

14 October 2022

To: *the Independent Board Committee and the Independent Shareholders of
Ruixin International Holdings Limited*

Dear Sirs or Madams,

**CONNECTED TRANSACTION IN RELATION TO
THE PROPOSED ALTERATION OF TERMS OF CONVERTIBLE NOTES**

INTRODUCTION

We refer to our appointment as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the Deed of Further Variation 2022 and the transactions contemplated thereunder, details of which are set out in the “Letter from the Board” (the “**Board Letter**”) contained in the circular of the Company dated 14 October 2022 issued to the Shareholders (the “**Circular**”), of which this letter forms part. Terms used in this letter shall have the same meanings as those defined in the Circular, unless the context requires otherwise.

As at the Latest Practicable Date, the Convertible Notes in an aggregate principal amount of HK\$158,400,000, convertible into Shares at the Current Conversion Price of HK\$0.22 per Share, are outstanding and held by the Noteholder. The Outstanding Convertible Notes are unsecured and have matured on 31 January 2022. The Company has received an irrevocable letter of undertaking dated 13 January 2022 from the Noteholder, pursuant to which the Noteholder has irrevocably undertaken in favour of the Company that before the Alteration of Terms comes into effect, he will not, among others, request the Company to repay the outstanding principal amount of the Convertible Notes and to pay any default interest and other related sums within one year from the maturity date of 31 January 2022. On 11 August 2022, the Board proposed to implement the Capital Reorganisation. Assuming that the Current Conversion Price of HK\$0.22 per Share will be adjusted to the Adjusted Conversion Price of HK\$2.20 per New Share as a result of the Capital Reorganisation becoming effective (but before the Alteration of Terms comes into effect), the Outstanding Convertible Notes in the principal amount of HK\$158,400,000 will be convertible into 72,000,000 New Shares. In view of the financial conditions of the Company, the Company and the Noteholder entered into the Deed of Further Variation 2022 in respect of the proposed alteration of certain terms and conditions of the Convertible Notes on even date, subject to the fulfilment of the Conditions Precedent.

Mr. Li, the Noteholder, is interested in approximately 27.72% of the total issued share capital of the Company and is a substantial Shareholder as at the Latest Practicable Date. As Mr. Li is a connected person of the Company, the entering into of the Deed of Further Variation 2022 constitutes a connected transaction of the Company under Chapter 14A of the Listing Rules. Therefore, the entering into of the Deed of Further Variation 2022 and the transactions contemplated thereunder are subject to reporting, announcement and the Independent Shareholders' approval requirements pursuant to the Listing Rules.

INDEPENDENT BOARD COMMITTEE

The Independent Board Committee comprising Mr. Ho Chi Fai and Mr. Zhang Jue, being all the independent non-executive Directors, has been established to advise the Independent Shareholders on the Deed of Further Variation 2022 and the transactions contemplated thereunder. Our role as independent financial adviser is to give our opinion and recommendations as to (i) whether the terms and conditions of the Deed of Further Variation 2022 and the Alteration of Terms, though not in the ordinary and usual course of business of the Group, are on normal commercial terms, fair and reasonable so far as the Independent Shareholders are concerned, and are in the interests of the Company and the Independent Shareholders as a whole; and (ii) how the Independent Shareholders should vote for the resolution to be proposed at the SGM regarding the Deed of Further Variation 2022 and the transactions contemplated thereunder.

BASIS OF OUR OPINION

In formulating our opinion and recommendation, we have considered, among other things, (i) the Deed of Further Variation 2022; (ii) the 2021 Annual Report; (iii) the 2022 Interim Report; and (iv) other information as set out in the Circular.

We have also relied on all relevant information, opinions and facts supplied and representations made to us by the Group, the Directors and the representatives of the Group. We have assumed that all such information, opinions, facts and representations provided to us or contained or referred to in the Circular, for which the Group, the Directors and the representatives of the Group are fully responsible, are true and accurate in all material respects as at the date hereof and may be relied upon. We have no reason to doubt the truth, accuracy and completeness of the information and representations provided to us by the Group, and the Group has confirmed that no material facts have been withheld or omitted from the information provided and referred to in the Circular, which would make any statement therein misleading.

We consider that we have reviewed sufficient information currently available to reach an informed view and to justify our reliance on the accuracy of the information contained in the Circular so as to provide a reasonable basis for our recommendation. We have not, however, carried out independent verification of the information provided by the Directors and the representatives of the Group, nor have we conducted any form of in-depth investigation into the businesses, affairs, operations, financial position or future prospects of the Company, the Group or any of their respective subsidiaries or associates.

OUR INDEPENDENCE

We are not connected with the Company, the Directors, the Noteholder, chief executives and substantial shareholders of the Company or any of their respective subsidiaries or associates and do not have any shareholding, direct or indirect, in any member of the Company or any right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Company as at the Latest Practicable Date. No arrangement exists whereby we will receive any benefits from the Company or the directors, chief executives and substantial shareholders of the Company, the Noteholder or any of their respective subsidiaries or associates for our services to the Company in connection with this appointment aside from our professional fees. During the past two years, we have no engagement for the provision of services to the Company and therefore would not affect our independence for acting as the independent financial adviser of the Company.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In formulating and giving our opinion to the Independent Board Committee and the Independent Shareholders in relation to the Deed of Further Variation 2022 and the transactions contemplated thereunder, we have taken into account the following principal factors:

I. BACKGROUND

Information of the Group

The Group is principally engaged in the manufacturing and trading of electronic and electrical parts and components.

The table below sets out the summary of financial information of the Group for the years ended 31 December 2020 and 2021 and the six months ended 30 June 2021 and 2022 as extracted from the 2021 Annual Report and the 2022 Interim Report:

	Year ended 31 December		Six months ended 30 June	
	2020 (HK\$'000) (Audited)	2021 (HK\$'000) (Audited)	2021 (HK\$'000) (Unaudited)	2022 (HK\$'000) (Unaudited)
Revenue	358,522	303,491	166,899	124,326
Gross profit	21,888	13,321	11,174	8,541
Loss before taxation	(56,383)	(53,926)	(23,581)	(25,353)
Loss for the year	(56,383)	(54,151)	(23,769)	(25,357)
	As at 31 December		As at 30 June	
	2020 (HK\$'000) (Audited)	2021 (HK\$'000) (Audited)	2021 (HK\$'000) (Unaudited)	2022 (HK\$'000) (Unaudited)
Non-current assets	9,874	2,623		1,637
Current assets	210,687	110,365		85,735
Current liabilities	129,400	197,723		195,536
Non-current liabilities	140,017	17,867		20,502
Net current assets/(liabilities)	81,287	(87,358)		(109,801)
Net liabilities	(48,856)	(102,602)		(128,666)

Profit and Loss of the Group

Based on the 2021 Annual Report and the 2022 Interim Report, we noted that the Group's revenue generated from its electronic products business operations has decreased. The Group's gross profits contributed from the electronic products business also decreased from approximately HK\$21.9 million for the year ended 31 December 2020 to approximately HK\$13.3 million for the year ended 31 December 2021. With a gross margin of approximately 6.1% in 2020 and 4.4% in 2021, gross profits were unable to cover distribution costs and administrative expenses in both years. In addition, non-cash accounting treatment of imputed interest expenses on the Convertible Notes also reduced the profitability of the Group. As a result, the Group made net losses in both years.

In order to understand the profitability of the Group better, we have reviewed past annual reports of the Company and noted that the Group has been experiencing losses in the past few years. Significant amount of historical losses can be attributable to non-cash impairment losses of goodwill and other intangible assets as well as imputed interest expenses on the Convertible Notes, which as a result created accumulated losses for the Group as these non-cash costs and intangible impairments were accumulated over the years. The revenue generated from operations of the electronic products business was unable to cover the costs of operations and resulted in losses for years. The Group is changing its mode of business from manufacturing and trading to trading of electronic parts and components in response and realigning to the quick market needs from customers amid the ongoing COVID-19 pandemic. Therefore, we are of the view that the Group should reserve its capital for its daily operations as well as the unforeseen circumstances in adapting to new business model rather than utilising its existing resources to repay the Outstanding Convertible Notes. As such, the delay of the repayment of the Outstanding Convertible Notes, if required, should be prolonged to ensure that the Group has sufficient working capital for its operations.

Statement of Financial Position of the Group

Based on the 2022 Interim Report, the Group had total non-current assets of approximately HK\$1.6 million and current assets of approximately HK\$85.7 million as at 30 June 2022. Among current assets as at 30 June 2022, trade receivables and inventories in relation to its electronic products business make up the bulk of current assets with cash and bank balances only accounting for approximately HK\$8.7 million. As for current liabilities as at 30 June 2022, trade payables and loan from a substantial shareholder accounted for approximately HK\$8.6 million and HK\$3.8 million, respectively, while the Outstanding Convertible Notes accounted for approximately HK\$158.4 million. As a result, the Group has a net current liabilities position of approximately HK\$109.8 million and net liabilities of approximately HK\$128.7 million.

We noted that the historical non-cash impairment losses of goodwill and other intangible assets, and the imputed interest expenses on the Convertible Notes which accounted for significant amount of the historical losses that as a result created accumulated losses for the Group as these non-cash cost and intangible impairments were accumulated over the years. As these losses were attributed to non-cash items, they did not affect the operations of the Group directly. However, having such a financial position would mean that the Group is unable to raise additional funding from financial institutions and will also find it difficult to convince potential investors to fund the Group with a net liabilities position and a large Outstanding Convertible Notes position. Therefore, we are of the view that it is unlikely that the Group will be able to raise additional funding for the repayment of the Outstanding Convertible Notes, and the negotiation for the delayed repayment, extension or conversion of the Outstanding Convertible Notes should commence as soon as practicable.

II. DEED OF FURTHER VARIATION 2022

Details of the Deed of Further Variation 2022 are set out below:

Date: 11 August 2022 (after trading hours)

Parties: (1) the Company; and
(2) the Noteholder

Alteration of Terms: Pursuant to the Deed of Further Variation 2022, it is agreed that (i) the maturity date of the Outstanding Convertible Notes will be extended from 31 January 2022 to 31 January 2025; and (ii) the Adjusted Conversion Price will be further adjusted to the Conversion Price of HK\$1.00 per New Share.

In addition, the Noteholder has irrevocably undertaken that, irrespective of whether the Alteration of Terms will become effective, he shall not exercise any of his rights under the Convertible Notes to demand for repayment of the principal amount of the Outstanding Convertible Notes and/or payment of any default interest and other related sums on the Outstanding Convertible Notes for the period from 1 February 2022 to 31 January 2023 (both days inclusive), and shall forgo his right to receive, and fully release and discharge the Company from, the payment of the default interest, if any, accrued on the Outstanding Convertible Notes during such period.

Save for the above proposed Alteration of Terms, all other terms and conditions of the Convertible Notes shall remain unchanged.

Conditions Precedent: The Alteration of Terms shall become effective upon the fulfilment of all the following Conditions Precedent:

- (a) the passing of ordinary resolution(s) by the Independent Shareholders at the SGM approving (i) the Deed of Further Variation 2022 and the transactions contemplated thereunder and (ii) upon the exercise of the conversion rights attaching to the Outstanding Convertible Notes, the allotment and issue of the Conversion Shares in accordance with the conditions of the Convertible Notes as varied by the Deed of Further Variation 2022;
- (b) the Capital Reorganisation becoming effective;
- (c) the Company having obtained the approval from holders of more than 50% of the aggregate outstanding principal amount of HK\$158,400,000 of the Convertible Notes for the Alteration of Terms;
- (d) the Listing Committee having granted or having agreed to grant the listing of, and permission to deal in, the Conversion Shares falling to be allotted and issued upon an exercise of the conversion rights attaching to the Outstanding Convertible Notes in accordance with the conditions of the Convertible Notes as amended by the Deed of Further Variation 2022; and
- (e) the Company having obtained from the Stock Exchange all requisite approval or consent to the Alteration of Terms as set out in the Deed of Further Variation 2022.

The Alteration of Terms shall take effect on the date on which the Company notifies the Noteholder in writing the fulfilment of the Conditions Precedent as set out above, being a date that is not more than five business days after the fulfilment of the condition precedent last in time to be fulfilled.

None of the Conditions Precedent can be waived. If any of the Conditions Precedent above has not been fulfilled on or before 30 November 2022 (or such other date as may be agreed by the parties to the Deed of Further Variation 2022 in writing), the Deed of Further Variation 2022 shall lapse and be of no further effect and none of the parties to the Deed of Further Variation 2022 will have any claim against or liability to the other parties in respect of the Deed of Further Variation 2022 save for any antecedent breaches thereof.

We have reviewed the Conditions Precedent and noted that the Conditions Precedent (i) ensure all regulatory approvals have been obtained before the Alteration of Terms can be effective; (ii) ensure the Capital Reorganisation becoming effective; and (iii) ensure consents from the affected parties, namely the Noteholder and the Independent Shareholders are obtained for the Alteration of Terms. Having considered the above factors, we are of the view that the Conditions Precedent are fair and reasonable and in the interest of the Company and Shareholders as a whole

III. ALTERATION OF TERMS

Pursuant to the Deed of Further Variation 2022, among other matters, the Company will revise the Adjusted Conversion Price of the Outstanding Convertible Notes of HK\$2.20 per New Share to the Conversion Price of HK\$1.00 per New Share, subject to the fulfilment of the Conditions Precedent therein. As the Deed of Further Variation 2022 will result in the reduction of the Adjusted Conversion Price, the interest of existing Shareholders will be further diluted.

Dilution effects of the Alteration of Terms

In determining the effects of the dilution, we have prepared all the scenarios to demonstrate the dilution effects:

Dilution table based on Adjusted Conversion Price:

Name	As at the Latest Practicable Date (Note 1)		Immediately upon the Capital Reorganisation becoming effective		Immediately upon the Capital Reorganisation becoming effective and full conversion of the Outstanding Convertible Notes (Note 2)	
	No. of Shares	Percentage Interest	No. of New Shares	Percentage Interest	No. of New Shares	Percentage Interest
	Existing shares held by Mr. Li (or the Noteholder)	232,863,576	27.72%	23,286,357	27.72%	23,286,357
Conversion shares to be issued assuming the remaining principal of HK\$158.4 million is converted at HK\$2.20	-	-	-	-	72,000,000	46.15%
Public Shareholders	607,310,638	72.28%	60,731,064	72.28%	60,731,064	38.93%
Total	840,174,214	100.00%	84,017,421	100.00%	156,017,421	100.00%

Dilution table based on Alteration of Terms:

Name	As at the Latest Practicable Date (Note 1)		Immediately upon the Capital Reorganisation becoming effective		Immediately upon the Capital Reorganisation becoming effective and full conversion of the Outstanding Convertible Notes upon the Alteration of Terms becoming effective (Note 2)	
	No. of Shares	Percentage Interest	No. of New Shares	Percentage Interest	No. of New Shares	Percentage Interest
	Existing shares held by Mr. Li (or the Noteholder)	232,863,576	27.72%	23,286,357	27.72%	23,286,357
Conversion Shares to be issued assuming the remaining principal of HK\$158.4 million is converted at HK\$1.00	-	-	-	-	158,400,000	65.34%
Public Shareholders	607,310,638	72.28%	60,731,064	72.28%	60,731,064	25.05%
Total	840,174,214	100.00%	84,017,421	100.00%	242,417,421	100.00%

Notes:

- Mr. Li is interested in 952,863,576 Shares, consisting of (i) an interest in 232,863,576 Shares beneficially owned and held in his own name; and (ii) a derivative interest in 720,000,000 conversion Shares to be allotted and issued upon full conversion of the Outstanding Convertible Notes issued to him by the Company with an aggregate principal amount of HK\$158,400,000.

2. Full conversion of the Outstanding Convertible Notes is for illustration purpose only. Pursuant to the terms of the S&P Agreement, no conversion of the Convertible Notes shall be made unless such conversion complies with the Listing Rules and the Takeovers Code (including but not limited to the public float requirement under Rule 8.08 of the Listing Rules). In addition, no conversion rights may be exercised by the Noteholder unless prior written confirmation has been given by the Noteholder to the Company that all the shares of the Company (including the conversion shares under the Convertible Notes issued or to be issued) held by the Noteholder, its associates and persons acting in concert (as defined under the Takeovers Code) on the conversion date will not become obliged to make a mandatory general offer in accordance with Rule 26 of the Takeovers Code. Accordingly, Mr. Li and parties acting in concert with him or successors of the holder(s) of the Outstanding Convertible Notes individually will not directly or indirectly control or be interested in Shares of 30% or more in the Company.

Based on the tables above, and assuming no other changes in the issued share capital of the Company from the Latest Practicable Date and up to the full conversion of the Outstanding Convertible Notes, the Independent Shareholders' interest in the Company will drop from the existing 72.28% to 38.93% based on the Adjusted Conversion Price of HK\$2.20 per Share. However, based on the Alteration of Terms, and assuming no other changes in the issued share capital of the Company from the Latest Practicable Date and up to the full conversion of the Outstanding Convertible Notes, the Independent Shareholders' interest in the Company will drop from the existing 72.28% to 25.05% based on the Conversion Price of HK\$1.00 per New Share under the Alteration of Terms. Based on the tables above, the reduction in Independent Shareholders' interest in the Company based on the Alteration of Terms is approximately 13.88% or a discount of 35.65% of the original interest. We are of the view that this dilution effect should not be considered on its own as it is a part of a series of transactions. Therefore, it has to be considered in totality with other factors as discussed below.

Movement of the Share price

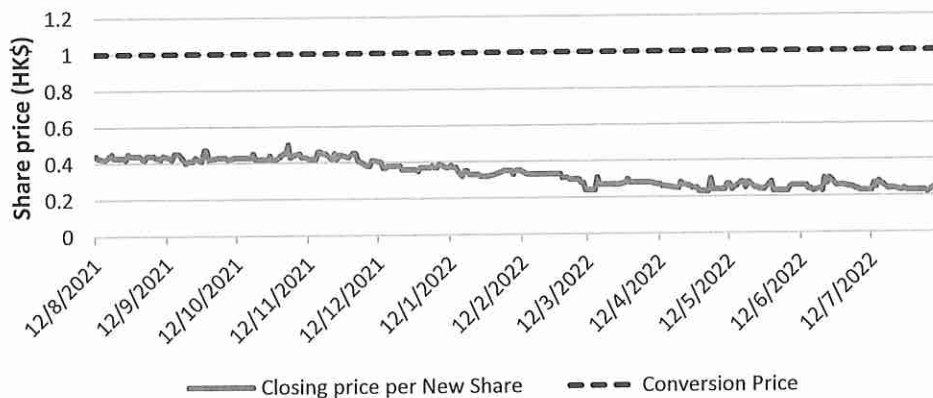
In order to assess whether the Conversion Price of HK\$1.00 per New Share under the Alteration of Terms is fair and reasonable and in the interest of the Company and Shareholders as a whole, we have performed a review on the historical closing prices of the Shares as extracted from the website of the Stock Exchange (www.hkex.com.hk) for the 12-months prior to the date of entering into the Deed of Further Variation 2022 (the "**Review Period**"). We consider that the sampling period of 12 months, which is a commonly adopted practice for analysis purpose, is fair and representative to illustrate (i) the prevailing market condition; (ii) the general trend of the Share price; and (iii) the recent price movements of the Shares, and a 12-month period is also in line with the normal financial reporting period of corporations which can adequately reflect the latest affairs of these corporations.

Share price movement during the Review Period



As illustrated by the above chart, we noted that the Share price had been in a generally downward trend since August 2021 and ranged from the highest of HK\$0.05 per Share to the lowest of HK\$0.022 per Share, with an average of approximately HK\$0.034 per Share. The Share price fluctuated between HK\$0.022 and HK\$0.025 for ten (10) business days prior to the Company entering into the Deed of Further Variation 2022 on 11 August 2022. Since the Board proposed to implement the Capital Reorganisation on even date, we have adjusted historical closing prices of the Shares with the effect of the Capital Reorganisation as shown in the graph below for illustrative purpose in order to better assess the Conversion Price under the Alteration of Terms.

New Share price movement during the Review Period



After the effect of the Capital Reorganisation, we noted that the Conversion Price is well above the adjusted historical closing prices of the Shares, which ranged from the highest of HK\$0.5 per New Share to the lowest of HK\$0.22 per New Share, with an average of approximately HK\$0.34 per New Share. The New Share price also fluctuated between HK\$0.22 and HK\$0.25 for ten (10) business days prior to the Company entering into the Deed of Further Variation 2022 on 11 August 2022.

As the Outstanding Convertible Notes has expired on 31 January 2022, the Company will have to repay it without much alternative. As stated in the Board Letter, liquidating the Group's assets to meet this obligation is not practical as they are needed for operations. We have also discussed with the Company with regards to additional funding and noted that they had sought the assistance from its bank but had been declined due to the loss-making position of the Group. In addition, as the Company is currently registering net liabilities, there may be concerns amongst investors on the Company's viability, which may reflect in the current low Share price. Besides, the Share price may further decline as the recent economic environment is volatile under the outbreak of COVID-19. Furthermore, the Company has been in discussion with its financial adviser to explore possible equity fund raising but was unable to secure funds on acceptable terms as at the Latest Practicable Date. Hence, it is not a favourable time for the Company to issue securities to repay the Outstanding Convertible Notes as the Company will only be able to raise new funds at low Share price or possibly a discount if a large number of Shares need to be placed out. Furthermore, the Share price as at the Latest Practicable Date of HK\$0.02 is far below the par value of the Share of HK\$0.2. Even if the Company was willing to raise funds at prevailing market price or a discount, the Company would not be able to conduct such equity fund raising exercise as the Company is not allowed to issue new Shares at a discount to the par value of such Shares under the laws of Bermuda.

Having considered that the Conversion Price is higher than the New Share price under the Review Period and the Alteration of Terms is a better alternative for the Company over the repayment of the Outstanding Convertible Notes, in view of current situation of the Company, we are of the view that the Conversion Price of HK\$1.00 per New Share under the Alteration of Terms is fair and reasonable and in the interest of the Company and Shareholders as a whole.

Financial effects of the Alteration of Terms

The financial effects of the Alteration of Terms set out below are purely for illustrative purposes only and do not reflect the future financial position of the Group after the Alteration of Terms becoming effective.

(a) Net asset value

According to the 2022 Interim Report, the net liabilities value of the Group was approximately HK\$128.7 million as at 30 June 2022. Upon the Alteration of Terms taking effect pursuant to the Deed of Further Variation 2022, there may be resulting in changes in fair value of the Outstanding Convertible Notes which will be subject to the valuation of independent valuers and the review of the independent auditors of the Company in subsequent financial statements of the Group.

(b) Liquidity

According to the 2022 Interim Report, the Group had bank balances and cash of approximately HK\$8.7 million as at 30 June 2022. The Alteration of Terms will enable the Group to delay a substantial cash outflow as the maturity date of the Outstanding Convertible Notes is extended, which would alleviate the immediate pressure on cash flow of the Group and retain financial resources for its operations. In addition, upon the Alteration of Terms becoming effective, the Outstanding Convertibles Notes will be reclassified as non-current liabilities. As a result, it could help to improve the immediate liquidity of the Group by turning the Group from net current liabilities position to net current assets position.

After taking into consideration of the above, particularly, the financial effects of the Alteration of Terms do not affect the actual cashflow of the Company and have only accounting impact on the financial statements of the Company, we are of the view that the Alteration of Terms is fair and reasonable and in the interest of the Company and the Shareholders as a whole.

Comparable Analysis

In order to determine the fairness and reasonableness of the terms of the Outstanding Convertible Notes under the Alteration of Terms, we have adopted a comparable approach whereby the terms of the Outstanding Convertible Notes under the Alteration of Terms are compared to its peers. Based on the information available from the Stock Exchange's website (<https://www.hkexnews.hk>), we have shortlisted a list of companies listed on the Stock Exchange which have announced the issuance of convertible securities on the dates three (3) months prior to the Company entering into the Deed of Further Variation 2022 for our purpose of comparison. We are of the view that three (3) months is a reasonable time period as pricing of securities is dependent on the current market trend and sentiment, and a prolonged time period would not be able to capture the current market trends. Our scope has also covered all announced issuance of convertible securities to both connected persons and independent third parties such that our comparable analysis would be more comprehensive and provide an unbiased reference on the market terms for better comparison with the terms of the Outstanding Convertible Notes under the Alteration of Terms. In order to make a fair comparison, we have further shortlisted those companies which did not make a profit since their last published annual reports (the "**Comparable Companies**"). We are of the view that due to the unique financial situation that the Group is in, the Comparable Companies should possess traits similar to the Group. Accordingly, we have identified transactions for 12 Comparable Companies (the "**Comparable Transactions**"), which to the best of our knowledge represent the exhaustive samples that meet the aforesaid selection criteria. Having considered (i) the Comparable Transactions reflect the prevailing market conditions for the issuance of convertible securities; (ii) the Comparable Transactions represent recent pricing and structure of the convertible securities issued in Hong Kong for companies with similar traits to the Group; and (iii) the Comparable Transactions provide general reference for the Independent Shareholders to have an understanding of the recent market practice of similar transactions, we are of the view that the aforesaid selection criteria is fair and representative.

Set out below is the list of the Comparable Companies:

Date of announcement	Company name	Stock code	Maturity (approximately) (years)	Interest per annum (approximately)	Premium/ (discount) of relevant conversion price over/to the closing price of the relevant shares as at the relevant last trading day prior to/on the date of the release of the announcement (approximately)
12/05/2022	Grown Up Group Investment Holdings Limited	1842	2.0	2.5%	(19.6)%
23/05/2022	Sino Splendid Holdings Limited	8006	2.0	1.5%	31.6%
23/05/2022	Beaver Group (Holding) Company Limited (now known as State Innovation Holdings Limited)	8275	2.0	2.5%	33.3%
08/06/2022	China Fordoo Holdings Limited	2399	2.0	8.0%	5.3%
09/06/2022	China Health Group Limited	673	2.0	6.0%	112.8%
10/06/2022	Anchorstone Holdings Limited	1592	1.0	2.0%	(10.0)% (Note 1)
14/06/2022	Ev Dynamics (Holdings) Limited	476	3.0	2.0%	0.7% (Note 2)
21/06/2022	China Zenith Chemical Group Limited	362	1.0	0.0%	49.3%
27/07/2022	Virtual Mind Holding Company Limited	1520	2.0	10.0%	6.8%
28/07/2022	Luye Pharma Group Ltd.	2186	1.0	6.5%	40.0%
01/08/2022	Vobile Group Limited	3738	3.0	4.0%	32.7%
04/08/2022	Shifang Holding Limited	1831	0.5	0%	0%
			(Note 3)		
	Minimum		0.5	0.0%	(19.6)%
	Maximum		3.0	10.0%	112.8%
	Average		1.8	3.8%	23.6%
11/08/2022	The Company (the Outstanding Convertible Notes)	724	3.0	0.0%	334.8%

Notes:

1. The conversion price of the convertible notes of Anchorstone Holdings Limited is 90% of the average closing price per share on any five consecutive business days as selected by the noteholder during the 45 business days immediately preceding the relevant conversion date on which shares were traded on the Stock Exchange. For illustration purpose, we have taken the ratio of conversion price over the market price as a discount of 10% for calculation.
2. The convertible notes of Ev Dynamics (Holdings) Limited comprises three equal tranches, which are further divided in sub-tranches, with conversion price set based on the share price preceding to relevant conversion date, except for the first five sub-tranches of first tranche of convertible notes with initial conversion price of HK\$0.0594. For illustration purpose, we have taken HK\$0.0594 as the conversion price for calculation.
3. The convertible bonds of Shifang Holding Limited comprises three equal tranches with different maturity dates of 30 September 2022, 30 November 2022 and 28 February 2023, respectively. For illustration purpose, we have taken 28 February 2023 as the maturity date for all convertible bonds for calculation.

According to the above table of the Comparable Companies, the tenure of the convertible bonds ranges from half year to three years, with an average of 1.8 years. We are of the view that the tenure of each of the convertible bonds among the Comparable Companies is dependent on the financing needs of each company and investors will adjust the other terms, namely the amount of interest demanded and the convertible price premium/discount to suit the companies' tenure. Having considered the financial performance and the liquidity position of the Group, the extension of three years of the maturity under the Deed of Further Variation 2022, which is at the high end of the range for the tenure of the convertible bonds among the Comparable Companies, will help alleviate the burden on cashflow for the operations of the Group.

As set out in the above table, we note that the interest rate of the convertible bonds for the Comparable Companies ranged from nil to 10.0%, with the average being approximately 3.8%. The zero interest rate of the Outstanding Convertible Notes represents the lower bound of the Comparable Companies and is more favourable as compared to the average interest rate of the Comparable Companies. Having considered the tenure of the Outstanding Convertible Notes (e.g. three years) is relatively long as compared with that of the Comparable Companies, the zero interest rate of the Outstanding Convertible Notes will save the Group from incurring interest expense and hence avoid further deterioration of the financial performance and the liquidity position of the Group.

In addition, we also note that the Comparable Companies offer their conversion price over the market price ranging from a discount of 19.6% to a premium of 112.8%, with the average premium being approximately 23.6%. The Conversion Price of HK\$1.00 per New Share of the Outstanding Convertible Notes, representing a premium of approximately 334.8% over the market price on the date of entering into the Deed of Further Variation 2022, is much higher than the average and maximum premium of the Comparable Companies and we are of the view that the Conversion Price is favourable to the Company.

Having considered the above analysis, we are of the view that the terms of the Outstanding Convertible Notes under the Alteration of Terms are on normal commercial terms, fair and reasonable, and in the interest of the Company and Shareholders as a whole.

ANALYSIS AND CONCLUSION

Based on our analysis as discussed above, we noted that the Group's financial performance has declined with revenues generated from its electronic products business not being enough to cover for its operations. In addition, the Company is changing its mode of business from manufacturing and trading to trading of electronic parts and components in response to and realigning to the quick market needs from customers amid the ongoing COVID-19 pandemic. We are of the view that the Group should reserve its capital for its daily operations as well as the unforeseen circumstances in adapting to new business model rather than utilising existing resources to repay the Outstanding Convertible Notes. Therefore, the Deed of Further Variation 2022 and the Alteration of Terms provide the Group with additional flexibility and allow the Group to reserve sufficient working capital for its operations.

Based on our study of their financial position above, it is unlikely that the Group will be able to obtain financing from any financial institution, especially when the Company is in a net liabilities position. We have further verified this with the Company and have obtained correspondence between the Company and its bank seeking assistance for additional funding but have been declined. In addition, the Company has been unable to secure funds on acceptable terms as at the Latest Practicable Date after exploring possible equity fund raising activities with its financial adviser. Therefore, the options available for the Company are limited to revising the terms of the Convertible Notes or repaying them. Based on the current financial situation of the Group, it is unlikely that the Company will be able to fully repay the Outstanding Convertible Notes whilst maintaining the current level of operations in their electronic products business. Hence the only viable option would be the Alteration of Terms so that the Group can continue operating without having to repay the Outstanding Convertible Notes.

While we have looked at the dilution effect which will reduce existing Shareholders' interest in the Company by approximately 13.88% or a discount of 35.65% of the original interest, having considered the above, we are of the view that the discount is reasonable as without accepting the Alteration of Terms, the Company will have to repay the Outstanding Convertible Notes and could experience a shortage of cashflow or suffer the consequences of failing to meet its Outstanding Convertible Notes obligations. Without the Deed of Further Variation 2022 and the Alteration of Terms, it will invariably lead the Company to liquidity issues and eventually may result in the Noteholder taking control of the Company through liquidation and Shareholders are only compensated negligible amount after the obligations of the Convertible Notes have been satisfied in full. Therefore, the discount or the dilution is a much better outcome than going through a liquidation process. As such, we are of the view that the dilution effect of the lowered Conversion Price under the Alteration of Terms is fair and reasonable and in the interest of the Company and Shareholders as a whole.

Based on our analysis of the Share price, we noted that the Share price is at a low point. While the timing to issue securities at the current Share price is not favourable to the Company, the Company has no alternative option as the Convertible Notes becomes due. Therefore, any attempt to raise similar amount of money whether from connected persons or independent third parties by issuing securities to satisfy the repayment of the Outstanding Convertible Notes invariably also leads to (i) dilution of the existing Shareholders; (ii) there may not be any interest to subscribe for the Shares in view of the financial situation of the Group without a discount to the Share price; and (iii) when a company is in the current financial situation of the Group, they would normally have so little bargaining power leading to even higher dilution. Furthermore, even if the Company was willing to raise funds at the prevailing market price or a discount, the Company is not able to conduct such equity fund raising exercise as the Company is not allowed to issue new Shares at a discount to the par value of such Shares under the laws of Bermuda. Having considered that (i) the Conversion Price of HK\$1.0 per New Share is much higher than the current market price of the New Shares by a premium of 334.8%; and (ii) the Alteration of Terms is a better alternative for the Company over the repayment of the Outstanding Convertible Notes in view of current situation of the Company, we are of the view that the Conversion Price under the Alteration of Terms is fair and reasonable and in the interest of the Company and Shareholders as a whole.

RECOMMENDATION

Based on the above principal factors and reasons, and in view of the Deed of Further Variation 2022 and the Alteration of Terms are (i) the only viable option available for the Group to continue to operate without experiencing significant financial distress in order to meet its financial obligation; (ii) the dilution effect of the Alteration of Terms is reasonable as the Independent Shareholders still have significant interest in the Company even after full conversion of all Outstanding Convertible Notes; and (iii) the Conversion Price adopted under the Alteration of Terms is much higher prices than the current market price of the New Shares, we are of the view that the terms and conditions of the Deed of Further Variation 2022 and the Alteration of Terms, though not in the ordinary and usual course of business of the Group, are fair and reasonable, on normal commercial terms so far as the Independent Shareholders are concerned, and are in the interests of the Company and the Shareholders as a whole. Accordingly, we advise the Independent Board Committee to recommend and we also recommend the Independent Shareholders to vote in favour of the proposed resolution(s) at the SGM to approve the Deed of Further Variation 2022 and the transactions contemplated thereunder.

Yours faithfully,

For and on behalf of

Frontpage Capital Limited



Chai Yee Choong

Director

Note: Mr. Chai Yee Choong is a licensed person registered with the Securities and Futures Commission of Hong Kong and a responsible officer of Frontpage Capital Limited to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities under the Securities and Futures Ordinance. He has more than 10 years of experience in corporate finance.