEDS OF NON-COMPETITION

Under the Supplemental SPA Deed, it is contemplated that the 2018 Deeds of Non-Competition will be amended. Under the Revised Deeds of Non-Competition, the Founder, Ms. Qu and each key employee of the New Classics Media and its subsidiaries management (each a "**Covenantor**", collective the "**Covenantors**") hereby irrevocably and unconditionally covenants with the Company that, unless with the consent by the Company:

(a) with effect from the date of the completion of the 2018 NCM Share Purchase Agreement and, until the latest of (i) December 31, 2024, (ii) three years from the termination of all the employment relationships between the Covenantor and the Group and (iii) the date on which such Covenantor holds, directly or indirectly through a controlled entity (which includes a person, body corporate, partnership, trust and trustee of the trust), less than 1% of the issued share capital of the Company, such Covenantor will and will do any act to procure any of his/her/its close associates (other than the Group):

(i) not to, within certain jurisdictions, directly or indirectly engage, participate, acquire or hold any right or interest in or otherwise undertake (whether or not as shareholder, partner, agent or any other capacity, and whether or not for profits, returns or any benefits) any business in competition with or which may be in competition with the existing business activity of the Group, namely the original literary works related business; publication of original literary works; PC/online/web/mobile gaming business; television series, web series and films production and publishing business, or any business activities which the Group may undertake in the future (the "**Restricted Activity**"), save and except for (i) the interest such Covenantor holds, directly or indirectly, in the Company, or where such activities are conducted or performed through, or for the Group; (ii) where such Covenantor holds less than 1% of the shares in issue of any company the shares of which are listed on the Stock Exchange or any other stock exchange which is engaged in, participate, acquire or hold any business that is or may be in competition with any business engaged by any member of the Group; (iii) with respect to any new business activities which the Group undertakes after the date of the Deed (for the avoidance of doubt, excluding any business activities which New Classics Media and its subsidiaries currently are or may in the future be involved in) ("**New Business**"), a Covenantor may engage in such New Business provided that such Covenantor has already engaged in such New Business before the Group and due notification is given to the Group once the Covenantor is aware that the Group intends to or has engaged in such New Business; and (iv) the interest in any business which has been referred by the Covenantors or any of his/her/its close associates to the Company pursuant to the Deed of Non-Competition and the Company has failed to respond to the offer notice within the 30 Business Day period of the Company's receipt of the offer notice or has declined the competing business opportunity after receipt of the offer notice;

(ii) not to solicit or induce any person who, to the best of the relevant Covenantor's knowledge, is a customer or supplier of the Group to cease to engage in the business and/or transaction with the Group;

(iii) not to solicit or induce any persons who are existing employees, consultants or service providers of the Group to leave the Group or terminate the relationship with the Group, or hire or in any ways employ such persons or engage as consultants or other service providers (provided that the foregoing shall not prohibit general solicitations or advertisements of employment (or hiring as a result thereof) by the Covenantor and/or his/her/its close associates not specifically directed at such persons);

(iv) not to, criticize or disparage any member of the Group or make any statements to, or take any actions with respect to, any person who is or, to the Covenantor's knowledge, is reasonably likely to become, a customer, supplier, contractor or client of any member of the Group, which are intended to, or reasonably likely to, damage any member of the Group's or any of their respective successors', relationship with such persons; and

(v) keep the directors (including its independent non-executive directors) informed of any matter, to the best of the relevant Covenantor's knowledge, of potential material conflicts of interests between him/her (including their close associates) and the Group, in particular, a transaction between him/her (including him/her close associates) and the Group.

(b) such Covenantor will not do any act to procure any of his/her/its/their close associates to, directly or indirectly, disclose any confidential information with respect to the Group or any member thereof to any third party, save and except for information that (i) is or becomes publicly known or available otherwise than as a consequence of a breach of the Revised Deed of Non-Competition Deed; (ii) is required to be disclosed by law or to satisfy a legally enforceable demand by a competent court of law, a governmental or regulatory body, or a stock exchange.

F. REVISED LOCK-UP UNDERTAKINGS

Under the Supplemental SPA Deed, it is contemplated that the 2018 Lock-up Undertakings will be amended. Under the Revised Lock-up Undertakings, the Consideration Shares issued to the Management Vendors will be subject to disposal restrictions from:

(a) in respect of the Consideration Shares already issued to the Management Vendors as at the date of the Amendment Deeds of Lock-up Undertaking ("**Relevant Existing Shares**"), the date of the Amendment Deeds of Lock-up Undertaking; and

(b) in respect of the Considerations Shares to be actually issued to the Management Vendors in 2020 to 2024 ("**Relevant Future Shares**"), the issue date of such Consideration Shares,

to April 1, 2025 (excluding the last date) and such Consideration Shares will be released from such restrictions in the following tranches:

As of the following release dates	Total Number of Relevant Existing Shares released from disposal restrictions	Total Number of Relevant Future Shares released from disposal restrictions
April 1, 2021	20%	20% of the Relevant Future Shares to be issued in respect of the New Earn Out Year ending December 31, 2020
April 1, 2022	40%	(i) 40% of the Relevant Future Shares to be issued in respect of the New Earn Out Year ending December 31, 2020; and (ii) 25% of the Relevant Future Shares to be issued in respect of the New Earn Out Year ending December 31, 2021
April 1, 2023	60%	(i) 60% of the Relevant Future Shares to be issued in respect of the New Earn Out Year ending December 31, 2020; (ii) 50% of the Relevant Future Shares to be issued in respect of the New Earn Out Year ending December 31, 2021; and (iii) 33.33% of the Relevant Future Shares to be issued in respect of the New Earn Out Year ending December 31, 2022
April 1, 2024	80%	(i) 80% of the Relevant Future Shares to be issued in respect of the New Earn Out Year ending December 31, 2020; (ii) 75% of the Relevant Future Shares to be issued in respect of the New Earn Out Year ending December 31, 2021; (iii) 66.66% of the Relevant Future Shares to be issued in respect of the New Earn Out Year ending December 31, 2022; and (iv) 50% of the Relevant Future Shares to be issued in respect of the New Earn Out Year ending December 31, 2023
April 1, 2025	100%	All Relevant Future Shares (*Note*)

Note: For the avoidance of doubt, the Relevant Future Shares to be issued in respect of the New Earn Out Year ending December 31, 2024 would not be subject to any disposal restrictions under the Revised Lock-up Undertaking.

The disposal restrictions under the Revised Lock-up Undertaking provide that the Holders shall not:

(a) sell, offer to sell, contract or agree to sell, mortgage, charge, pledge, assign, hypothecate, lend, grant or sell any option, warrant, contract or right to purchase, grant or purchase any option, warrant, contract or right to sell, or otherwise transfer (including but not limited to dividend/distribution in specie) or dispose of or create an encumbrance over, or agree to transfer or dispose of or create an encumbrance over, either directly or indirectly, conditionally or unconditionally, any legal or beneficial interest in the Relevant Shares (the foregoing restriction is expressly agreed to preclude each of the Holders from engaging in any hedging or other transactions which is designed to or which reasonably could be expected to lead to or result in a sale or disposition of any Relevant Shares even if such shares would be disposed of by someone other than each of the Holders and/or his/her/its affiliate(s) or nominee(s), respectively. Such prohibited hedging or other transactions would include without limitation any put or call option with respect to any Relevant Shares or with respect to any security that includes, relates to or derives any significant part of its value from such shares); or

(b) enter into any swap or other arrangement that transfers to another, in whole or in part, any of the economic consequences of ownership (legal or beneficial) of Relevant Shares or any interest therein (including, without limitation, any securities convertible into or exchangeable or exercisable for or that represent the right to receive, or any warrants or other rights to purchase, such Relevant Share); or

(c) enter into any transaction with the same economic effect as any transaction specified in (a) or (b) above; or

(d) without prejudice to (a), (b) and (c) above, sell or permit to be sold any shares or interests in any company or entity holding or controlling (directly or indirectly) any Relevant Shares; or

(e) offer to or agree to or announce any intention to effect any transaction specified in (a), (b), (c) or (d) above, in each case, whether or not completion of any of the transactions specified in (a), (b) or (c) or (d) above will occur within the lock-up period of the Relevant Shares.

G. REASONS AND BENEFITS OF THE TRANSACTION DOCUMENTS

After the completion of acquisition of New Classics Media, the television and film industry in mainland China has been undergoing profound changes due to fluid and changing macro and industry environment (including factors such as policy and regulation changes, and competitive landscape of online video platforms etc.), resulting in a declining trend in the number of TV series and film project filings, productions and releases, as well as lower-than-expected revenue and profits from certain individual projects. In addition, the business operation of New Classics Media has been significantly affected by the outbreak of COVID-19 since the beginning of 2020. The outbreak of COVID-19 has resulted in a decrease in the advertising revenue of online video platforms and in turn a decrease in sales price of projects, longer production cycle of TV series and film projects and delayed launching of film projects due to impact of lockdown policies nationwide.

It is a difficult time for all sectors, especially for TV series and film production companies. Taking into account such environment, the Company believes that the benchmark profit for the year ending December 31, 2020 under the Original Earn Out Mechanism in the 2018 NCM Share Purchase Agreement is no longer commercially feasible nor reasonable and the Original Earn Out Mechanism should be adjusted, in order to better suit the current market conditions and long-term strategies of the Company.

Notwithstanding the challenging market conditions, New Classics Media continues to maintain steady production of premium quality TV series and film projects. Under the current business strategy, the Company and New Classics Media will have in-depth collaboration to explore the opportunities of their respective intellectual properties including the cooperation on over 50 media projects covering different genres of films and television series. Such business strategy and projects will be supported by the continuous efforts from the New Classics Media's renowned and experienced management team led by the Founder, Mr. Cao Huayi. As a well-known industry veteran with over 20 years of experience across script writing, intellectual property adaptation, and TV series and film production, the Founder has established a reputation of producing premium quality contents and an extensive network in television and film industry, attracting a talented and acclaimed roster of scriptwriters, directors and producers to work closely with New Classics Media in various projects. Other core management team members of New Classics Media are also experienced in the content production industry with strong track record, specializing in areas such as scriptwriting, intellectual property adaptation, production project management, sales of projects to TV stations and online video platforms, as well as project advertising and distribution. New Classics Media's core management team is of great importance to it and the Group in terms of managing New Classics Media's daily business operations and bringing industry resources to the Group's intellectual property ecosystem.

Although the benchmark profit for the year ending December 31, 2020 under the Original Earn Out Mechanism could hardly be met, the Company is of the view that the performance of New Classics Media has been outstanding among its peers with a clear core value, and the synergy between the Group and New Classics Media has been proven with the success of Joy of Life (慶餘年).

The Original Earn Out Mechanism includes terms to adjust the Original Earn Out Consideration based on the reference Net Profits of New Classics Media for the three years ending December 31, 2020. There will be no consideration payable to the Management Vendors if the Net Profit of New Classics Media for the year ending December 31, 2020 falls below certain benchmark profit. It follows that there may be no amounts to be placed into the Controlled Account, which is designed to incentivize the Management Vendors to continue their employment relationships with the Group until March 31, 2023. For the purpose of motivating the management team of New Classics Media and sufficiently aligning interests of the Company and the Management Vendors, the Original Earn Out Mechanism should be adjusted.

The New Earn Out Mechanism remains the same aggregate maximum amounts payable to the Management Vendor as the maximum amount that would have to be paid in the year ending December 31, 2020 under the Original Earn Out Mechanism. Meanwhile, such payments will be spread over four more years (i.e. 2021 to 2024) to lengthen the incentives to the Management Vendors to continue developing the business of New Classics Media. Therefore, the New Earn Out Mechanism further aligns the long-term interests of the Management Vendors and the Company in respect of its investment in New Classics Media.

With the New Earn Out Mechanism, the core management team of New Classics Media could be incentivized to contribute to the production of high quality contents, integration of business of and synergy between the Group and New Classics Media in the long run which is expected to bring strategic benefit to New Classics Media and the Group as a whole and in turn, a more stable performance of the Group and New Classics Media could be achieved, due to the following reasons:

(1) the New Earn Out Years will be extended under the New Earn Out Mechanism to cover the five years ending December 31, 2024;

(2) New Classics Media has to achieve the Reference Minimum Net Profit for each New Earn Out Year in order for the Management Vendors to be able to receive the New Earn Out Consideration. While the actual Net Profit of New Classics Media is not solely dependent on whether key employees remain as employees of New Classics Media, considering the potential negative impact on the operations of New Classics Media if they were to leave, the Company can expect such key employees to stay as employees of New Classics Media and contribute to the net profit to obtain the New Earn Out Consideration during the New Earn Out years;

(3) a significant portion of the New Earn Out Consideration will be settled by the issuance of Consideration Shares, aligning the interests of both the Management Vendors and the Company to combine their efforts, work more closely and create synergies, all of which might be jeopardized if the key employees were to leave New Classics Media during the New Earn Out Years;

(4) with an aim to further deter key employees from leaving New Classics Media and/or breaching any non-competition undertakings with the Group, an additional Adjustment Amount will be deducted from the New Earn Out Consideration; and

(5) with an aim to further deter the Founder from leaving New Classics Media and/or breaching his non-competition undertaking with the Group, a Founder Non-Compete and Leaver Amount shall be paid by the Founder SPV to the Company in the amount and manner as set out in this circular.

Furthermore, the relevant 2018 Deeds of Non-Competition and 2018 Lock-up Undertakings will also be revised to reflect the extension of the New Earn Out Years under the New Earn Out Mechanism, further securing the services of New Classics Media's core management team for a further period.

As the Company is also undergoing changes in its management team, the extension of the New Earn Out Years under the New Earn Out Mechanism provides the Company with more time to strengthen the Company's intellectual property business, steered by a stable and motivated top creation team from New Classics Media.

Following the amendments to the Original Earn Out Mechanism, the new management team will drive the business synergy and integration progress through the establishment of a team with cross-sector knowledge in both online literature and drama production. This team will collaborate more closely with New Classics Media's team mainly towards the following directions:

(1) to utilize New Classics Media's capacity and increase the number of TV series and films adapted from the Company's intellectual properties;

(2) to leverage all resources that New Classics Media possesses, including its experienced management team, directors, producers, high calibre scriptwriters and market practitioners that have been working closely with it since its establishment to consistently improve the quality of TV series and films adapted from the Company's intellectual properties; and

(3) to gain greater control and more experience over the whole intellectual property adaptation process, accumulate more industry resources, and establish more extensive industry network during the New Earn Out Years.

With the action plan mentioned above, the new management team expects the Company to have a team with cross-sector knowledge and in-house production capability after the New Earn Out Years. Therefore, it is in the interest of the Company to continue to retain the Management Members, and to extend the earn out periods to include the New Earn Out Years.

H. FINANCIAL EFFECTS ON THE GROUP

Based on the Original Earn Out Mechanism, the Management Vendors may have an obligation to repay consideration previously received based on the original earn out formula and other applicable adjustments with reference to the actual Net Profit, which was estimated to be approximately RMB724.0 million as at June 30, 2020 based on the expected 2020 Net Profit of NCM (the "**Original Contingent Receivable**"). Under the New Earn Out Mechanism, if the Founder ceases/terminates his employment or breaches the Revised Deed of Non-Competition as set out in the paragraph headed "(iii) Founder Non-Compete and Leaver Amount" during a New Earn Out Year, the Founder is required to repay his portion of the Original Contingent Receivable to the Company, being approximately 60.7% of the Original

Earn Out Consideration payable to the Management Vendors for the year ending December 31, 2020. Therefore the relevant repayment amount will be recognized as deferred compensation cost and charged to the Company's consolidated statement of comprehensive income as general and administrative expenses during the period starting from the effective date of the Revised NCM Share Purchase Agreement till the end of the New Earn Out Years. The remaining portion of the Original Contingent Receivable will no longer be repayable by the Management Vendors under the New Earn Out Mechanism on the effective date of the Revised NCM Share Purchase Agreement, and will therefore be charged to the Company's consolidated statement of comprehensive income as other loss, net.

Under the New Earn Out Mechanism, a maximum amount of RMB20 million (being the total Leaver Amount of RMB4 million per New Earn Out Year for the five New Earn Out Years) out of the New Earn Out Consideration will be treated as compensation to retain the key employees of New Classics Media, and will be charged to the Company's consolidated statement of comprehensive income as general and administrative expenses for the years ending December 31, 2020 to 2024, according to the Leaver Amount allocated to the key employees for each year. The estimated contingent consideration payable arising from the New Earn Out Mechanism will be recognized as financial liability and shall be initially and subsequently measured at fair value, with fair value changes recognized as other gains/(losses) in the subsequent New Earn Out Years.

I. LISTING RULES IMPLICATIONS

As of the Latest Practicable Date, the Founder is a non-executive Director and thus a connected person of the Company. Furthermore, the Founder SPV and the Executive SPV are the associates of the Founder and thus connected persons of the Company. The transactions contemplated under the Transaction Documents constitute connected transactions of the Company pursuant to Chapter 14A of the Listing Rules.

As the highest applicable percentage ratio in respect of the acquisition of the entire equity interest of New Classics Media under the 2018 NCM Share Purchase Agreement is more than 25% but all the percentage ratios are below 100%, the Transaction Documents and the transactions contemplated thereunder (including the amendment of the 2018 NCM Share Purchase Agreement, the 2018 Lock-up Undertakings and the 2018 Deeds of Non-Competition) constitute major and connected transactions of the Company and are therefore subject to reporting, announcement, annual review and independent Shareholders' approval under Chapter 14 and 14A of the Listing Rules.

J. INFORMATION ON THE PARTIES

The Group is principally engaged in online literature business, and is a pioneer of China's online literature market and operates the leading online literature platforms.

The Founder currently serves as a non-executive Director, and the Founder SPV is principally engaged in investment holding. Ms. Qu is a citizen and resident of the PRC and the Qu SPV is principally engaged in investment holding. The Executive SPV is principally engaged in investment holding.

K. FINANCIAL INFORMATION OF NEW CLASSICS MEDIA

Set out below is a summary of the financial statements of New Classics Media (which was incorporated on May 18, 2018 and acquired by the Company on October 31, 2018), for the two months ended December 31, 2018 and the year ended December 31, 2019:

	For the two months ended December 31, 2018 *(approximate)* *(RMB in millions)*	**For the year ended December 31, 2019** *(approximate)* *(RMB in millions)*	**For the six months ended June 30, 2020** *(approximate)* *(RMB in millions)*
Revenues	275.3	3,236.3	129.9
Net profit/(Loss)	67.9	554.3	(97.1)

	As at December 31, 2018 *(approximate)* *(RMB in millions)*	**As at December 31, 2019** *(approximate)* *(RMB in millions)*	**As at June 30, 2020** *(approximate)* *(RMB in millions)*
Net assets	1,649.1	2,202.5	2,105.4
Total assets	5,426.2	5,462.2	4,828.7

L. GENERAL

Your attention is drawn to the letter from the Independent Board Committee set out on page 33 of this circular, which contains its recommendation to the Independent Shareholders in relation to the Transaction Documents and the transactions contemplated thereunder. Your attention is also drawn to the letter of advice from the Independent Financial Adviser set out on pages 34 to 65 of this circular, which contains its advice to the Independent Board Committee and the Independent Shareholders in relation to the Transaction Documents and the transactions contemplated thereunder, and the principal factors and reasons taken into account in arriving at its recommendation.

The register of members of the Company will be closed from Friday, December 4, 2020 to Wednesday, December 9, 2020, both days inclusive, in order to determine the eligibility of shareholders to attend the above meeting, during which period no share transfers will be registered. To be eligible to attend the above meeting, all properly completed transfer forms accompanied by the relevant share certificates must be lodged for registration with the Hong Kong share registrar of the Company, Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong not later than 4:30 p.m. on Thursday, December 3, 2020.

M. NOTICE OF EXTRAORDINARY GENERAL MEETING

A notice convening the Extraordinary General Meeting to be held at Niccolo Room, Level 25, The Murray, Hong Kong, a Niccolo Hotel, 22 Cotton Tree Drive, Central, Hong Kong at 3:00 p.m. on Wednesday, December 9, 2020 is set out on pages EGM-1 to EGM-3 of this circular. At the Extraordinary General Meeting, ordinary resolution will be proposed to Shareholders to consider and approve, inter alia, the Transaction Documents.

N. FORM OF PROXY

A form of proxy is enclosed for use at the Extraordinary General Meeting. Such form of proxy is also published on the websites of the Stock Exchange (www.hkexnews.hk) and the Company (http://ir.yuewen.com). Whether or not you intend to attend the Extraordinary General Meeting, you are requested to complete the form of proxy in accordance with the instructions printed thereon and return it to the Hong Kong share registrar of the Company, Computershare Hong Kong Investor Services Limited, at 17M Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong not less than 48 hours before the time fixed for holding the Extraordinary General Meeting or any adjournment thereof. Completion and delivery of the form of proxy shall not preclude a Shareholder from attending and voting in person at the Extraordinary General Meeting if they so wish and in such event the form of proxy shall be deemed to be revoked. **In view of the outbreak of COVID-19 pandemic, you are strongly encouraged to appoint the chairman of the Extraordinary General Meeting as proxy to attend and vote on your behalf at the Extraordinary General Meeting.**

O. VOTING BY POLL

The Management Vendors, namely the Founder SPV (directly holding 25,047,972 Shares), the Qu SPV (directly holding 11,258,413 Shares) and the Executive SPV (directly holding 4,810,165 Shares) are required under the Listing Rules to abstain from voting on the resolutions on approving the Transaction Documents at the Extraordinary General Meeting. Save as disclosed above, the Board is not aware of any other Shareholder who has any material interest that is required under the Listing Rules to abstain from voting on the aforementioned resolutions.

Pursuant to Rule 13.39(4) of the Listing Rules and article 13.6 of the Articles of Association, any resolution put to the vote of the Shareholders at a general meeting shall be decided on a poll except where the chairman of the Extraordinary General Meeting, in good faith, decides to allow a resolution which relates purely to a procedural or administrative matter to be voted on by a show of hands. Accordingly, the resolution set out in the notice will be taken by way of poll.

On a poll, every Shareholder present in person or by proxy or, in the case of a Shareholder being a corporation, by its duly authorized representative, shall have one vote for every fully paid Share of which he/she is the holder. A Shareholder entitled to more than one vote needs not use all his/her votes or cast all the votes he/she uses in the same way.

P. OPINION FROM THE BOARD

The Directors (excluding the independent non-executive Directors whose view will be disclosed in the circular) are of the view that the terms of the Transaction Documents were determined after arm's length negotiation, and the transactions contemplated thereunder are on normal commercial terms, fair and reasonable and in the interests of the Company and the Shareholders as a whole.

The independent non-executive Directors have formed the Independent Board Committee for the purposes of advising the independent Shareholders in respect of the Transaction Documents and their views and recommendation are included in the circular to be dispatched by the Company.

Mr. Cao Huayi, a Director, is a party to the Transaction Documents and has therefore abstained from voting on the relevant Board resolutions approving the Transaction Documents.

Q. RECOMMENDATION

The Directors recommend the Shareholders to vote in favor of the resolution to be proposed at the Extraordinary General Meeting.

The Independent Board Committee, having taken into account the advice of Somerley, consider that the Transaction Documents and the transactions contemplated thereunder are on normal commercial terms, are fair and reasonable so far as the Independent Shareholders are concerned, and in the interests of the Company and the Shareholders as a whole. Accordingly, the Independent Board Committee recommends the Independent Shareholders to vote in favor of the ordinary resolution in respect of the entering into of the Transaction Documents and the transactions contemplated thereunder at the Extraordinary General Meeting.

Yours faithfully
By order of the Board
CHINA LITERATURE LIMITED
Mr. James Gordon Mitchell
Chairman of the Board and Non-executive Director

The following is the text of a letter from the Independent Board Committee setting out its recommendation to the Independent Shareholders in relation to the Transaction Documents.

阅文集团

CHINA LITERATURE LIMITED

阅文集团

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 772)

November 10, 2020

To the Independent Shareholders

Dear Sirs or Madams,

THE TRANSACTION DOCUMENTS

We refer to the circular dated November 10, 2020 issued by the Company to the Shareholders (the "**Circular**"), of which this letter forms part. Terms defined in this circular shall have the same meanings herein unless the context otherwise requires.

We have been appointed by the Board as members of the Independent Board Committee to advise the Independent Shareholders as to whether the Transaction Documents and the transactions contemplated thereunder are on normal commercial terms, and the entering into of the Transaction Documents is not in the ordinary and usual course of business of the Group, is in the interests of the Company and the Shareholders as a whole and are fair and reasonable so far as the Independent Shareholders are concerned. Somerley has been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in this regard.

After taking into account the advice of Somerley as set out in this circular, we consider that the Transaction Documents and the transactions contemplated thereunder are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned, and the entering into of the Transaction Documents is in the interests of the Company and the Shareholders as a whole.

Accordingly, we recommend the Independent Shareholders to vote in favour of the ordinary resolution to be proposed at the Extraordinary General Meeting to approve the Transaction Documents and the transaction contemplated thereunder.

Yours faithfully,

The Independent Board Committee

Ms. YU Chor Woon Carol Ms. LEUNG Sau Ting Miranda Mr. LIU Junmin

Independent non-executive Directors

The following is the full text of a letter of advice from Somerley to the Independent Board Committee and the Independent Shareholders, which has been prepared for the purpose of inclusion in the Circular.

SOMERLEY CAPITAL LIMITED
20th Floor
China Building
29 Queen's Road Central
Hong Kong

November 10, 2020

To: the Independent Board Committee and
the Independent Shareholders

Dear Sirs,

MAJOR AND CONNECTED TRANSACTION
AMENDMENT OF 2018 NCM SHARE PURCHASE AGREEMENT,
2018 LOCK-UP UNDERTAKINGS AND
2018 DEEDS OF NON-COMPETITION

INTRODUCTION

We refer to our appointment to advise the Independent Board Committee and the Independent Shareholders in relation to the Transaction Documents and the transactions contemplated thereunder (the "**Proposed Amendments**"), details of which are contained in the letter from the Board in the circular issued by the Company to the Shareholders dated November 10, 2020 (the "**Circular**"), of which this letter forms a part. Unless the context otherwise requires, capitalised terms used in this letter shall have the same meanings as those defined in the Circular.

The Founder SPV is wholly owned by Mr. Cao, who is a non-executive director of the Company. Furthermore, the Executive SPV is an associate of Mr. Cao. Therefore, the Founder SPV and the Executive SPV are connected persons of the Company. Accordingly, the Proposed Amendments constitute connected transactions of the Company pursuant to Chapter 14A of the Listing Rules.

As the highest applicable percentage ratio in respect of the acquisition of the entire equity interest of NCM under the 2018 NCM Share Purchase Agreement (the "**Acquisition**") is more than 25% but all the percentage ratios are below 100%, the Proposed Amendments (including the amendment of the 2018 NCM Share Purchase Agreement, the 2018 Lock-up Undertakings and the 2018 Deeds of Non-Competition) constitute major and connected transactions of the Company and are therefore subject to announcement, reporting and independent Shareholders' approval requirements under Chapter 14 and Chapter 14A of the Listing Rules.

In view of the Management Vendors' interests in the Proposed Amendments, the Management Vendors and their respective associates are required under the Listing Rules to abstain from voting on the ordinary resolution to be proposed at the Extraordinary General Meeting to approve the Transaction Documents and the transactions contemplated thereunder.

The Independent Board Committee, comprising all the independent non-executive Directors, namely Ms. Yu Chor Woon Carol, Ms. Leung Sau Ting Miranda and Mr. Liu Junmin, has been established to advise the Independent Shareholders in respect of the Transaction Documents and the transactions contemplated thereunder. We, Somerley, have been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in this regard.

During the past two years, we have acted as the independent financial adviser to the independent board committee and the independent shareholders of the Company in relation to certain connected transactions, details of which were set out in the circular of the Company dated April 9, 2019 and October 23, 2019. In addition, we are currently acting as the independent financial adviser to the Company in relation to the licensing transactions between the Group and its connected persons contemplated under a distribution framework agreement, as detailed in the announcement of the Company dated August 11, 2020. The above engagements were/are limited to providing independent advisory services to the independent board committee and the independent shareholders of the Company pursuant to the Listing Rules, for which we received or will receive normal professional fees from the Company. Notwithstanding the above engagements, as at the Latest Practicable Date, there were no relationships or interests between (a) Somerley, and (b) the Group, the Management Vendors and their respective subsidiaries and associates that could reasonably be regarded as a hindrance to our independence as defined under Rule 13.84 of the Listing Rules to act as the Independent Financial Adviser.

In formulating our opinion and recommendation, we have relied on the information and facts supplied, and the opinions expressed, by the Directors and management of the Group and have assumed that such information, facts and opinions were true, accurate and complete in all material aspects and will remain so up to the time of the Extraordinary General Meeting. We have reviewed (i) the Supplemental SPA Deed and the draft of the Amendment Deeds of Lock-up Undertaking and the Amendment Deeds of Non-Competition, (ii) the relevant information as disclosed in the annual reports of the Company for the two years ended December 31, 2019 (the "**2019 Annual Report**") and the interim report of the Company for the six months ended June 30, 2020 (the "**2020 Interim Report**"), and (iii) the information contained in the Circular. We have also sought and received confirmation from the Directors that all material relevant information has been supplied to us and no material facts have been omitted from the information supplied and opinions expressed to us. We have no reason to believe that any material information has been omitted or withheld from us, or to doubt the truth, accuracy or completeness of the information provided. We have relied on such information and consider that the information we have received is sufficient for us to reach an informed view. We have, however, not conducted any independent investigation into the business, affairs and financial position of the Group, the Management Vendors and their respective subsidiaries or associates, nor have we carried out any independent verification of the information supplied.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In formulating our opinion and recommendation with regard to the Proposed Amendments, we have taken into account the following principal factors and reasons:

1. Background information on the Group

The Group principally engages in the provision of reading services, copyright commercialisation, writer cultivation and brokerage, operation of text work reading and related open platform, and the realisation of these activities through technology methods and digital media, including but not limited to personal computers, Internet and mobile network in the PRC. In 2019, the Group had average monthly active users of approximately 219.7 million and average monthly paying users of approximately 9.8 million on its self-owned platform products and self-operated channels on Tencent products respectively. Shares of the Company have been listed on the Stock Exchange since November 2017 and the Company had a market capitalisation of approximately HK$65.2 billion as at the Latest Practicable Date.

In the past year, the Group has been adjusting its strategies in response to market changes. This included an introduction of a free-to-read model on the Group's self-operated channels on certain Tencent products in 2019, supporting authors who choose to monetise their efforts via such model. In addition, the Group continued to develop NCM's position as a leading drama series and film production studio by utilizing its position as a content library and creator. As at December 31, 2019, the Group had 8.1 million writers and approximately 12.2 million works of literature, including approximately 11.5 million original literary works written by writers on its platforms and approximately 0.7 million works sourced from third-party platforms and e-book. A number of drama series and animations were adapted by NCM from the Group's popular intellectual property, such as Joy of Life (慶餘年) which ranked first among all television and web series on Baidu's and Toutiao's 2019 search indices, according to the 2019 Annual Report.

Currently, the Group has two reportable business segments, namely (i) online business, which derives revenues from online paid reading, online advertising and game publishing, and (ii) intellectual property operations and others, which derives revenues mainly from the production and distribution of television, web and animated series, films and licensing of intellectual property rights for adaptation.

For the year 2019 and for the first six months of 2020, the Group recorded revenues of approximately RMB3,710.4 million and RMB2,495.4 million respectively from its online business segment. Revenues from the Group's intellectual property operations and others segment during the above periods were approximately RMB4,637.3 million and RMB764.8

million respectively. Profit attributable to the equity holders to the Company amounted to approximately RMB1,096.0 million in 2019, but the Group recorded a loss attributable to the equity holders of the Company of approximately RMB3,295.9 million in the first six months of 2020. Such loss was mainly attributable to the impairment provisions of (i) goodwill and trademark rights related to the Acquisition of approximately RMB4,015.9 million and RMB389.8 million respectively, and (ii) the Company's long-term investments related to certain investee companies of approximately RMB252.0 million, partly offset by a fair value gain on consideration liabilities of approximately RMB1,240.3 million due to an expected saving of earn-out consideration under the Original Earn Out Mechanism.

According to the 2020 Interim Report, as at June 30, 2020, the Group had total assets and net assets of approximately RMB21,460.4 million and RMB16,432.7 million, and the Group continued to maintain a healthy and sound financial position, with net cash (calculated as cash and cash equivalents, term deposits and restricted bank deposits, less total borrowings) of approximately RMB4,530.4 million.

Based on our discussion with the management of the Group, the Group has been strengthening its in-house drama production capabilities and adapting its intellectual property library to other media formats including, among others, television and web series, film, animations and mobile games.

2. Background to and reasons for the Proposed Amendments

The Acquisition

In August 2018, the Company entered into the 2018 NCM Share Purchase Agreement to acquire the entire interest in NCM held by Tencent Holdings Limited ("**Tencent**") and the Management Vendors at a total consideration of RMB15.5 billion, to be settled in the form of cash and Consideration Shares (based on the agreed RMB:HKD exchange rate of 1.1847 and the Issue Price of HK$80 per Consideration Share). The Acquisition, which was approved by the then independent shareholders of the Company at an extraordinary general meeting, completed on October 31, 2018.

As set out in the circular of the Company relating to the Acquisition dated September 28, 2018, the then Directors considered that the Acquisition was in line with the Company's strategic objective to unleash the monetization potential of its intellectual property and would provide significant opportunities to enhance the Company's content ecosystem, promote long term growth and create value for shareholders. In particular, the Acquisition would (i) allow the Group to adapt more high-quality literary content into popular television series, web series and films, by leveraging NCM's proven track record of script development and production across multiple literary genres, and (ii) elevate the Group's participation in literary content adaptation from fixed licensing fees, passive revenue-sharing and co-investment models to an active in-house production role, which in turn allows the Company to capture a larger share of China's fast-growing television, web series and films market and achieve a greater control of the adaptation process.

The consideration payable to Tencent was fully settled by Consideration Shares upon completion of the Acquisition. On the other hand, the total consideration payable to the Management Vendors of approximately RMB10,210.1 million would be subject to the Original Earn Out Mechanism and settled by instalments, in the form of 50% by cash and remaining 50% by Consideration Shares. Details of the consideration paid/payable to the Management Vendors as of the Latest Practicable Date are as follows:

The Management Vendors	**Total consideration payable** *(RMB million)*	**Method of payment** *(approximate)*	**Initial consideration paid upon completion** *(approximate)*	**Original Earn Out Consideration paid for 2018** *(approximate) (Note 1)*	**Original Earn Out Consideration paid for 2019** *(approximate) (Note 2)*	**Total consideration paid** *(approximate)*	**Original Earn Out Consideration payable for 2020** *(approximate)*
The Founder SPV	6,200.6	Cash of RMB3,100.3 million	RMB930.1 million	RMB721.3 million	RMB620.1 million	RMB2,271.5 million	RMB620.1 million
		45.9 million Shares	23.0 million Shares	Nil	2.1 million Shares	25.0 million Shares	9.2 million Shares
The Qu SPV	2,787.0	Cash of RMB1,393.5 million	RMB418.1 million	RMB324.2 million	RMB278.7 million	RMB1,021.0 million	RMB278.7 million
		20.6 million Shares	10.3 million Shares	Nil	0.9 million Shares	11.3 million Shares	4.1 million Shares
The Executive SPV	1,222.4	Cash of RMB611.2 million	RMB183.4 million	RMB142.2 million	RMB122.2 million	RMB447.8 million	RMB122.2 million
		9.1 million Shares	4.5 million Shares	Nil	0.4 million Shares	4.9 million Shares	1.8 million Shares
Total	**10,210.1**	**Cash of RMB5,105.5 million**	**RMB1,531.5 million**	**RMB1,187.8 million**	**RMB1,021.0 million**	**RMB3,740.3 million**	**RMB1,021.0 million**
		75.6 million Shares	**37.8 million Shares (equivalent to RMB1,403.0 million)** *(Note 3)*	**Nil**	**3.4 million Shares (equivalent to RMB96.3 million)** *(Note 4)*	**41.2 million Shares (equivalent to RMB1,499.3 million)**	**15.1 million Shares**

Notes:

(1) The total Original Earn Out Consideration payments for the year 2018 to the Founder SPV, the Qu SPV and the Executive SPV were reduced by approximately RMB854.2 million (comprising approximately RMB343.7 million cash and approximately 7.6 million Shares), as the actual Net Profit in 2018 fell below the corresponding reference Net Profit benchmark under the Original Earn Out Mechanism

(2) The total Original Earn Out Consideration payments for the year 2019 to the Founder SPV, the Qu SPV and the Executive SPV were reduced by approximately RMB788.4 million (comprising approximately 11.7 million Shares), as the actual Net Profit in 2019 fell below the corresponding reference Net Profit benchmark under the Original Earn Out Mechanism

(3) Based on the closing price of HK$41.20 per Share as quoted on the Stock Exchange on October 30, 2018, being the business day immediately prior to the issue of the Consideration Shares at completion

(4) Based on the closing price of HK$31.05 per Share as quoted on the Stock Exchange on April 6, 2020, being the business day immediately prior to the issue of the Consideration Shares for settling the Original Earn Out Consideration for the year 2019

(5) The above figures may not add up due to rounding

A total consideration payment of approximately RMB5,239.6 million (the "**Paid Consideration**", being the sum of approximately RMB3,740.3 million settled in cash and RMB1,499.3 million settled in shares as shown in the table above) has been made to the Management Vendors. As NCM failed to achieve the reference Net Profit benchmark of RMB500 million and RMB700 million in each of the year 2018 and 2019, the total consideration paid to the Management Vendors for the Original Earn Out Consideration for the years 2018 and 2019 were reduced by a deduction amount, calculated in accordance with the formula (the "**Original Earn Out Formula**") below.

$$\text{Deduction amount} = \frac{\text{(Reference Net Profit benchmark for the year - actual Net Profit for the year)}}{\text{Total reference Net Profit benchmark (i.e. RMB2,100 million)}} \times \text{Total consideration payable to the Management Vendors (as if there is no adjustment under the 2018 NCM Share Purchase Agreement), i.e. approximately RMB10,210 million}$$

Note: If the actual Net Profit of NCM in any relevant earn out year is a negative figure, for the purpose of the formula as set out above, the amount of Net Profit of NCM for that relevant earn out year shall be regarded as zero

Under the 2018 NCM Share Purchase Agreement, for the year 2020, the reference Net Profit benchmark for the Original Earn Out Consideration, is RMB900 million and the total consideration payable to the Management Vendors is approximately RMB2,042.0 million. Full payment shall be made if the actual Net Profit reached RMB900 million. On the other hand, if the actual Net Profit in 2020 is RMB480 million or below, the deduction amount would be approximately RMB2,042.0 million or above based on the Original Earn Out Formula, meaning the Company would not be required to pay any consideration to the Management Vendors for the year 2020. In the event that there remains any outstanding deduction amount which have not yet been applied for the reduction, the relevant Management Vendor shall pay to the Company such amount pursuant to the terms of the 2018 NCM Share Purchase Agreement. Based on the above Original Earn Out Formula, the maximum deduction amount for the year 2020 would be approximately RMB4,375.7 million if the actual Net Profit in 2020 is nil or negative. Please note the above figure represents the theoretical maximum based on the Original Earn Out Formula, and refer to the section headed "Principal terms of the Proposed Amendments – Our comments" regarding the estimated contingent receivable from the Management Vendors as at June 30, 2020.

In order to further align the long-term interests of the Company and the Management Vendors, the Management Vendors have further agreed with the Company to place a maximum of RMB500 million from the Original Earn Out Consideration for the year 2020 into a designated bank account (the "**Controlled Account**"), such that a Management Member's right to his/her respective amount deposited into the Controlled Account would be lost if he/she ceases employment with the Group before March 31, 2023.

Reasons for and benefits of the Proposed Amendments

It is stated in the letter from the Board that the television and film industry in China has been undergoing profound changes due to fluid and changing macro and industry environment, resulting in a declining trend in the number of television series and film project filings, as well as productions and releases. As stated in the 2020 Interim Report, consolidation with NCM failed to produce full synergy. Although the Group converted certain leading intellectual properties into television series and films, the integration with NCM fell behind schedule, as the management considered that the Group (i) lacked a team with sufficient knowledge of both online literature and drama production to drive progress, and (ii) lacked a structure to create an intellectual property-centric content and operational strategy and to promote cross-media production. As such, the original intention of fully integrating NCM, and bringing out the business potential of its media production expertise for the Group's intellectual property operations hasn't yet been realised.

In addition to the above industry-specific factors that adversely impacted NCM, the outbreak of COVID-19 in 2020 and the nationwide lockdown policies resulted in a decrease in sales price of projects, a longer production cycle of television series and film projects and delayed launching of film projects.

The Group has confidence in the capability and expertise of NCM's management, as evidenced by the release of certain popular drama series in 2019. In particular, the success of Joy of Life (慶餘年), which was adapted from one of the Group's most popular novels, illustrates the feedback cycle from content extensions back to the original literary work. According to the letter from the Board, Mr. Cao, the founder of NCM, is a well-known industry veteran with experience across script writing, intellectual property adaptation, and television series and film production. He has established reputation of producing premium quality contents and an extensive network in the television and film industry, attracting a talented and acclaimed roster of scriptwriters, directors and producers to work closely with NCM in various projects. Other core management team members of NCM are experienced in the content production industry with strong track record. NCM's management have made continuous efforts in producing quality television series and film projects in the past, and the Company considers that the core management of NCM is of great importance in managing NCM's daily operations and bringing industry resources to the Group's intellectual property ecosystem.

While this has been the case, the three-year period that is subject to the Original Earn Out Mechanism will expire by the end of this year. The Group considers it crucial to retain and incentivise the core management of NCM (i.e. the Management Members), who can continue to play an important role to assist the Group in its integration with NCM in the long run, including the production of high quality contents, integration of business of and synergy between the Group and NCM. The Directors stated in the letter from the Board that the above is expected to bring strategic benefit to NCM and the Group as a whole.

As set out in the letter from the Board, following the Proposed Amendments becoming effective, the new management team of the Group will drive the business synergy and integration progress through the establishment of a team with knowledge in both online literature and drama production, and a closer collaboration with NCM's core management. The main directions are as follows:

(i) to utilise NCM's capacity and increase the number of television series and films adapted from the Group's intellectual properties;

(ii) to leverage on all resources that NCM possesses, including its experienced management team, directors, producers, scriptwriters and market practitioners, in order to improve the quality of television series and films adapted from the Group's intellectual properties; and

(iii) to gain a greater control over the adaptation process, accumulate more industry resources, and establish more extensive industry network during the New Earn Out Years.

On top of the above directions, based on our discussions with the management of the Group, the Company have formulated detailed action plans with NCM's core management to achieve better integration and enhanced synergies during the New Earn Out Years. Set out below is a summary of the key action plans:

(i) Weekly communication on the selection and adaptation of intellectual properties between the Group and NCM's intellectual properties planning and development teams, with a view to, among others, exploring opportunities for key and high potential intellectual properties and updating the latest adaptation progress. Monthly reporting will be made to the chief executive officer of the Company and the management teams of the Group and NCM;

(ii) Establishment of a committee headed by the chief executive officer of the Company and Mr. Cao to discuss, manage and oversee business development, content creation process and resources integration between the Group and NCM on a regular basis;

(iii) Establishment of an effective mechanism between the Group, NCM and their respective management teams to better integrate NCM industry resources, including scriptwriters, directors and producers to incentivise them to adapt the Group's intellectual properties, and align interests with premium industry talents in the long term; and

(iv) The chief executive officer and president of the Company have been appointed as board members of NCM, with a view to participating in the operational decision-making process and procedures of NCM's projects and strengthening the Group's control over material matters of NCM, including long-term contracts with industry talents, procurement of intellectual properties or scripts, project approval and development.

With the implementation of the above action plans, the Company expects that the Group will be able establish a team with cross-sector knowledge and in-house production capability after the New Earn Out Years. The Directors have stated in the letter from the Board that it is in the interest of the Company to continue to retain the Management Members.

In view of the above, the Supplemental SPA Deed was entered into on August 27, 2020 in order to, among others, extend the earn out periods to the year ending December 31, 2024 and to continue the contractual relationships with the Management Vendors such that they will continue to develop the business of NCM and assist its integration with the Group.

Our comments

We agree that as a result of the events after the Acquisition as explained above, the Group's original plan to fully integrate NCM's business to strengthen its business of intellectual property operations has been negatively impacted and is currently behind schedule. The profitability of NCM has also been negatively impacted and was behind the original expectation as set out in the Original Earn Out Mechanism. This is evidenced by the impairment provisions of goodwill and trademark rights related to the Acquisition of approximately RMB4,015.9 million and RMB389.8 million respectively as disclosed in the 2020 Interim Report, and on the other hand a fair value gain on consideration liabilities of approximately RMB1,240.3 million was recorded due to an expected saving of earn out consideration.

The Original Earn Out Mechanism includes terms to adjust the Original Earn Out Consideration based on the reference Net Profits of NCM from 2018 to 2020. As stated in the 2018 and 2019 annual reports of the Company, the actual Net Profit of NCM in 2018 and 2019 were approximately RMB324.3 million and RMB537.8 million respectively, less than the respective reference Net Profit benchmarks of RMB500 million and RMB700 million. Based on our discussion with management of the Group, the Net Profit of NCM in 2020 is expected to be lower than RMB480 million based on the latest estimation, such that no consideration will be payable to the Management Vendors. It follows that there may be no amounts to be placed into the Controlled Account, which is designed to incentivise the Management Vendors to continue their employment relationships with the Group until March 31, 2023.

As a result of the above, we concur with the management of the Group that the Original Earn Out Mechanism is no longer considered realistic and, more importantly, no longer sufficiently align interests of the Company and the Management Vendors. The Proposed Amendments, in principle, re-align the long-term interests of the Management Vendors and the Company in respect of its investment in NCM. As it still takes time for the business of NCM to be fully integrated into that of the Group, it is in the interest of the Company to continue to retain the Management Members, and to extend the periods subject to earn out to include the New Earn Out Years. The aggregate maximum amounts to be paid pursuant the Proposed Amendments would be the same as the maximum amount that would have to be paid in 2020 under the Original Earn Out Mechanism. Under the New Earn Out Mechanism, such payments will be spread over four more years (i.e. 2021 to 2024) to lengthen the incentives to the

Management Vendors to continue developing the business of NCM. It is stated in the letter from the Board that the Company is undergoing changes in its management team. We agree with the management that the extension of the New Earn Out Years would help ensure stability and provide more time for the Company's new management to develop synergies between the Group and NCM, including the establishment of a team with profound expertise in both online literature, drama production, as well as business integration, which is expected to bring strategic benefit to NCM and the Group as a whole in the long run.

3. Principal terms of the Proposed Amendments

On August 27, 2020, the Company entered into the Supplemental SPA Deed with Mr. Cao, the Founder SPV, Ms. Qu, the Qu SPV and the Executive SPV, pursuant to which the parties agreed to amend the terms of the 2018 NCM Share Purchase Agreement. Further, the parties to the 2018 Lock-Up Undertakings will enter into the Amendment Deeds of Lock-up Undertaking to revise the terms thereunder, and the parties to the 2018 Deeds of Non-Competition will enter into the Amendment Deeds of Non-Competition to revise the terms thereunder. The main Proposed Amendments are summarised below, please refer to the section headed "Supplemental SPA Deed" in the letter from the Board for further details.

(i) Amendment of the Original Earn Out Mechanism

The Original Earn Out Mechanism will be revised, such that the Original Earn Out Consideration payable by the Company for the year ending December 31, 2020 under the Original Earn Out Mechanism will be apportioned into five equal tranches and allocated to cover the five years ending December 31, 2024. Below is a summary showing the maximum cash amount ("**Cash Amount**") and the maximum Consideration Shares ("**New Earn Out Shares**") payable by the Company to the relevant Management Vendors under the New Earn Out Mechanism:

The Management Vendors	**Method of payment**	**Original Earn Out Consideration payable for 2020** *(approximate)*	**New Earn Out Consideration for each New Earn Out Year** *(approximate)* *(Note 1)*
The Founder SPV	Cash	RMB620.1 million	RMB124.0 million
	Shares	9.2 million	1.8 million
The Qu SPV	Cash	RMB278.7 million	RMB55.7 million
	Shares	4.1 million	0.8 million

The Management Vendors	**Method of payment**	**Original Earn Out Consideration payable for 2020** *(approximate)*	**New Earn Out Consideration for each New Earn Out Year** *(approximate)* *(Note 1)*
The Executive SPV	Cash	RMB122.2 million	RMB24.4 million
	Shares	1.8 million	0.4 million
Total	Cash	RMB1,021.0 million	RMB204.2 million
	Shares	15.1 million	3.0 million

Notes:

(1) Being the Original Earn Out Consideration for 2020 divided by five tranches for the New Earn Out Years 2020 to 2024

(2) The above figures may not add up due to rounding

Under the New Earn Out Mechanism, the amount of New Earn Out Consideration payable by the Company in a particular New Earn Out Year will depend on the Net Profit for the corresponding New Earn Out Year. The new benchmark levels for the Net Profit during the New Earn Out Years are set out below:

New Earn Out Year ending	**Reference Minimum Net Profit** *(RMB million)*	**Reference Maximum Net Profit** *(RMB million)*
December 31, 2020	200	400
December 31, 2021	300	500
December 31, 2022	300	500
December 31, 2023	300	500
December 31, 2024	300	500

As confirmed by the management of the Group, the Reference Minimum Net Profit and the Reference Maximum Net Profit during the New Earn Out Years are determined after taking into account (i) the production capability and existing pipeline projects of NCM, (ii) the financial performance and actual Net Profit of NCM in 2018 and 2019, (iii) the prevailing industry environment of the television and film industry in China, and (iv) the impact arising from COVID-19 on the production and release cycle of NCM's media projects. Based on our discussion with the management of the Group, given that the television and film industry in China faces a high degree of uncertainties, the parties agreed to set fixed benchmark levels for all the New Earn Out Years, with a downward adjustment of a RMB100 million for the year 2020, mainly reflecting the negative impacts on the industry from COVID-19.

If the Net Profit for the relevant New Earn Out Year is less than the Reference Minimum Net Profit, no New Earn Out Consideration will be payable by the Company for the relevant New Earn Out Year. Otherwise, the Company shall settle the New Earn Out Consideration in cash and by issuing Consideration Shares in accordance with the following formulas (the "**New Earn Out Formula(s)**"):

(a) Cash Amount:

$$\textit{Cash Amount} = \frac{\textit{Net Profit for that New Earn Out Year}}{\textit{Reference Maximum Net Profit for that New Earn Out Year}} \times \textit{Maximum Cash Amount} - \textit{Adjustment Amount (cash portion) for that New Earn Out Year}$$

(b) New Earn Out Shares:

$$\textit{New Earn Out Shares} = \frac{\textit{Net Profit for that New Earn Out Year}}{\textit{Reference Maximum Net Profit for that New Earn Out Year}} \times \textit{Maximum New Earn Out Shares} - \frac{\textit{Adjustment Amount (share portion) for that New Earn Out Year}}{\textit{Issue Price}}$$

Notes:

(i) If the Net Profit for a New Earn Out Year is greater than the Reference Maximum Net Profit for that New Earn Out Year, the Net Profit for that New Earn Out Year will be the Reference Maximum Net Profit for that corresponding New Earn Out Year

(ii) Under no circumstances shall the Cash Amount and number of New Earn Out Shares for the relevant Management Vendor be less than zero or exceed the maximum Cash Amount and maximum New Earn Out Shares (as set out above) respectively for that Management Vendor for any New Earn Out Year

(iii) The aggregate Adjustment Amounts applicable to the Management Vendors during each New Earn Out Year is RMB4 million

(ii) Additional condition and adjustment of the New Earn Out Consideration

The New Earn Out Consideration applicable to the Founder SPV, the Qu SPV and the Executive SPV shall be subject to an additional adjustment (the "**Adjustment Amount(s)**"). In the event that:

(i) in the case of the Founder SPV, certain selected employee(s) of NCM other than the Management Members,

(ii) in the case of the Qu SPV, Ms. Qu, or

(iii) in the case of the Executive SPV, all shareholders of the Executive SPV who are also employees of NCM and/or its subsidiaries,

(a) breaches his/her Revised Deed of Non-Competition in a New Earn Out Year (the "**Non-Compete Trigger Event**"); and/or (b) ceases or terminates his/her employment relationship(s) with the Group in a New Earn Out Year by reason of resignation, dismissal or otherwise (other than certain exclusions as set out in the Revised NCM Share Purchase Agreement) (the "**Leaver Trigger Event**" and together with the Non-Compete Trigger Event, the "**Trigger Events**"), an agreed amount determined with reference to the positions held by such employees shall be an Adjustment Amount and shall be deducted from the New Earn Out Consideration applicable to the Founder SPV, the Qu SPV and the Executive SPV for each Trigger Event in that New Earn Out Year and each New Earn Out Year thereafter. 50% of the Adjustment Amount will be deducted from the Cash Amount and the remaining 50% will be deducted from the New Earn Out Shares.

The Adjustment Amount applicable to each selected employee was determined in accordance with that employee's contribution to the success of the business of NCM. In determining an employee's contribution to NCM, the Company took into account the following factors: (a) the seniority, position, qualifications and experience of that employee; (b) the length of service of that employee; (c) the work performance of that employee; and (d) how critical that employee is to NCM.

The maximum aggregate Adjustment Amount applicable to the Management Vendors during a New Earn Out Year is RMB8 million, of which half (being RMB4 million) is allocated to the Non-Compete Trigger Event and the remaining half to the Leaver Trigger Event. The aggregate Adjustment Amount was determined after arm's length negotiations between the Company and the Management Vendors.

(iii) Founder Non-Compete and Leaver Amount

In the event that Mr. Cao causes any Trigger Events, the Founder SPV must return to the Company an amount on a one-time basis (namely the Founder Non-Compete and Leaver Amount) equal to the shortfall between the deduction amount and the instalment amount for the Founder SPV for the year ending December 31, 2020 under the Original Earn Out Mechanism and in accordance with the return of consideration under the Original Earn Out Mechanism, as calculated in accordance with the following formula:

$$\textit{Founder Non-Compete and Leaver Amount} = \frac{\textit{Net Profit shortfall for the year 2020 under the Original Earn Out Mechanism}}{\textit{Total reference Net Profit benchmark under the Original Earn Out Mechanism (i.e. RMB2,100 million)}} \times \textit{Total consideration payable to the Founder SPV} - \textit{Original Earn Out Consideration payable to the Founder SPV for the year 2020}$$

Notes:

(1) The total consideration payable to the Founder SPV is RMB6,200,626,591 under the 2018 NCM Share Purchase Agreement

(2) The Original Earn Out Consideration payable to the Founder SPV for the year 2020 is RMB1,240,125,318 under the Original Earn Out Mechanism

(3) The Founder Non-Compete and Leaver Amount shall not be less than zero or exceed a cap equal to the total consideration actually received by the Founder SPV from the Company

The Founder Non-Compete and Leaver Amount shall be settled, first by returning to the Company the portion of cash received by the Founder SPV under the Supplement SPA Deed, and thereafter, the number of the Consideration Shares (the value of which would be based on the Issue Price regardless of the actual trading price at the relevant time).

(iv) Removal of Roll-Over Mechanism, Overall Final Adjustment and Return of Consideration

The roll-over mechanism and overall final adjustment under the Original Earn Out Mechanism will be removed, and no such adjustment will be applied towards the New Earn Out Consideration, due to the different methodologies used to calculate the Original Earn Out Consideration under the Original Earn Out Mechanism and the New Earn Out Consideration under the New Earn Out Mechanism.

The return of consideration will be, to the extent it relates to the Founder SPV, amended in accordance with the Founder Non-Compete and Leaver Amount (as set out above) and, to the extent it relates to the Qu SPV and the Executive SPV, removed.

(v) Removal of Controlled Account

Under the existing arrangement of the 2018 NCM Share Purchase Agreement, a maximum of RMB500 million (or approximately 5% of the Original Earn Out Consideration payable to the Management Vendors of approximately RMB10,210 million) will be deposited into the Controlled Account until March 31, 2023.

No New Earn Out Consideration will be placed into escrow or any controlled account under the Revised NCM Share Purchase Agreement.

(vi) Amendment of 2018 Lock-up Undertakings

Pursuant to the Amendment Deeds of Lock-up Undertaking, the Consideration Shares issued or to be issued to the Management Vendors will be subject to disposal restrictions from:

(a) *in respect of the Consideration Shares already issued to the Management Vendors as at the date of the Amendment Deeds of Lock-up Undertaking*: the date of the Amendment Deeds of Lock-up Undertaking to April 1, 2025 (excluding the last date) and such Consideration Shares will be released from such restrictions in tranches; and

(b) *in respect of the Considerations Shares to be actually issued to the Management Vendors in respect of each New Earn Out Year*: the issue date of such Consideration Shares to April 1, 2025 (excluding the last date) and such Consideration Shares will be released from such restrictions in tranches.

(vii) Amendment of 2018 Deeds of Non-Competition

The non-competition undertakings given by Mr. Cao, Ms. Qu and each key employee of New Classics Media and its subsidiaries (each a "**Covenantor**") will be extended to the latest of (a) December 31, 2024; (b) three years from the termination of all employment relationships between the relevant Covenantor and the Group; and (c) the date on which the relevant Covenantor holds, directly or indirectly through a controlled entity, less than 1% of the issued share capital of the Company.

Conditions precedent

The amendment of the 2018 NCM Share Purchase Agreement under Supplemental SPA Deed shall take effect from the date falling on the next day immediately after the conditions precedent are satisfied or waived, details of which are set out in the section headed "Conditions Precedent" in the letter from the Board. The major ones are as follows:

(i) the approval of the Independent Shareholders having been obtained at the EGM in relation to the entering into of the Transaction Documents;

(ii) the Listing Committee of the Stock Exchange having granted or having agreed to grant the listing of, and permission to deal in, the Consideration Shares on the Stock Exchange; and

(iii) the due execution of the Amendment Deeds of Non-Competition and the Amendment Deeds of Lock-up Undertaking.

The Company may at any time waive the condition precedent (iii) above. As at the Latest Practicable Date, none of the conditions precedent set out above had been satisfied or waived.

Our comments

The main amendments to the New Earn Out Mechanism are the extension of the earn out period for four additional years till the end of 2024, and the splitting of the Original Earn Out Consideration for the year 2020 to five years from 2020 to 2024. No additional consideration, other than what would be payable for the year 2020 under the Original Earn Out Mechanism (assuming the 2020 profit benchmark would be achieved), would be payable under the New Earn Out Mechanism if all the Reference Maximum Net Profits in all the New Earn Out Years would be achieved. The level of consideration payable would depend on the future actual Net Profit, with a minimum threshold (the Reference Minimum Net Profit) incorporated such that no consideration will be payable if the future actual Net Profit is below such threshold.

As regards the removal of the controlled account feature from the Proposed Amendments, we understand from the management of the Group that it is mainly because the Management Vendors are now committing to the benchmark profits for four more years till the end of 2024, thus achieving the purpose of aligning the long-term interests of the Company and the Management Vendors.

Currently, under the Original Earn Out Mechanism, the Management Vendors may have an obligation to repay consideration previously received based the Original Earn Out Formula and other applicable adjustments with reference to the actual Net Profit, which was estimated to be approximately RMB724.0 million as at June 30, 2020 based on the expected 2020 Net Profit of NCM (the "**Original Contingent Receivable**"). While the above will no longer be receivable by the Group pursuant to the Proposed Amendments, the Founder SPV will be obliged to return the Founder Non-Compete and Leaver Amount to the Company as compensation if Mr. Cao, the founder and key management member of NCM, breaches the Revised Deed of Non-Competition or terminates his employment relationships with the Group before the end of 2024. On the other hand, if Ms. Qu and other key employees and management of NCM breach the Revised Deed of Non-Competition or terminates his/her employment relationships with the Group before the end of 2024, a downward-only adjustment (i.e. the Adjustment Amounts) will be applied to the New Earn Out Consideration. While such Adjustment Amounts may not be considered significant as compared to the total New Earn Out Consideration, we concur with the Directors' view that it nevertheless would serve as a deterrent to the selected employees from triggering the Non-Compete Trigger Event and/or the Leaver Trigger Event, when compared to the current situation that no amount is expected to be placed into the Controlled Account to incentivise the Management Vendors to continue their employment.

4. Information on NCM

Principal activities and business development

NCM principally engages in production and distribution of television series, web series and films in the PRC. NCM has dedicated to its quality focused strategy and the production of premium content, and it produced a number of popular television series and films across different genres in the past few years. Among which, certain television series and films, such as Ruyi's Royal Love in the Palace (如懿傳), Wu Kong (悟空傳), and Joy of Life (慶餘年), were adapted from the Group's library contents. In light of the macro changes in the PRC's media industry environment and the increasing demand from the online video platforms for high-quality contents, NCM started to implement new business strategy to expand its business scope since mid-2019 by licensing its adaptation rights and scripts for fixed fees at an earlier time when compared with the traditional production business model.

NCM has a roster of scriptwriters, directors and producers. It has been collaborating with experienced directors and producers to produce and develop television series, web series and films, and has entered into contracts with scriptwriters to create original scripts and conduct adaptation on scripts or intellectual properties which are sourced from other third parties. The key employees and management of NCM are currently led by Mr. Cao, who are experienced in the filming and production industry. As advised by the management of the Group, all the key employees and management of NCM have entered into employment contracts with the Group following completion of the Acquisition, and none of the contracts has been terminated as of the Latest Practicable Date.

Financial performance

The following table sets out a summary of the consolidated income statements of the NCM Group for the three years ended December 31, 2017, 2018 and 2019 and for the six months ended June 30, 2019 and 2020, as extracted from the audited consolidated financial information and unaudited consolidated management accounts of the Company as well as New Classics Media Corporation, which have been prepared in accordance with the International Financial Reporting Standards.

	For the six months ended June 30,		**For the year ended December 31,**		
	2020	**2019**	**2019**	**2018**	**2017**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Revenue	129,854	664,290	3,236,279	1,871,157	1,683,909
Cost of revenue	(56,533)	(270,113)	(2,140,300)	(1,235,958)	(832,688)
Gross profit	73,321	394,177	1,095,979	635,199	851,221
Gross margin	*56.5%*	*59.3%*	*33.9%*	*33.9%*	*50.6%*
Interest income	2,537	4,131	6,471	6,645	1,738
Other gains, net	682	3,429	14,980	32,067	13,228
Selling and marketing expenses	(45,674)	(114,933)	(231,430)	(147,790)	(244,833)
General and administrative expenses	(15,720)	(18,786)	(37,552)	(35,209)	(42,977)
Impairment loss/(reversal) on financial assets	(105,493)	5,625	(17,178)	29,784	(88,267)
Share of profits of associates and joint ventures	(864)	(797)	(1,465)	(1,648)	(1,604)
Finance costs	(54,431)	(88,378)	(164,120)	(126,893)	(69,119)
Income tax credit/(expense)	48,552	(88,968)	(111,417)	(46,192)	(42,715)
(Loss)/profit for the period/year	(97,090)	95,500	554,268	345,963	376,672
(Loss)/profit attributable to equity holders of the NCM Group	(96,322)	96,366	548,599	346,487	383,479

*Note: NCM was incorporated on May 18, 2018. It entered into a series of agreements with the registered shareholders of New Classics Media Corporation to obtain control over all the legal or beneficial interest in New Classics Media Corporation and its subsidiaries (the "**Operating Entity Group**"). Since the Acquisition, NCM and its subsidiaries (the "**NCM Group**") have become subsidiaries of the Company. We consider the inclusion of the financial performance of the Operating Entity Group, including the period before the incorporation of NCM, gives a better picture of the historical performance trend of NCM. The analysis of NCM's financial performance in this letter assumes inclusion of the financial performance of the Operating Entity Group throughout the above review period*

Revenue

Revenue of the NCM Group mainly derived from the licensing of television series and film rights to television stations and online video platforms, film distribution in movie theatres, sales of adaptation rights and scripts, as well as advertising services. As shown in the above table, the NCM Group recorded revenue growth in recent years, increasing from approximately RMB1,683.9 million in 2017 to approximately RMB1,871.2 million and RMB3,236.3 million in 2018 and in 2019 respectively. The significant revenue increase in 2019 was mainly attributable to (i) a higher number of television series and web series that were successfully broadcasted during the year. In particular, revenues from certain popular contents, namely Memories of Peking (芝麻胡同), Joy of Life (慶餘年) and The Best Partner (精英律師) were recognised, and (ii) additional revenue contributions from sales of adaptation rights and scripts, being the new business strategy that NCM started to explore starting from 2019.

Due to the unusually slow broadcast approval process for television series on television channels and online video platforms, and the negative impact on the PRC's macro-economy arising from the outbreak of COVID-19, NCM's production cycle for film and television projects has elongated and becomes less predictable in 2020. As a result, the NCM Group recorded revenue of approximately RMB129.9 million for the first six months of 2020, representing a significant decrease of approximately 80.5% as compared to the corresponding period last year.

Cost of revenue and gross profit margin

As advised by the management of the Group, cost of revenue primarily include the amortisation of capitalised production costs. Since the production costs for each of television series, web series and films varies, the cost of revenue can fluctuate substantially depending on the television series, web series and films being distributed in a given period. In addition, revenue generated from certain films being premiered in 2018 and 2019 were lower than associated production costs. As a result, the gross profit margin of the NCM Group fluctuated during the periods presented above. In particular, it decreased from approximately 50.6% in 2017 to approximately 33.9% in 2018 and in 2019, and increased back to approximately 56.5% in the first half of 2020. As advised by management of the Group, in the first half of 2020, there was no new television series or films being broadcasted or premiered, thus the revenue was generated mainly from those television series or films released in prior years, with recognition of limited associated production costs.

(Loss)/profit attributable to equity holders of the NCM Group

The profit attributable to equity holders of the NCM Group slightly decreased by approximately 9.6% from approximately RMB383.5 million in 2017 to approximately RMB346.5 million in 2018, but significantly increased by approximately 58.3% to approximately RMB548.6 million in 2019, which was mainly attributable to the successful distribution of the television series, web series and films during the year, partly offset by the corresponding increase in selling and marking expenses and a higher amount of finance costs as a result of additional bank borrowings obtained to support its increased production activities.

The NCM Group recorded a loss attributable to its equity holders of approximately RMB96.3 million for the first six months of 2020, as opposed to a profit attributable to equity holders of the NCM Group of approximately RMB96.4 million for the corresponding period last year, mainly attributable to the increase in impairment loss of certain trade and other receivables, and the significant decrease in revenue as explained above.

Pursuant to the 2018 NCM Share Purchase Agreement, the Net Profit for the purpose of calculating the Original Earn Out Consideration payable to the Management Vendors is determined based on NCM's consolidated net profits after tax, excluding (a) government subsidies; (b) investment income from joint venture and associates; (c) gain or loss from disposal of long-term assets; (d) fair value gain or loss from the re-measurement and disposal of long-term equity investments; (e) non-monetary assets exchange gains; (f) income from financial instruments held for investment purposes; and (g) associated tax effects arising from the above items (if applicable). On this basis, the Net Profit for the years 2018 and 2019 were approximately RMB324.3 million and RMB537.8 million respectively.

Financial position

The following table sets out a summary of the consolidated statements of financial position of the NCM Group as at December 31, 2017, 2018 and 2019 and as at June 30, 2020, as extracted from the audited consolidated financial information and unaudited consolidated management accounts of the Company as well as New Classics Media Corporation, which have been prepared in accordance with the International Financial Reporting Standards.

	As at June 30, 2020	As at December 31, 2019	2018	2017
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Trade and notes receivables	1,532,190	2,452,791	1,096,506	1,133,283
Television series and film rights and adaptation rights and scripts	1,611,525	1,501,293	2,488,167	1,742,461
Prepayments, deposits and other assets	581,418	539,274	523,043	541,043
Cash and cash equivalents	806,403	703,629	1,244,603	574,718
Other assets	297,205	265,225	73,916	126,983
Total assets	4,828,741	5,462,212	5,426,235	4,118,488
Borrowings	839,436	673,072	1,290,445	1,211,419
Other payables and accruals	1,279,925	1,879,430	1,429,436	1,314,533
Trade payables	246,086	280,845	333,924	262,881
Other liabilities	357,888	426,369	723,352	30,387
Total liabilities	2,723,335	3,259,716	3,777,157	2,819,220
Equity attributable to shareholders	2,101,453	2,197,775	1,650,385	1,303,890

As at June 30, 2020, the NCM Group recorded total assets of approximately RMB4,828.7 million, which mainly comprised (i) trade and notes receivables of approximately RMB1,532.2 million, mainly representing receivables from television stations, online video platforms and film distributors (net of allowance for doubtful debts), (ii) television series and film rights and adaptation rights and scripts of approximately RMB1,611.5 million, mainly representing adaption rights and scripts, television series, web series and films under production and completed television series, web series and films, and (iii) cash and cash equivalents of approximately RMB806.4 million.

As at June 30, 2020, the NCM Group had total liabilities of approximately RMB2,723.3 million. Of which, approximately RMB1,279.9 million was related to other payables and accruals, which mainly comprised of (a) loan and interest payables due to the Company of approximately RMB851.9 million, (b) payables of proceeds from licensing and distribution of television programs and film rights as distributor for joint operation television and film projects of approximately RMB161.8 million, and (c) payments received from co-producers of approximately RMB113.7 million for co-produced television series, web series and films under joint operation agreements. In addition, the NCM Group recorded bank borrowings of approximately RMB839.4 million, bearing interest rates of approximately 4.8% to 5.7% per annum, guaranteed by Mr. Cao and/or other subsidiaries of the Group.

Prospects

We have discussed with the management of the Group the latest business development of NCM, that the performance of NCM in 2020 has been below expectation mainly as a result of the macro changes to the television and film industry environment in China and the impact arising from the outbreak of COVID-19. However, the broadcast approval process for television series on television channels and online video platforms by the relevant PRC authorities has been gradually resuming to normal. In addition, movie theatres in the PRC are allowed to begin the reopening process starting from July 2020 with the execution of prevention and control measures regarding COVID-19. Given that the outbreak of COVID-19 in the PRC is currently under control, the Company expects that NCM's television and film projects are expected to release as scheduled in the coming years.

Separately, we were informed by the management of the Group that NCM possesses a diversified pipeline of television series, web series and films covering major genres that are under production or are ready to launch, such as My Best Friends' Story (流金歲月), My Heroic Husband (贅婿), Sword Snow Stride (雪中悍刀行), Douluo Continent (斗羅大陸) and The Golden Hairpin (青簪行), among which both My Heroic Husband (贅婿) and Douluo Continent (斗羅大陸) are adapted from the Group's intellectual properties. NCM also possesses a sizeable content library which can be leveraged in the long-term. On October 19, 2020, Tencent Pictures (Tencent's movie production unit), NCM and the Company held a joint press conference, announcing an in-depth collaboration to explore the opportunities of their respective intellectual properties. At the conference, the parties announced over 50 media projects, covering different genres of films and television series. For example, Joy of Life Season 2 (慶餘年第二季), which is adapted from one of the Group's popular intellectual properties, is currently under production by NCM and is expected to be released in the upcoming years.

We have reviewed statistics released by the National Radio and Television Administration and noted that the number of television series that are approved to be broadcasted on television channels decreased from 323 in 2018 to 254 in 2019, and the number of web series that are self-produced and acquired by licensed online video platforms decreased by approximately 10.4% to 1,911 in 2019. On the other hand, total revenue generated from television channels and online video platforms business in the PRC continued to grow, amounting to approximately RMB676.7 billion in 2019 and representing a year-on-year increase of approximately 20.0%. In particular, total revenue generated from online video platforms business (including licensing and paid content subscription of web series) recorded continued growth, reaching approximately RMB60.9 billion in 2019, representing a year-on-year increase of approximately 172.1%.

Given that the broadcast approval process has been gradually resuming to normal, and assuming there will be no resurgence of COVID-19, the market size of the PRC's media industry is expected to grow in the future. It follows that NCM's business, which mainly produce premium quality contents to television stations and online video platforms, will benefit from the above-mentioned media industry growth and the closer collaboration with the Group and Tencent Pictures as discussed above.

5. Evaluation of the Proposed Amendments

The Proposed Amendments are considered to be adjustments to the Original Earn Out Mechanism currently in place relating to the acquisition of the Management Vendors' interest in NCM. In order to provide a quantitative evaluation of the New Earn Out Mechanism, we looked into (a) the implied consideration for 100% interest in NCM by referencing the total consideration paid and payable to the Management Vendors and (b) the implied trading multiples on the assumption that NCM would be able to achieve, for each of the New Earn Out Years, (i) the Reference Minimum Net Profit ("**Scenario 1**"), below which the Company would not be required to pay any New Earn Out Consideration, and (ii) the Reference Maximum Net Profit ("**Scenario 2**"), where the maximum New Earn Out Consideration would be payable by the Company. The implied trading multiples as calculated above would be compared against those of NCM's listed peers. We consider the use of price to earnings ratio to be an appropriate benchmark for the above evaluation, as the amount of the New Earn Out Consideration potentially payable to the Management Vendors depends on the future Net Profit of NCM in the New Earn Out Years.

The calculations of total consideration paid and payable to the Management Vendors under each of Scenario 1 and Scenario 2 are as follows:

	Scenario 1 – NCM meeting the Reference Minimum Net Profit *(RMB million)*	**Scenario 2 – NCM meeting the Reference Maximum Net Profit** *(RMB million)*
The Paid Consideration *(Note 1)*	5,239.6	5,239.6
Consideration to be paid under the New Earn Out Mechanism:		
– Cash Amount	592.2 *(Note 2)*	1,021.0 *(Note 3)*
– Value of New Earn Out Shares	485.3 *(Note 4)*	836.7 *(Note 5)*
Total Consideration	6,317.1	7,097.3
Implied consideration for 100% interest in NCM ("Implied Full Consideration") *(Note 6)*	11,296.7	12,691.9

Notes:

(1) As calculated in the section headed "Background to and reasons for the Proposed Amendments"

(2) Based on the sum of Cash Amount payable for all New Earn Out Year to (i) the Founder SPV (i.e. approximately RMB62.0 million for 2020 and approximately RMB74.4 million for each of 2021 to 2024), (ii) the Qu SPV (i.e. approximately RMB27.9 million for 2020 and approximately RMB33.4 million for each of 2021 to 2024) and (iii) the Executive SPV (i.e. approximately RMB12.2 million for 2020 and approximately RMB14.7 million for each of 2021 to 2024) under Scenario 1, based on the New Earn Out Formula for the Cash Amount and assuming the Adjustment Amount is nil

(3) Based on the sum of Cash Amount payable for all New Earn Out Year to (i) the Founder SPV (i.e. approximately RMB124.1 million for each of 2020 to 2024), (ii) the Qu SPV (i.e. approximately RMB55.7 million for each of 2020 to 2024) and (iii) the Executive SPV (i.e. approximately RMB24.4 million for each of 2020 to 2024) under Scenario 2, based on the New Earn Out Formula for the Cash Amount and assuming the Adjustment Amount is nil

(4) Based on the product of (a) 8,769,492 New Earn Out Shares, which is the minimum number of New Earn Out Shares to be issued to (i) the Founder SPV (i.e. 918,235 New Earn Out Shares for 2020 and 1,101,882 New Earn Out Shares for each of 2021 to 2024), (ii) the Qu SPV (i.e. 412,723 New Earn Out Shares for 2020 and 495,268 New Earn Out Shares for each of 2021 to 2024) and (iii) the Executive SPV (i.e. 181,023 New Earn Out Shares for 2020 and 217,228 New Earn Out Shares for each of 2021 to 2024) for each New Earn Out Year under Scenario 1, based on the New Earn Out Formula for the New Earn Out Shares and assuming the Adjustment Amount is nil, (b) the closing price of HK$64.15 per Share as quoted on the Stock Exchange as at the Latest Practicable Date, and (c) the RMB:HKD exchange rate of 1.1593 as at the Latest Practicable Date

(5) Based on the product of (a) 15,119,815 New Earn Out Shares, which is the maximum number of New Earn Out Shares to be issued to (i) the Founder SPV (i.e. 1,836,470 New Earn Out Shares for each of 2020 to 2024), (ii) the Qu SPV (i.e. 825,446 New Earn Out Shares for each of 2020 to 2024) and (iii) the Executive SPV (i.e. 362,047 New Earn Out Shares for each of 2020 to 2024) for each New Earn Out Year under Scenario 2, based on the New Earn Out Formula for the New Earn Out Shares and assuming the Adjustment Amount is nil, (b) the closing price of HK$64.15 per Share as quoted on the Stack Exchange as at the Latest Practicable Date, and (c) the RMB:HKD exchange rate of 1.1593 as at the Latest Practicable Date

(6) Based on the total consideration under the respective scenario as per above, and the total shareholding of approximately 55.92% held by the Management Vendors in NCM, on an as-converted fully diluted basis, acquired by the Group pursuant to the Acquisition

We have reviewed Hong Kong listed companies engaging in a business similar to NCM (i.e. production and distribution of television series, web series and films in the PRC), with (i) at least half of their revenues generated from this activity and recorded net profits attributable to their shareholders in the latest published full year financial statements, and (ii) a market capitalisation of at least HK$1 billion as at the Latest Practicable Date. Based on these selection criteria, we have only identified two Hong Kong listed comparable companies, namely Cathay Media and Education Group Inc. (Stock code: 1981.HK) and China Bright Culture Group (Stock code: 1859.HK) that we consider comparable in principle to NCM according to our research on the website of the Stock Exchange. Given the limited market comparables listed on the Stock Exchange, we have expanded our research to cover companies listed on stock exchanges outside Hong Kong that can be identified on Bloomberg and fall within the stated selection criteria above. A total of 5 comparable companies (the "**Comparable Companies**") have been identified on this basis. In our view, the Comparable

Companies set out below represent a full list of companies that we were able to identify which satisfied the said selection criteria, on a best effort basis:

Company name and stock code	**Market capitalisation as at the Latest Practicable Date** *(RMB million)* *(Note 1)* **(A)**	**Reported profit** *(RMB million)* *(Note 2)* **(B)**	**Adjusted profit** *(RMB million)* *(Note 3)* **(C)**	**Price to earnings ("FY P/E") ratio** *(times)* **(A/B)**	**Price to adjusted earnings ("Adjusted P/E") ratio** *(times)* **(A/C)**
Beijing Enlight Media Company Limited (Stock code: 300251.CH)	35,761	948	892	37.7	40.1
Cathay Media and Education Group Inc. (Stock code: 1981.HK)	6,128	177	293	34.6	20.9
Beijing Hualu Baina Film & TV Company Limited (Stock code: 300291.CH)	4,643	114	101	40.7	46.0
Ciwen Media Co Ltd (Stock code: 2343.CH)	3,334	165	164	20.2	20.3
China Bright Culture Group (Stock code: 1859.HK)	925	148	148	6.3	6.3
			Mean	***27.9***	***26.7***
			Median	***34.6***	***20.9***
			Maximum	***40.7***	***46.0***
			Minimum	***6.3***	***6.3***
NCM					
Based on 2019					
reported and	11,296.7			20.6	20.6
normalised profit	12,691.9	548.6	547.7	23.1	23.2

Company name and stock code	Market capitalisation as at the Latest Practicable Date *(RMB million)* *(Note 1)* **(A)**	Reported profit *(RMB million)* *(Note 2)* **(B)**	Adjusted profit *(RMB million)* *(Note 3)* **(C)**	Price to earnings ("FY P/E") ratio *(times)* **(A/B)**	Price to adjusted earnings ("Adjusted P/E") ratio *(times)* **(A/C)**
Scenario 1 – NCM meeting the Reference Minimum Net Profit	11,296.7	280.0	280.0	40.3 *(Note 4)*	40.3 *(Note 4)*
Scenario 2 – NCM meeting the Reference Maximum Net Profit	12,691.9	480.0	480.0	26.4 *(Note 5)*	26.4 *(Note 5)*

Source: Bloomberg and Comparable Companies' public filings

Notes:

(1) In respect of the Comparable Companies: being the product of the respective closing price as quoted on the relevant stock exchange and the number of issued shares, as at the Latest Practicable Date; In respect of NCM: being the Implied Full Consideration under each of Scenario 1 and Scenario 2 as calculated above

(2) Being the respective consolidated net profits attributable to the shareholders for each of the Comparable Companies and NCM, as extracted from the latest published full year financial statements

(3) Being the respective consolidated net profits attributable to the shareholders for the Comparable Companies, excluding those non-recurring items, such as gain/(loss) on disposal of long-term assets, early contract termination fee income/penalty costs and listing expenses (if applicable), before taking into account related impacts on tax and non-controlling interests, as extracted from the latest published full year financial statements

(4) Calculated by dividing (a) the Implied Full Consideration under Scenario 1 by (b) the average Reference Minimum Net Profit for the five years ending December 31, 2024, being RMB280 million

(5) Calculated by dividing (a) the Implied Full Consideration under Scenario 2 by (b) the average Reference Maximum Net Profit for the five years ending December 31, 2024, being RMB480 million

*(6) We consider Tvzone Media Co Ltd ("***Tvzone***") (Stock code: 603721.CH) to be a Comparable Company as it falls under the above criteria. However, based on the published financial information, Tvzone recorded consolidated net profits attributable to its shareholders of approximately RMB19.3 million, which included a gain arising from one-off disposal of approximately RMB51.9 million. The FY P/E Ratio of Tvzone was approximately 102.6 times, while the Adjusted P/E Ratio was not applicable to Tvzone, given its loss making position after excluding the non-recurring items. To avoid distortion of our analysis, we have excluded the relevant ratios of Tvzone as an outlier from the above table and the analysis below*

(i) FY P/E ratios and Adjusted P/E ratios

As set out in the table above, the FY P/E ratios of the Comparable Companies are between approximately 6.3 times to 40.7 times, with a mean and median of approximately 27.9 times and 34.6 times respectively. However, we note that certain Comparable Companies recorded various non-recurring items in their respective consolidated net profits attributable to the shareholders in the latest published full year financial statements. For the sake of better comparability for their underlying financial performance and as a further check, we have calculated the Adjusted P/E Ratios for each of the Comparable Companies, such that these non-recurring items are excluded. On this basis, the Adjusted P/E Ratios of the Comparable Companies are in a range of approximately 6.3 and 46.0 times, with a mean and median of approximately 26.7 and 20.9 times respectively. Should the same calculation methods applied to NCM, the implied P/E ratios of NCM as represented by the Implied Full Consideration under Scenario 1 and 2 range from approximately 20.6 to 23.2 times, are lower than or close to the mean and median of the Comparable Companies.

(ii) Implied P/E ratios (based on the New Earn Out Consideration)

Since the amount of the New Earn Out Consideration potentially payable to the Management Vendors depends on the future Net Profit of NCM in each of the New Earn Out Years, we consider the implied P/E ratio of NCM as represented by the Reference Minimum Net Profit and the Reference Maximum Net Profit under Scenario 1 and 2 respectively to be more relevant from perspective of the Independent Shareholders.

Under Scenario 1, assuming that all the Reference Minimum Net Profit in each New Earn Out Year are just met and there is no Adjustment Amount, the implied P/E ratio of NCM, dividing the Implied Full Consideration of approximately RMB11,296.7 million and the average Reference Minimum Net Profit of RMB280 million, would be approximately 40.3 times. Such figure is higher than the mean and median of both FY P/E ratios and Adjusted P/E ratios of the Comparable Companies but fall within the range, as shown in the table above. If NCM records Net Profit at a level higher than the Reference Minimum Net Profit during the New Earn Out Years, the resultant P/E ratio will be lower.

Under Scenario 2, assuming that all the Reference Maximum Net Profit in each New Earn Out Year are met and there is no Adjustment Amount, the implied P/E ratio of NCM, dividing the Implied Full Consideration of approximately RMB12,691.9 million and the average Reference Maximum Net Profit of RMB480 million, would be approximately 26.4 times. Such figure is lower than the mean and median of FY P/E ratios of the Comparable Companies, and between the mean and median of Adjusted P/E ratios of the Comparable Companies.

As stated in the 2020 Interim Report, the Company expects that performance of NCM in 2020 will be below expectation, impairment provisions of goodwill and trademark rights related to the Acquisition of approximately RMB4.4 billion in total was recognised for the six months ended June 30, 2020. Against this backdrop, we have reviewed and discussed with management of the Group, the cash flow projections of NCM for the years ending December 31, 2026 that was performed for the purpose of the assessment of the above impairment provisions.

We note that despite the lower-than-expected performance in the first half of 2020, it is expected that the production and distribution of television and films projects by NCM will gradually pick up in the second half of 2020, and that the performance will continue to improve for the remainder of the projection periods. In determining the cash flows projections for the years 2020 and 2021, the Company mainly made reference to (i) the existing pipeline projects (either under production or in the process of obtaining licence), and (ii) the historical revenue and associated production costs per episode for similar genres of projects. Projections for the years beyond 2021 were mainly based on the year 2021 and assumed a gradual growth in revenue and associated costs. Having considered NCM's future cash flow projections as described above and the determination bases of the Reference Minimum Net Profit and the Reference Maximum Net Profit as set out in the section headed "Principal terms of the Proposed Amendments", we consider the way the parties set the Reference Minimum Net Profit and the Reference Maximum Net Profit is reasonable.

Based on our analysis on the implied P/E ratios against those of NCM's listed peers and our observations on the expected performance of NCM based on the management's projections as presented above, we consider the consideration payable to the Management Vendors under the New Earn Out Mechanism to be justifiable.

6. The effects of the Proposed Amendments on the Group

Financial effects – earnings and assets/liabilities

As disclosed in the 2020 Interim Report, the Original Contingent Receivable of approximately RMB724.0 million was recognised as at June 30, 2020, which represents the estimated contingent receivable from the Management Vendors. Under the New Earn Out Mechanism, the Founder Non-Compete and Leaver Amount, representing the portion of the Original Contingent Receivable attributable to Mr. Cao (approximately 60.7% of the total, or approximately RMB439.5 million), will be repayable to the Company if he ceases/terminates his employment or breaches the Revised Deed of Non-Competition during the New Earn Out Years and, therefore, will be recognised as deferred compensation cost and amortised as expenses during the New Earn Out Years. The remaining portion of the Original Contingent Receivable of approximately RMB284.5 million will no longer be repayable by the Management Vendors under the New Earn Out Mechanism, and will therefore be charged to the Group's profit or loss as other losses, net.

Under the New Earn Out Mechanism, the Adjustment Amounts, with a maximum amount of RMB20 million (being the aggregate Leaver Amount for the five New Earn Out Years) out of the New Earn Out Consideration will be treated as compensation to retain the key employees of NCM, and will be charged to profit or loss as general and administrative expenses from 2020 to 2024. The remaining portion, which represents the vast majority of the New Earn Out Consideration, will be treated as an increase in contingent consideration payable and will be recognised as other losses, net, following the effective date of the Revised NCM Share Purchase Agreement. Although most of the New Earn Out Consideration payable in future will not be capitalised but instead recognised as immediate one-off adjustments as other net losses in the Group's profit or loss, the actual benefits of the New Earn Out Mechanism of potentially higher level of earnings will only be reflected in future financial statements of NCM and the Group. For each of the New Earn Out Years, any change in the fair value of contingent consideration payable will be recognised in the Group's profit or loss.

Financial effects – cash flow

The Group maintained a healthy financial position as at June 30, 2020, with net cash of approximately RMB4,530.4 million. It is expected that a maximum cash payment of approximately RMB1,021.0 million (or approximately RMB204.2 million for each New Earn Out Year) will be payable to the Management Vendors pursuant to the New Earn Out Mechanism. Given the strong net cash position, the above future cash payment is not expected to create substantial financial constrain to the Group.

Shareholding structure

The New Earn Out Consideration includes issuing Consideration Shares to the Management Vendors for the five years ending December 31, 2024. For illustration purpose only, set out below is the shareholding structure of the Company (i) as at the Latest Practicable Date, and (ii) immediately upon the issuance of all the Consideration Shares under the New Earn Out Mechanism under the Revised Share Purchase Agreement (assuming that all the Reference Maximum Net Profit are met and the Adjustment Amount is nil, and no other changes in the Company's issued Shares):

	As at the Latest Practicable Date		Immediately upon the issuance of all the Consideration Shares under the New Earn Out Mechanism under the Revised Share Purchase Agreement (assuming that all the Reference Maximum Net Profit are met and the Adjustment Amount is nil, and no other changes in the Company's issued Shares)	
Name of Shareholder	**Number of Shares**	**Approximate % of total issued Shares**	**Number of Shares**	**Approximate % of total issued Shares**
Tencent	601,126,564	59.18%	601,126,564	58.31%
Other connected persons *(Note 1)*	15,950,546	1.57%	15,950,546	1.55%
The Management Vendors				
– Founder SPV	25,047,972	2.47%	34,230,322	3.32%
– Qu SPV	11,258,413	1.11%	15,385,643	1.49%
– Executive SPV	4,810,165	0.47%	6,620,400	0.64%
Other public Shareholders	357,588,056	35.20%	357,588,056	34.69%
Total	1,015,781,716	100.0%	1,030,901,531	100.0%

Notes:

(1) Comprising the Shares held by Mr. Wu Wenhui, Mr. James Gordon Mitchell, Mr. Cheng Yun Ming Matthew and Mr. Cheng Wu, all being the Directors and the connected person of the Company

(2) The above figures may not add up due to rounding

As illustrated above, the shareholdings in the Company held by other public Shareholders would be diluted from approximately 35.2% as at the Latest Practicable Date to approximately 34.7%. Notwithstanding the above, Shareholders should note that the maximum number of Consideration Shares which may be issued to the Management Vendors under the New Earn Out Mechanism for the five years ending December 31, 2024 is equal to the maximum number of the Consideration Shares to be issued in 2020 pursuant to the Original Earn Out Mechanism. As such, the level of dilution under the Proposed Amendments as disclosed above will not be more than that as expected under the original terms.

DISCUSSION

NCM principally engages in production and distribution of television series, web series and films in the PRC. When NCM was acquired by the Group in 2018, it was a stated intention for the Group to utilise NCM's production capability to unlock the potential value of the Group's literary content library, and to expand the adaptation value chain and gain more control of the adaptation process. As further explained in the letter from the Board, changes in the television and film industry in China led to a declining trend in project filings, productions and releases. The outbreak of COVID-19 has resulted in a decrease in sales price of projects and a longer production cycle. The above seriously and negatively impacted the financial performance of NCM compared to the original expectation as reflected in the original Net Profit benchmarks, and the integration with NCM fell behind schedule. We concur with the Company's management that for reasons which could not be predicted at the time, the Original Earn Out Mechanism is no longer realistic, and no longer serves its purpose to align the interests of the Company and the Management Vendors.

The Proposed Amendments extend the Original Earn Out Mechanism and set more appropriate net profit benchmarks for NCM from 2020 to 2024 based on the up-to-date expectation of NCM's future performance, which have the effect of extending the incentives to the Management Members to stay with NCM and continue developing the business of NCM, and to improve profitability of NCM for four additional years. The Proposed Amendments reduce the risk of the Management Members leaving NCM or under-performing following the end of the original earn out period (i.e. end of 2020) through re-aligning the interest of the Management Vendors and the Group and increasing the disincentives for departure and under-performance. The Proposed Amendments also allow the new management team of the Group to drive the business synergy and integration progress with NCM through the establishment of a team with knowledge in both online literature and drama production, and a closer collaboration with NCM's team, who will have renewed incentives to stay with NCM during the New Earn Out Years. The Founder is a well-known industry veteran with a reputation of producing premium quality contents and an extensive network talented industry partners. Other core management team members of NCM are experienced in content production with strong track record. The Directors believe that it is in the interest of the Company to continue to retain the Management Members, and expect the detailed action plans formulated with NCM's core management will achieve better integration and enhanced synergies during the New Earn Out Years.

The Original Earn Out Consideration payable for the year 2020 will, under the New Earn Out Mechanism, be apportioned into five equal tranches to cover the five years ending December 31, 2024, so there will be no additional amount payable by the Group beyond that contemplated in the Original Earn Out Mechanism.

Pursuant to the New Earn Out Mechanism, if the Net Profit of NCM reaches RMB400 million in 2020, or RMB500 million in each of 2021 to 2024, the maximum consideration per year comprising (i) cash of approximately RMB204.2 million and (ii) approximately 3.0 million Shares valued at approximately RMB167.3 million (based on the closing price of the Shares of HK$64.15 as at the Latest Practicable Date) will be payable to the Management Vendors. No New Earn Out Consideration will be payable if the Net Profit of NCM is less than RMB200 million in 2020, or RMB300 million in each of 2021 to 2024.

As approximately 40% in value of the New Earn Out Consideration will be payable in shares, the interest of the Management Vendors and the Company will be aligned to a considerable extent. The lock-up in respect of the Consideration Shares previously issued and to be issued in future will be extended and to be released in tranches. The non-competition undertakings given by the key Management Members, will also be extended to at least until the end of the New Earn Out Years. The portion of the Original Contingent Receivable repayable by Mr. Cao (estimated to be approximately RMB439.5 million as at June 30, 2020) will continue to be repayable to the Group if he ceases his employment with the Group before December 31, 2024 or breaches the Revised Deed of Non-Competition during the New Earn Out Years. This serves as a further incentive for Mr. Cao, as a crucial member of NCM management, to dedicate his efforts during the New Earn Out Years.

The Proposed Amendments adhere to the principles of the Original Earn Out Mechanism pursuant the terms of the Acquisition in 2018. To assess the New Earn Out Mechanism, we reviewed the implied consideration for 100% equity interest in NCM referencing the total consideration paid previously and payable in future to the Management Vendors. The implied P/E ratio of NCM, assuming it meets the Reference Minimum Net Profit, is higher than the means and medians, but within the range, of the P/E ratios of NCM's listed peers based on their latest reported and adjusted full year earnings. The implied P/E ratio of NCM, assuming it achieves the Reference Maximum Net Profit, is close to the means of the P/E ratios of the peers.

As disclosed in the 2020 Interim Report, the Original Contingent Receivable of approximately RMB724.0 million was recognised as current assets of the Group as at June 30, 2020. Upon the New Earn Out Mechanism becoming effective, it is expected that one-off losses will be recognised in the Group's profit or loss, mainly arising from (i) reversal of the portion of the Original Contingent Receivable attributable to the Management Vendors other than the Founder SPV, and (ii) losses on remeasurement of contingent consideration payable, which represents the vast majority of the New Earn Out Consideration. Notwithstanding that the above financial impacts to the Group's profit or loss are substantial, they represented one-off adjustments to the expected consideration payable in future during the New Earn Out Years, while the actual benefits of the New Earn Out Mechanism of potentially higher level of earnings will not be reflected until they can be included in future financial statements of NCM and the Group. The dilution effect to the Shareholders as a result of the issue of a maximum of approximately 15.1 million new Shares is not significant (less than 1.5%) when compared to the total issued Shares of approximately 1,015.8 million as at the Latest Practicable Date.

Taking into consideration the above and the other factors presented in this letter, we consider the Proposed Amendments represent an appropriate response to unexpected conditions (e.g. industry changes and COVID-19) so as to restore the arrangements to align the long-term interests of the Management Vendors and the Company, with a view to optimise the performance of NCM. While certain elements of the Proposed Amendments are considered to be disadvantages, in particular the abovementioned one-off losses arising mainly from the recognition of contingent consideration payable relating to the New Earn Out Consideration and the fact that the Original Contingent Receivable will no longer be receivable, we consider it fair to view such elements in conjunction with the benefits of incentivising contributions from the Management Vendors, improving future NCM earnings and achieving a better integration of NCM, all of which are of strategic importance to the Group. In our view, the entering into of the Transaction Documents is a move to revitalise NCM which, together with the implementation of action plans as explained in the section headed "Background to and reasons for the Proposed Amendments", is expected to bring long-term strategic benefits to the Company.

OPINION AND RECOMMENDATION

Having taken into account the principal factors and reasons set out above, we consider that the Proposed Amendments are on normal commercial terms and fair and reasonable so far as the Independent Shareholders are concerned. Although the entering into of the Transaction Documents is not considered to be in the ordinary and usual course of business of the Group due to the nature of the Proposed Amendments being adjustments to the terms of the Acquisition, we consider that it is in the interests of the Company and its Shareholders as a whole. Accordingly, we recommend that the Independent Board Committee to advise, and we ourselves recommend, the Independent Shareholders to vote in favour of the ordinary resolution to be proposed at the Extraordinary General Meeting to approve the Transaction Documents and the transactions contemplated thereunder.

Yours faithfully,
for and on behalf of
SOMERLEY CAPITAL LIMITED
John Wong
Director

Mr. John Wong is a licensed person registered with the Securities and Futures Commission and a responsible officer of Somerley Capital Limited, which is licensed under the SFO to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities. He has over ten years of experience in the corporate finance industry.

I. FINANCIAL INFORMATION OF THE GROUP FOR THE THREE FINANCIAL YEARS ENDED DECEMBER 31, 2019

Financial information of the Group for the years ended December 31, 2017, 2018 and 2019 have been disclosed on the annual report of the Company for the year ended December 31, 2017, 2018 and 2019 and Appendix I of the global offering prospectus dated October 26, 2017, all of which are published on the website of the Stock Exchange at http://www.hkexnews.hk/, and the website of the Company at http://ir.yuewen.com:

- 2017 Annual Report (for the financial information of the Group for the year ended December 31, 2017): http://www1.hkexnews.hk/listedco/listconews/sehk/2018/0412/ltn20180412473.pdf

- 2018 Annual Report (for the financial information of the Group for the year ended December 31, 2018): https://www1.hkexnews.hk/listedco/listconews/sehk/2019/0409/ltn201904091216.pdf

- 2019 Annual Report (for the financial information of the Group for the year ended December 31, 2019): https://www1.hkexnews.hk/listedco/listconews/sehk/2020/0427/2020042701968.pdf

II. INDEBTEDNESS

Borrowings and lease liabilities

As at the close of business on September 15, 2020, being the latest practicable date for the purpose of this indebtedness statement prior to the printing of the Circular, the Group had the following outstanding borrowings and lease liabilities:

	As at September 15, 2020
	RMB'000
Borrowings	
current portion	
guaranteed	420,282
guaranteed and pledged	190,489
non-guaranteed and unpledged	350,000
non-current portion	
guaranteed	300,000
non-guaranteed and unpledged	411,630
Subtotal	**1,672,401**

	As at September 15, 2020
	RMB'000
Lease liabilities	
current portion	35,904
non-current portion	25,623
Subtotal	**61,527**
Total	**1,733,928**

Contingent liabilities

As at the close of business on September 15, 2020, being the latest practicable date for the purpose of this indebtedness statement prior to the printing of the Circular, the Group had no unrecorded significant contingent liabilities, guarantees, mortgages, charges or any litigation against it.

III. WORKING CAPITAL

Taking into account the financial resources available to the Group, including the internally generated funds and available banking facilities and after due and careful enquiry, the Directors are of the opinion that the Group has sufficient working capital to meet its present requirements for the next twelve months from the date of this circular.

IV. FINANCIAL AND TRADING PROSPECTS OF THE GROUP

As mentioned in the annual report of the Company for the year 2019, the Company has sought and is seeking to enhance its capabilities and elevate its strategy in certain areas, while adhering to long-held principles and directions in others. Areas where market changes have prompted the Group to evolve its strategy include: (a) adding its own free-to-read (advertising-funded) services, initially in Tencent's Mobile QQ and QQ Browser apps, and then in its stand-alone Feidu app; (ii) deepening its integration into the Weixin Reading app, and nurturing users' payment habits inside Weixin Reading; and (iii) licensing its IP not only into live action costume drama series, where the entire genre has been subject to a period of delay in being broadcast, but also into modern-day live action drama series and animated drama series, which have not been subject to such a period.

V. THE GROUP'S LIQUIDITY AND FINANCIAL RESOURCES

Our Group funds cash requirements principally from capital contributions from shareholders, cash generated from our operations. As of June 30, 2020, our Group had net cash of RMB4,530.4 million, compared to RMB5,139.3 million as of December 31, 2019. The decrease in net cash in the first half of 2020 was mainly due to the payment of earn out cash consideration to the Management Vendors under the Original Earn Out Mechanism based on the financial performance of New Classics Media for the financial year ended December 31, 2019, partially offset by the cash generated from the operating activities of the Group. The Group's bank balances and term deposits are primarily in USD, RMB and HKD. Our Group monitors capital on the basis of gearing ratio, which is calculated as debt divided by total equity. As of June 30, 2020:

- The Group's gearing ratio was 11.3%, compared to 6.7% as of December 31, 2019.
- The Group's total borrowings were RMB1,864.2 million, which were primarily denominated in RMB.
- The Group's unutilized banking facility was RMB1,407.8 million.

As of June 30, 2020 and December 31, 2019, the Group had no significant contingent liabilities.

As of June 30, 2020 and December 31, 2019, the Group had not used any financial instruments for hedging purposes.

As of June 30, 2020, the Group have not hedged against any fluctuations in foreign currency.

VI. THE CAPITAL STRUCTURE OF THE GROUP

The Company continued to maintain a healthy and sound financial position. The Group's total assets decreased from RMB26,250.0 million as of December 31, 2019 to RMB21,460.4 million as of June 30, 2020, while the Group's total liabilities decreased from RMB6,839.2 million as of December 31, 2019 to RMB5,027.8 million as of June 30, 2020. Liabilities-to-assets ratio decreased from 26.1% as of December 31, 2019 to 23.4% as of June 30, 2020.

As of June 30, 2020, the current ratio (the ratio of total current assets to total current liabilities) was 291.7%, compared to 206.1% as of December 31, 2019.

As of June 30, 2020, the Group has pledged receivables of RMB224.7 million as security to a certain bank borrowing, compared to RMB324.2 million as of December 31, 2019.

VII. REMUNERATION AND EMPLOYEE BENEFITS SCHEME

A remuneration committee was set up for reviewing the Group's remuneration policy and structure for all remuneration of the Directors and senior management of the Group, having regard to the Group's operating results, individual performance of the Directors and senior management and comparable market practices. As to the employee benefits of the Group, it includes (i) wages, salaries and bonuses; (ii) social security costs, housing benefits and other employee benefits; (iii) pension costs under defined contribution plans; and (iv) awards under the restricted stock unit plans of the Company adopted on December 23, 2014 and May 15, 2020, respectively.

1. RESPONSIBILITY STATEMENT

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

2. SHARE CAPITAL

The following is a description of the authorized and issued share capital of our Company in issue and to be issued as fully paid or credited as fully paid immediately following the completion of the Acquisition:

Authorized Share Capital

Number of Shares	Aggregate nominal value of Shares *(US$)*
10,000,000,000	1,000,000

Issued Share Capital

The issued share capital of our Company immediately following the completion of the Acquisition will be as follows:

Number of Shares	Description of Shares	Aggregate nominal value of Shares *(US$)*
1,015,781,716	Shares in issue as at the Latest Practicable Date	101,578.1716
15,119,815	The maximum Shares to be issued due to the Earn Out Mechanism (assuming that the Reference Maximum Net Profit for the five New Earn Out Years ending December 31, 2024 are met and without any adjustment under the Revised Share Purchase Agreement)	1,511.9815
1,030,901,531	Shares in total	103,090.1531

All the Shares in issue and the consideration Shares issued and to be issued under the Revised Share Purchase Agreement are and will (when allotted and fully paid or credited as fully paid) rank pari passu in all respects with each other as regards dividends, voting rights and return of capital. The holders of all the consideration Shares issued and to be issued under the Revised Share Purchase Agreement will be entitled to receive all future dividends and distributions which are declared, made or paid after the date of allotment and issue of the consideration Shares.

Since December 31, 2019 (being the end of the last financial year of the Company) and up to and including the Latest Practicable Date, no new Shares had been issued by the Company and as at the Latest Practicable Date, the Company did not have any outstanding options, warrants or securities which will be convertible or exchangeable into Shares.

3. EXPERT AND CONSENTS

The following are the qualification of the experts who have given opinions and advice contained in this circular:

Name	Qualification
Somerley	a corporation licensed to carry on type 1 (dealing in securities) and type 6 (advising on corporate finance) regulated activities as defined under the SFO

As at the Latest Practicable Date, Somerley:

(a) have given and have not withdrawn their respective written consent to the issue of this circular with the inclusion of their respective letter and references to their respective name, in the form and context in which they appear.

(b) neither had any shareholding in any member of the Group nor had any right (whether legally enforceable or not) to subscribe for or nominate persons to subscribe for any securities in any member of the Group.

(c) did not have any direct or indirect interest in any assets which have been acquired or disposed of by, or leased to any member of the Group, or were proposed to be acquired or disposed of by, or leased to any member of the Group since December 31, 2019, being the date to which the latest published audited consolidated financial statements of the Company were made up.

4. NO MATERIAL ADVERSE CHANGE

The Directors are not aware of any material adverse change in the financial or trading position of the Group since December 31, 2019, being the date to which the latest published audited annual financial statements of the Company were made up.

5. SERVICE CONTRACTS OF DIRECTORS

Each of the executive Directors has entered into a service contract with the Company for a term of three years commencing from August 1, 2020 and is subject to retirement by rotation and re-election in accordance with the Articles of Association as a replacement of the service contract entered into between the Company and the executive Directors on April 27, 2020, and is subject to termination as provided in the service contract.

Each of Mr. James Gordon Mitchell, Mr. Cao Huayi and Mr. Cheng Yun Ming Matthew, as the non-executive Director, has entered into an appointment letter with the Company on October 19, 2017, May 17, 2019 and November 22, 2019, respectively, for an initial term of three years commencing from the date of their respective appointment letter, subject to retirement by rotation and re-election in accordance with the Articles of Association and is subject to termination as provided in the appointment letter. Mr. Wu Wenhui, a non-executive Director, has entered into an appointment letter with the Company for an initial term of one year commencing from April 27, 2020.

Each of the independent non-executive Directors has entered into an appointment letter with the Company on October 19, 2017 for an initial term of three years, subject to re-election in accordance with the Articles of Association and is subject to termination as provided in the appointment letter.

None of the Directors has a service contract which is not determinable by the Group within one year without payment of compensation (other than statutory compensation).

6. DISCLOSURE OF INTERESTS

As at the Latest Practicable Date, the interests and short positions of the Directors and the chief executives of the Company in the Shares, underlying Shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which have been notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have taken under such provisions of the SFO), or which were recorded in the register required to be kept pursuant to section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code as set out in Appendix 10 of the Listing Rules were as follows:

Interests of Directors and Chief Executives of the Company

Name	Capacity/Nature of Interest	Number of Shares	Long/short position	Approximate Percentage of Shareholding in the Company[1]
Mr. Wu Wenhui[2]	Interest in controlled corporations	5,100,626	Long position	0.50%
	Interest in controlled corporations	9,485,220	Short position	0.93%

Name	Capacity/Nature of Interest	Number of Shares	Long/short position	Approximate Percentage of Shareholding in the Company[1]
Mr. James Gordon Mitchell	Beneficial owner	281,352	Long position	0.03%
Mr. Cao Huayi[3]	Interest in controlled corporations	40,850,722	Long position	4.02%
Mr. Cheng Yun Ming Matthew	Beneficial owner	3,092	Long position	0.00%
Mr. Cheng Wu	Beneficial owner	1,304,400	Long position	0.13%
Mr. Hou Xiaonan	Beneficial owner	112,072	Long Position	0.01%

Interests of Directors and Chief Executives in associated corporations of the Company

Name	Name of associated corporations	Capacity/Nature of Interest	Number of Shares	Approximate Percentage of Shareholding in the associated corporation[1]
Mr. James Gordon Mitchell	Tencent Holdings Limited	Beneficial owner	8,969,302[4]	0.09%
	Tencent Music Entertainment Group	Beneficial owner	456	0.00%
Ms. Yu Chor Woon Carol	Tencent Holdings Limited	Beneficial owner	5,000	0.00%
Mr. Cheng Yun Ming Matthew	Tencent Holdings Limited	Beneficial owner	434,233[5]	0.00%

Name	Name of associated corporations	Capacity/Nature of Interest	Number of Shares	Approximate Percentage of Shareholding in the associated corporation[1]
Mr. Cheng Wu	Tencent Holdings Limited	Beneficial owner	284,925[6]	0.00%
Mr. Hou Xiaonan	Tencent Holdings Limited	Beneficial owner	111,833[7]	0.00%
Mr. Wu Wenhui[8]	Tencent Holdings Limited	Interest of controlled corporation	300,000	0.00%
Mr. Wu Wenhui[9]	Shanghai Hongwen Networking Technology Co., Ltd.	Interest of controlled corporation	3,462,000	34.62%
Mr. Wu Wenhui[9]	Shanghai Yuewen Information Technology Co., Ltd.	Interest of controlled corporation	3,462,000	34.62%

Notes:

(1) The calculation is based on the total number of 1,015,781,716 Shares in issue as of Latest Practicable Date.

(2) Mr. Wu Wenhui holds the entire share capital of Grand Profits Worldwide Limited. Hence, Mr. Wu Wenhui is deemed to be interested in (i) the 5,100,626 Shares held by Grand Profits Worldwide Limited, and (ii) the derivatives held by Grand Profits Worldwide Limited, representing 9,485,220 underlying Shares.

(3) Mr. Cao Huayi is interested in 100% and 43.63% of C-Hero Limited and X-Poem Limited respectively and is therefore deemed to be interested in the 34,230,324 Shares and 6,620,398 Shares interested in by C-Hero Limited and X-Poem Limited pursuant to the 2018 NCM Share Purchase Agreement, without taking into account the Supplemental SPA Deed, respectively.

(4) These interests comprise (i) 2,172,136 shares of Tencent, (ii) 55,396 shares underlying Tencent in respect of the awarded shares granted to Mr. James Gordon Mitchell under share award schemes of Tencent, and (iii) 6,741,770 shares underlying Tencent in respect of the options granted to Mr. James Gordon Mitchell under share option schemes of Tencent. Tencent is the controlling shareholder of the Company and thus is an associated corporation of the Company.

(5) These interests comprise (i) 340,237 shares of Tencent, (ii) 27,273 shares underlying Tencent in respect of the awarded shares granted to Mr. Cheng Yun Ming Matthew under share award schemes of Tencent, and (iii) 66,723 shares underlying Tencent in respect of the options granted to Mr. Cheng Yun Ming Matthew under share option schemes of Tencent. Tencent is the controlling shareholder of the Company and thus is an associated corporation of the Company.

(6) These interests comprise (i) 22,208 shares of Tencent, (ii) 579 shares underlying Tencent in respect of the awarded shares granted to Mr. Cheng Wu under share award schemes of Tencent, and (iii) 262,138 shares underlying Tencent in respect of the options granted to Mr. Cheng Wu under share option schemes of Tencent. Tencent is the controlling shareholder of the Company and thus is an associated corporation of the Company.

(7) These interests comprise (i) 64,508 shares of Tencent, (ii) 21,196 shares underlying Tencent in respect of the awarded shares granted to Mr. Hou Xiaonan under share award schemes of Tencent, and (iii) 26,129 shares underlying Tencent in respect of the options granted to Mr. Hou Xiaonan under share option schemes of Tencent. Tencent is the controlling shareholder of the Company and thus is an associated corporation of the Company.

(8) Mr. Wu Wenhui holds the entire share capital of Grand Profits Worldwide Limited and therefore is deemed to be interested in the 300,000 shares of Tencent held by Grand Profits Worldwide Limited.

(9) Each of Shanghai Hongwen Networking Technology Co., Ltd. (上海宏文網絡科技有限公司, "**Shanghai Hongwen**") and Shanghai Yuewen Information Technology Co., Ltd. (上海閱文信息技術有限公司, "**Shanghai Yuewen**") are owned as to 34.62% by Ningbo Meishan Bonded Port Area Yuebao Investment Co., Ltd. (寧波梅山保税港區閱寶投資有限公司), which in turn is held as to 83.88% by Mr. Wu Wenhui. Under the SFO, Shanghai Hongwen and Shanghai Yuewen are associated corporations of the Company.

Save as disclosed above, As at the Latest Practicable Date, none of the Directors or the chief executive of the Company had or was deemed to have any interest or short position in the shares, underlying shares or debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO) that was required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have taken under such provisions of the SFO), or required to be recorded in the register required to be kept under Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

Save as disclosed herein, none of the Directors, directly or indirectly, has had any interest in any assets which had since December 31, 2019 (being the date to which the latest published audited financial statements of the Company were made up) been acquired or disposed of by or leased to any member of the Group, or were proposed to be acquired or disposed of by or leased to any member of the Group.

Save as disclosed in this circular, there was no contract or arrangement subsisting as at the Latest Practicable Date, in which any of the Directors was materially interested and which was significant in relation to the businesses of the Group.

Interests and Short Positions in Shares of Substantial Shareholders of the Company

Substantial Shareholders' Interests and Short Positions in Shares and Underlying Shares

As at the Latest Practicable Date, the following persons (not being a Director or chief executive of the Company) had interests or short positions in the Shares or underlying Shares which fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO as recorded in the register required to be kept by the Company pursuant to Section 336 of the SFO:

Name	Capacity/Nature of Interest	Number of Shares	Long/short position	Approximate Percentage of Shareholding in the Company(1) (%)
Tencent Holdings Limited(2)	Interest in controlled corporations	601,126,564	Long position	59.18
THL A13 Limited(2)	Beneficial owner	292,083,460	Long position	28.75
Qinghai Lake Investment Limited(2)	Beneficial owner	230,705,634	Long position	22.71
Tencent Mobility Limited(2)	Beneficial owner	78,337,470	Long position	7.71

Notes:

(1) The calculation is based on the total number of 1,015,781,716 Shares in issue as of June 30, 2020.

(2) THL A13, Qinghai Lake and Tencent Mobility Limited are wholly owned subsidiaries of Tencent. Under the SFO, Tencent is deemed to be interested in the (i) 577,643,604 Shares directly held by THL A13, Qinghai Lake and Tencent Mobility Limited in aggregate; and (ii) 23,482,960 underlying Shares with respect to certain put options granted by THL A13 at an exercise price of HK$40 per Share.

7. COMPETING INTERESTS

As at the Latest Practicable Date, none of the Directors and any of their close associate(s) had interest in a business which competes or may compete with the business of the Group, or may have any conflicts of interest with the Group pursuant to Rule 8.10 of the Listing Rules.

8. LITIGATION

So far as the Company is aware, as at the Latest Practicable Date, no member of the Group was engaged in any litigation or arbitration of material importance and there is no litigation or claim of material importance.

9. OTHER INFORMATION

The company secretaries of the Company are Mr. Zhao Jincheng and Ms. Lai Siu Kuen. Ms. Lai Siu Kuen is a fellow member of the Hong Kong Institute of Chartered Secretaries and the Institute of Chartered Secretaries and Administrators in United Kingdom.

10. MATERIAL CONTRACTS

As at the Latest Practicable Date, the following contracts, not being contracts entered into in the ordinary course of business, were entered into by members of the Group within the two years immediately preceding the Latest Practicable Date which are, or may be material:

(a) the Supplemental SPA Deed;

(b) the acquisition agreements dated September 27, 2019 entered into by Cloudary Holdings Limited ("**Cloudary**"), a subsidiary of the Company with with Kapok Tree Investment Limited ("**Kapok Tree**"), Ookbee Company Limited ("**Ookbee**") and/or Ookbee U Company Limited ("**OBU**") (as applicable), pursuant to which (i) Kapok Tree has conditionally agreed to sell, and Cloudary has conditionally agreed to acquire, 10.2443% of total issued shares of OBU; (ii) Ookbee has conditionally agreed to sell, and Cloudary has conditionally agreed to acquire, 3.1945% of total issued shares of OBU; and (iii) Cloudary has agreed to subscribe, and OBU has conditionally agreed to issue and allot, 6.5612% of total issued shares of OBU (on a fully diluted basis), at the aggregate consideration of USD10,511,178.

11. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection at the office of Clifford Chance at 27/F, Jardine House, One Connaught Place, Central, Hong Kong during normal business hours from the date of this circular up to November 25, 2020 (both days inclusive):

(a) Supplemental SPA Deed;

(b) Letter from the Independent Board Committee;

(c) Letter from the Independent Financial Adviser;

(d) Letter of consent from Somerley;

(e) The memorandum and articles of the Company;

(f) The service contracts of the Directors;

(g) The material contracts of the Company as disclosed above;

(h) The extracts from the annual report of the Company for the year ended December 31, 2018 and 2019; and

(i) A copy of the circular issued pursuant to the requirements set out in Chapter 14 and/or 14A which has been issued since the date of the latest published audited accounts of the Company.

阅文集团

CHINA LITERATURE LIMITED
阅文集团

(Incorporated in the Cayman Islands with limited liability)
(Stock Code: 772)

NOTICE OF EXTRAORDINARY GENERAL MEETING

NOTICE IS HEREBY GIVEN THAT the extraordinary general meeting of China Literature Limited (the "**Company**") will be held at Niccolo Room, Level 25, The Murray, Hong Kong, a Niccolo Hotel, 22 Cotton Tree Drive, Central, Hong Kong on Wednesday, December 9, 2020 at 3:00 p.m. for the purposes of considering and, if thought fit, passing with or without modifications, the following resolution as ordinary resolution.

Unless otherwise specified, capitalized terms used in this notice and the following resolution shall have the same meanings as those defined in the circular of the Company dated November 10, 2020 (the "**Circular**").

Ordinary Resolution

1. To consider and, if thought fit, pass with or without modification the following resolution as an ordinary resolution:

   "**That**:

   (a) the Transaction Documents and the transactions contemplated thereunder, details of which are more particularly described in the Circular, be and is hereby approved, ratified and confirmed;

   (b) any one executive Director (if execution under the common seal of the Company or by deed is required, two executive Directors or one executive Director and the Secretary of the Company) be and are hereby authorized for and on behalf of the Company to execute, and where required, to affix the common seal of the Company to, any documents, instruments or agreements, and to do any acts and things deemed by him or her to be necessary, expedient or appropriate in order to give effect to and implement the transactions contemplated under the Transaction Documents; and

(c) conditional upon the Listing Committee of The Stock Exchange of Hong Kong Limited granting the listing of, and permission to deal in 15,119,815 shares of the Company ("**Consideration Shares**") at the issue price of HK$80.00 per Consideration Share (the "**Issue Price**"), the directors of the Company be and are hereby granted a Specific Mandate (as defined in the Circular) to allot and issue the Consideration Shares at the Issue Price pursuant to the terms and conditions of the Revised NCM Share Purchase Agreement and the articles of association of the Company, provided that this Specific Mandate shall be in addition to, and shall not prejudice or revoke any existing or such other general or special mandates which may from time to time be granted to the directors of the Company prior to the passing of this resolution."

By order of the Board
CHINA LITERATURE LIMITED
Mr. James Gordon Mitchell
Chairman of the Board and Non-executive Director

Hong Kong, November 10, 2020

Registered office:
The offices of Maples Corporate
Services Limited
PO Box 309, Ugland House
Grand Cayman KY1-1104
Cayman Islands

Head office and principal place of business in China:
Block 6, No. 690 Bi Bo Road
Pudong XinQu, Shanghai
People's Republic of China

Principal place of business in Hong Kong:
Room 1503-04, ICBC Tower
3 Garden Road
Central
Hong Kong

Notes:

(i) A shareholder entitled to attend and vote at the above meeting is entitled to appoint one or more proxies to attend, speak and vote in his/her stead. The proxy does not need to be a shareholder of the Company.

(ii) Where there are joint registered holders of any shares, any one of such persons may vote at the above meeting (or at any adjournment of it), either personally or by proxy, in respect of such shares as if he/she were solely entitled thereto but the vote of the senior holder who tenders a vote, whether in person or by proxy, will be accepted to the exclusion of the vote(s) of the other joint holders and, for this purpose, seniority shall be determined by the order in which the names stand in the register of members of the Company in respect of the relevant joint holding.

(iii) In order to be valid, the completed form of proxy, must be deposited at the Hong Kong share registrar of the Company, Computershare Hong Kong Investor Services Limited, at 17M Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong together with the power of attorney or other authority (if any) under which it is signed or a certified copy of that power of attorney or authority (such certification to be made by either a notary public or a solicitor qualified to practice in Hong Kong), at least 48 hours before the time appointed for holding the above meeting or any adjournment thereof (as the case may be). The completion and return of the form of proxy shall not preclude shareholders of the Company from attending and voting in person at the above meeting (or any adjourned meeting thereof) if they so wish.

(iv) The register of members of the Company will be closed from Friday, December 4, 2020 to Wednesday, December 9, 2020, both days inclusive, in order to determine the eligibility of shareholders to attend the above meeting, during which period no share transfers will be registered. To be eligible to attend the above meeting, all properly completed transfer forms accompanied by the relevant share certificates must be lodged for registration with the Hong Kong share registrar of the Company, Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong not later than 4:30 p.m. on Thursday, December 3, 2020.

(v) Pursuant to Rule 13.39(4) of the Listing Rules, voting for the resolution set out in this notice will be taken by poll at the above meeting.