



6 June 2023

*The Independent Board Committee and the Independent Shareholders of
Fountain Set (Holdings) Limited*

Dear Sir/Madam,

REVISION OF EXISTING ANNUAL CAPS FOR CONTINUING CONNECTED TRANSACTIONS

INTRODUCTION

We refer to our engagement as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in relation to:

- (i) the revision of the Existing Chinatex Annual Caps pursuant to the Chinatex Supplemental Agreement; and
- (ii) the revision of the Existing Deposit Annual Cap pursuant to the COFCO Finance Supplemental Agreement,

(collectively, "**the Revision of Existing Annual Caps**"), details of which are set out in the letter from the Board (the "**Letter from the Board**") contained in the circular of the Company dated 6 June 2023 to the Shareholders (the "**Circular**"), of which this letter forms part. Terms used herein have the same meanings as those defined in the Circular unless otherwise stated.

As stated in the Letter from the Board, on 15 May 2023, the Company entered into (i) the Chinatex Supplemental Agreement with Chinatex to revise the Existing Chinatex Annual Caps; and (ii) the COFCO Finance Supplemental Agreement with COFCO Finance to revise the Existing Deposit Annual Cap.

As at the Latest Practicable Date, Chinatex is a controlling Shareholder indirectly holding 478,352,000 Shares, representing approximately 39.05% of the issued Shares. Therefore, Chinatex is a connected person of the Company. Accordingly, members of the Chinatex Group are associates of Chinatex and hence connected persons of the Company under the Listing Rules. As such, the Chinatex Supplemental Agreement and the transactions contemplated thereunder constitute continuing connected transactions of the Company under Chapter 14A of the Listing Rules.

As at the Latest Practicable Date, COFCO is the parent company of Chinatex directly holding 100% equity interest in Chinatex. As such, COFCO is the controlling Shareholder. COFCO Finance is an indirect wholly-owned subsidiary of COFCO and is therefore an associate of COFCO and a connected person of the Company under the Listing Rules. Accordingly, the COFCO Finance Supplemental Agreement and the transactions contemplated thereunder will constitute continuing connected transactions of the Company under Chapter 14A of the Listing Rules.

Pursuant to Rule 14A.54 of the Listing Rules, if the Company intends to revise the annual caps for the continuing connected transactions, the Company will be required to re-comply with relevant provisions of Chapter 14A of the Listing Rules in respect of the relevant continuing connected transactions.

As the highest of the applicable percentage ratios in respect of the Revised Chinatex Annual Caps is higher than 5% but less than 25% on an annual basis, the Revised Chinatex Annual Caps are subject to reporting, annual review, announcement and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

As the highest of the applicable percentage ratios in respect of the Revised Deposit Annual Cap is higher than 5% but less than 25% on an annual basis, the Revised Deposit Annual Cap is subject to reporting, annual review, announcement and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

Pursuant to Rule 13.39(4) of the Listing Rules, all resolutions will be passed by way of poll at the AGM. Any shareholder with a material interest in the Revision of Existing Annual Caps and his close associates will abstain from voting on the ordinary resolutions for approving the Revision of Existing Annual Caps at the AGM. As COFCO has a material interest in the Revision of Existing Annual Caps, COFCO and its associates will abstain from voting on the relevant resolutions for approving the Supplemental Agreements and the transactions contemplated thereunder at the AGM. Save as disclosed above, to the best of the Directors' knowledge, information and belief, having made all reasonable enquiries, no Shareholders will be required to abstain from voting on the relevant resolutions approving the Supplemental Agreements and the transactions contemplated thereunder at the AGM.

The Independent Board Committee, comprising all of the independent non-executive Directors, namely Mr. NG Kwok Tung, Mr. YING Wei, Mr. William LAM and Mr. WONG Kwong Chi, has been established to advise the Independent Shareholders on (i) whether the terms of the Supplemental Agreements are fair and reasonable and are in the interests of the Company and its Shareholders as a whole; (ii) whether the Revised Annual Caps are on normal commercial terms or better terms and in the ordinary and usual course of business of the Company; and (iii) how the Independent Shareholders should vote at the AGM. In our capacity as the Independent Financial Adviser, our role is to advise the Independent Board Committee and the Independent Shareholders in this regard.

INDEPENDENCE

We did not act as financial adviser to the Group and its respective connected persons in the past two years immediately preceding the Latest Practicable Date.

In the past two years immediately preceding the Latest Practicable Date, we have not acted as the independent financial adviser to independent board committee and independent shareholders of the Company.

As at the Latest Practicable Date, we did not have any relationship with or interest in the Company or any other parties that could reasonably be regarded as relevant to our independence.

We are independent from and not connected with the Group pursuant to Rule 13.84 of the Listing Rules and, accordingly, are qualified to advise the Independent Board Committee and the Independent Shareholders in relation to the Revision of Existing Annual Caps. Apart from the normal advisory fee payable to us in connection with our appointment as the Independent Financial Adviser, no arrangement exists whereby we shall receive any other fees or benefits from the Company.

BASIS OF OUR OPINION

In formulating our opinion to the Independent Board Committee and the Independent Shareholders, we have relied on the statements, information, opinions and representations contained in the Circular and the information and representations provided to us by the Directors and management of the Company. We have no reason to believe that any information and representations relied on by us in forming our opinion is untrue, inaccurate or misleading, nor are we aware of any material facts the omission of which would render the information provided and the representations made to us untrue, inaccurate or misleading. We have assumed that all statements, information, opinions and representations contained or referred to in the Circular, which have been provided by the Directors and management of the Company and for which they are solely and wholly responsible, were true and accurate at the time they were made and continue to be true until the date of the AGM.

The Directors have collectively and individually accepted full responsibility for the accuracy of the information contained in the Circular and have confirmed that, having made all reasonable enquiries, to the best of their knowledge and belief, the information contained in the Circular is accurate and complete in all material respects and not misleading or deceptive, and there are no material facts and representations the omission of which would make any statement in the Circular or the Circular misleading.

We consider that we have reviewed sufficient information to reach an informed view regarding the Revision of Existing Annual Caps and to justify reliance on the accuracy of the information contained in the Circular and to provide a reasonable basis for our recommendation. We have not, however, for the purpose of this exercise, conducted any form of independent in-depth investigation or audit into the businesses or affairs or future prospects of the Group, nor have we considered the taxation implication on the Group.

Our opinion is based on the financial, economic, market, and other conditions in effect and the information made available to us as at the Latest Practicable Date. Shareholders should note that subsequent developments (including any material change in market and economic conditions) may affect and/or change our opinion, and we have no obligation to update this opinion to take into account events occurring after the Latest Practicable Date or to update, revise, or reaffirm our opinion. In addition, nothing contained in this letter should be construed as a recommendation to hold, sell, or buy any shares or any other securities of the Company.

This letter is issued for the information for the Independent Board Committee and the Independent Shareholders solely in connection with the Revision of Existing Annual Caps and, except for its inclusion in the Circular, is not to be quoted or referred to, in whole or in part, nor shall this letter be used for any other purpose, without our prior written consent.

PRINCIPAL FACTORS AND REASONS CONSIDERED

A. Background information of the parties

1. The Group

The Group is principally engaged in the production and sale of knitted fabrics, production and sale of garments and provision of knitting, dyeing, printing and finishing services.

The tables below set forth a summary of the consolidated financial information of the Group for the year ended 31 December 2021 ("**FY2021**") and the year ended 31 December 2022 ("**FY2022**") as extracted from the final results announcement of the Company for FY2022:

	FY2021 <i>HK\$'000</i> (Audited)	FY2022 <i>HK\$'000</i> (Audited)
Total revenue	6,751,277	6,053,645
(Loss)/Profit after taxation	270,258	(93,164)

	As at	
	31 December 2021 <i>HK\$'000</i> (Audited)	31 December 2022 <i>HK\$'000</i> (Audited)
Total assets	5,748,390	5,046,765
Total liabilities	1,989,292	1,622,998
Net assets	3,759,098	3,423,767

Revenue

The revenue of the Group decreased from approximately HK\$6,751 million for FY2021 to approximately HK\$6,054 million for FY2022, which was mainly due to the decrease in the revenue from the production and sales of dyed fabrics and yarns as a result of the reduction in foreign orders for textile and apparel due to Russia-Ukraine war for FY2022.

Profit after taxation

The Group has turned around from consolidated profit after taxation of approximately HK\$270 million for FY2021 to consolidated loss after taxation of approximately HK\$93 million for FY2022, which was mainly due to (i) the reduction of consumers' purchasing power as a result of COVID-19 pandemic, overall global inflation, and Russia-Ukraine war; and (ii) a one-off redundancy compensation paid to certain employees of the Group.

Total assets

The consolidated total assets of the Group decreased from approximately HK\$5,748 million as at 31 December 2021 to approximately HK\$5,046 million as at 31 December 2022, which was mainly due to the decrease in the inventories.

Total liabilities

The consolidated total liabilities of the Group decreased from approximately HK\$1,989 million as at 31 December 2021 to approximately HK\$1,623 million as at 31 December 2022. Such decrease was mainly due to the fact that the Group's trade and bill payables turnover period shortened in FY2022.

Net assets

The net assets of the Group decreased from approximately HK\$3,759 million as at 31 December 2021 to approximately HK\$3,424 million as at 31 December 2022, which was mainly due to the decrease in the profit after taxation of the Group in FY2022.

2. Chinatex and the Chinatex Group

As at the Latest Practicable Date, Chinatex is a directly wholly-owned subsidiary of COFCO, a state-owned enterprise established in the PRC and a direct wholly-owned subsidiary of SASAC.

The Chinatex Group is principally engaged in the business of manufacturing and sale of yarns, cotton, garments and oil and foodstuff.

3. COFCO Finance

COFCO Finance is a non-banking financial institution established in the PRC in 2002 and holds a finance license granted by CBIRC. As at the Latest Practicable Date, COFCO Finance is an indirect wholly-owned subsidiary of COFCO. It is subject to the supervision of CBIRC. COFCO Finance is authorized to provide services such as (a) financial consultation services, credit appraisal and consulting services and agency business services; (b) deposit services, loans and bills acceptance and discounting; (c) payment and receipt settlement; and (d) loans and financing leases.

The tables below set forth a summary of the key financial information of COFCO Finance for FY2021, FY2022, the three months ended 31 March 2022 ("**3M2022**"), and three months ended 31 March 2023 ("**3M2023**"):

	FY2021 <i>RMB'000</i> (Audited)	FY2022 <i>RMB'000</i> (Audited)	3M2022 <i>RMB'000</i> (Unaudited)	3M2023 <i>RMB'000</i> (Unaudited)
Net interest income	272,007	237,433	77,927	57,982
Profit after taxation	163,288	153,455	76,282	78,456

	31 December 2021 <i>RMB'000</i> (Audited)	As at 31 December 2022 <i>RMB'000</i> (Audited)	31 March 2023 <i>RMB'000</i> (Unaudited)
Total assets	28,290,428	32,943,454	34,251,161
Total liabilities	23,914,245	28,413,223	29,640,681
Net assets	4,376,183	4,530,231	4,610,480

Net interest income

The net interest income of COFCO Finance decreased from approximately RMB272 million for FY2021 to approximately RMB237 million for FY2022, which was mainly due to the increase in the interest expenses paid for the deposits from COFCO and its subsidiaries.

The net interest income of COFCO Finance decreased from approximately RMB78 million for 3M2022 to approximately RMB58 million for 3M2023, which is mainly due to the increase in the interest expenses paid for the deposits from COFCO and its subsidiaries.

Profit after taxation

The profit after taxation of COFCO Finance decreased from approximately RMB163 million for FY2021 to approximately RMB153 million for FY2022, which is mainly due to the decrease in the net interest income.

The profit after taxation of COFCO Finance increased from approximately RMB76 million for 3M2022 to approximately RMB78 million for 3M2023, which is mainly due to the reverse of the expected credit loss as a result of the decrease in the amount of loans.

Total assets

The total assets of COFCO Finance amounted to approximately RMB28,290 million as at 31 December 2021, approximately RMB32,943 million as at 31 December 2022 and approximately RMB34,251 million as at 31 March 2023. The overall increase is mainly due to the increase in the deposits with banks and other financial institutions.

Total liabilities

The total liabilities of COFCO Finance amounted to approximately RMB23,914 million as at 31 December 2021, approximately RMB28,413 million as at 31 December 2022 and approximately RMB29,641 million as at 31 March 2023. The overall increase is mainly due to the increase in the deposit from COFCO and its subsidiaries.

As a financial institution regulated by CBIRC, COFCO Finance is required to operate in compliance with Measures for the Administration of Finance Companies of Enterprise Groups (企業集團財務公司管理辦法)(the "**Measures**") to prevent possible financial risk, including credit risk. Pursuant to the Measures, it requires the following:

- (i) in the event that COFCO Finance falls into financial difficulty, COFCO undertakes that they would provide financial support to COFCO Finance to satisfy its capital need, such as additional capital injection into COFCO Finance, to restore its financial position; and
- (ii) COFCO Finance is required to comply with certain financial ratio requirements set by CBIRC from time to time. As provided by the Company, the below table sets out the key financial ratios of COFCO Finance as at 31 December 2022 and 31 March 2023 respectively:

Financial ratios	Requirements of CBIRC	As at 31 December 2022	As at 31 March 2023
Capital adequacy ratio	Not less than 10.5%	17.89%	18.71%
Inter-bank borrowing balance to total capital ratio	Not more than 100%	0.00%	0.00%
Total amount of outstanding guarantees to total capital ratio	Not more than 100%	13.61%	0.00%
Total amount of investment to total capital ratio	Not more than 70%	6.89%	27.09%
Self-owned fixed assets to total capital ratio	Not more than 20%	0.04%	0.04%

As set out in the table above, COFCO Finance complied with the key financial ratio requirements set by CBIRC as at 31 December 2022 and 31 March 2023.

In addition, pursuant to the article of association of COFCO Finance, in the event that COFCO Finance has financial difficulties, COFCO undertakes that it will provide financial support to COFCO Finance to resolve the financial difficulties by COFCO Finance. Based on the above, there is no limit to the provision of working capital by COFCO under such circumstances.

As such, we are of the view that the Measures would mitigate the credit risk exposed to the Company when COFCO Finance provides Deposit Services to the Group.

Assessment on the undertaking of COFCO

In our assessment on the sufficiency of the undertaking by COFCO, we have reviewed (a) the management account as at/for the three months ended 31 March 2023 of COFCO; (b) the breakdown of the balance of bank credit facility of COFCO as at 31 March 2023; and (c) the latest credit rating report of COFCO issued on 15 July 2022 by China Lianhe Credit Rating Co., Ltd. (聯合資信評估股份有限公司), one of the major credit rating agencies approved by China Securities Regulatory Commission to carry out credit rating service. We noted that:

- (i) the net working capital, which is calculated by current assets (excluding bank balances and cash) less current liabilities (excluding interest-bearing debt), of COFCO Finance amounted to approximately RMB2,196 million as at 31 March 2023, representing approximately 11% of the net working capital of COFCO of approximately RMB19,803 million as at 31 March 2023. As such, the working capital of COFCO Finance is relatively insignificant to the working capital of COFCO. In the event that COFCO Finance has any financial difficulties, the financial support to be provided by COFCO will not have significant adverse impact on its financial position. Such financial support will not lead to financial distress of COFCO or non-compliance with the Measures. Therefore, the undertaking by COFCO is meaningful and practical;
- (ii) the bank balances and cash of COFCO as at 31 March 2023 amounted to approximately RMB2,707 million and the balance of unused bank credit facility of COFCO as at 31 March 2023 amounted to approximately RMB518,000 million, the sum of which is sufficient to cover the Revised Deposit Annual Cap of RMB155 million; and
- (iii) the corporate credit rating of COFCO is "AAA" (based on the aforementioned credit rating report), indicating that COFCO has a strong capacity to meet financial commitments with a remote risk of default.

As such, we are of the view that COFCO has the capacity to provide financial support to COFCO Finance to restore its financial position in the event that COFCO Finance falls into financial difficulty.

B. Chinatex Supplemental Agreement and revision of the Existing Chinatex Annual Caps

1. Background

On 16 December 2021, the Company entered into the Existing Material Purchase Framework Agreement with Chinatex, pursuant to which the Chinatex Group agreed to supply yarns, cotton and other materials to the Group for the manufacture of fabric, garments and cooking oil and foodstuffs for a term of three years commencing from 1 January 2022 to 31 December 2024.

On 15 May 2023, the Company entered into the Chinatex Supplemental Agreement with Chinatex to revise the Existing Chinatex Annual Caps. Save for the revision of the Existing Chinatex Annual Caps, all other terms and conditions under the Existing Material Purchase Framework Agreement remain unchanged.

2. Reasons for and benefits of the revision of the Existing Chinatex Annual Caps

As stated under the section headed "B. Chinatex Supplemental Agreement and revision of the Existing Chinatex Annual Caps – 5. Analysis on the Revised Chinatex Annual Caps" below, taking into account (i) the saving of the transportation time relating to yarns and cotton and the rental cost of warehouses by the Group due to the establishment of specialized warehouses located in the same cities of the factories of the Group by the Chinatex Group; and (ii) the predetermined fixed price of yarns and cotton provided by the Chinatex Group to the Group, the Directors expected that the purchase volume of yarns and cotton from the Chinatex Group by the Group will increase in FY2023 and FY2024. As such, the Existing Chinatex Annual Caps for FY2023 and FY2024 would be insufficient and need to be revised upwards to accommodate the latest business development of the Group.

3. Principal terms of the Chinatex Supplemental Agreement

(1) Date

15 May 2023

(2) Parties

- (i) the Company; and
- (ii) Chinatex

(3) Subject Matter

Pursuant to the Chinatex Supplemental Agreement, upon the approval by the Independent Shareholders at the AGM, the Existing Chinatex Annual Caps shall be revised to the Revised Chinatex Annual Caps under the Chinatex Supplemental Agreement as follows:

	For the year ended/ending 31 December		
	2022	2023	2024
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Existing Chinatex Annual Caps	63,000	63,000	63,000
Revised Chinatex Annual Caps	63,000	363,000	363,000

(4) Pricing Policy

As a general principle, the price and terms of the individual order in respect of the transactions under the Chinatex Supplemental Agreement would be on normal commercial terms, negotiated on an arm's length basis and shall be on terms which are no less favorable to the Group than those provided by independent third party suppliers.

Subject to the general principle above, the purchase price payable by the Group under the individual orders in respect of the transactions under the Chinatex Supplemental Agreement will be determined with reference to the following:

- (i) the prevailing market prices of similar products;
- (ii) the quality and prices of the products offered by other independent third party suppliers; and
- (iii) the expected cost to be incurred by the Chinatex Group in providing such products.

In addition, the Group would make reference to the China Statistical Yearbook, an annual statistics publication which is published by China Statistics Press, a specialized publisher under the National Bureau of Statistics of the PRC. It provides comprehensive data on the economic and social development of China, including the price indices of certain commodities such as cotton and cooking oil.

4. Assessment on the internal control procedures of the pricing method

In assessing the internal control associate with the continuing connected transactions contemplated under the Existing Material Purchase Framework Agreement, we have carried out the following procedures:

- (i) we have randomly selected seven transactions (two transactions for each of the year ended 31 December 2020 ("FY2020"), FY2021, FY2022 and one transaction for 3M2023) of the purchase of materials from the Chinatex Group by the Group, and noted that when determining the purchase price of an individual order, the Group has obtained the quotations by email from at least three independent suppliers to get a reference on the prevailing market prices for the products to be procured. The prices of the above transactions (a) were determined with reference to the prevailing market price; and (b) were no less favorable than those offered by the independent third parties of the Company.

- (ii) we noted from the annual report of the Company for FY2022 ("**2022 Annual Report**") that the INEDs have reviewed the continuing connected transactions contemplated under the Existing Material Purchase Framework Agreement and confirmed that all such transactions had been entered into by the Group (a) in the ordinary and usual course of business of the Group; (b) on normal commercial terms or on terms no less favorable to the Group than terms available to or from independent third parties; and (c) in accordance with the terms of the agreements governing such transactions that were fair and reasonable and in the interests of the Shareholders as a whole;
- (iii) we noted from the 2022 Annual Report that the auditor of the Company has confirmed that the continuing connected transactions contemplated under the Existing Material Purchase Framework Agreement (a) had been approved by the Board; (b) were in accordance with the pricing policies of the Group; (c) had been entered into in accordance with the terms of the agreements governing the transactions; and (d) had not exceeded the Existing Chinatex Annual Caps; and
- (iv) we noted from the 2022 Annual Report that, if a Director had a conflict of interest in a transaction or proposal to be considered by the Board and such transaction or proposal was considered to be material by the Board, the individual Director had to declare his interest and was required to abstain from voting on any matter in which he or any of his close associates (as defined in the Listing Rules) had a material interest and that he would not be counted in the quorum present at the Board meeting. We have randomly selected one minute of the board meeting convened in FY2022, and noted that all the Directors in the Board meeting have declared as to whether they have conflict of interest in the issues contemplated under the board meeting.

Taking into account the above, we are of the view that

- (i) the continuing connected transactions contemplated under the Existing Material Purchase Framework Agreement have complied with the requirements under the internal control measures of the Group. As such, it is expected that the transactions contemplated under the Existing Material Purchase Framework Agreement would be carried out in compliance with the internal control measures of the Company; and
- (ii) the Group has adequate internal control policies and procedures in place to ensure that the transactions under Existing Material Purchase Framework Agreement would be conducted in accordance with the pricing policy of the Group and the Revised Chinatex Annual Caps would not be exceeded.

5. Analysis on the Revised Chinatex Annual Caps

- (1) *The historical transaction amounts, the Existing Chinatex Annual Caps and the Revised Chinatex Annual Caps*

The following table sets forth (i) the utilization of the annual caps for the year ended 31 December 2019 ("**FY2019**"), FY2020, FY2021, FY2022 and the year ending 31 December 2023 ("**FY2023**"); and (ii) the comparison between the Existing Chinatex Annual Caps and the Revised Chinatex Annual Caps for FY2023 and the year ending 31 December 2024 ("**FY2024**"):

		FY2019	FY2020	FY2021	FY2022	FY2023		FY2024	
		HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000 Existing	HK\$'000 Revised	HK\$'000 Existing	HK\$'000 Revised
Historical transaction amount	a	22,924	6,507	1,224	18,461	3,386 (Note)	N/A	N/A	N/A
Annual cap	b	63,000	63,000	63,000	63,000	63,000	363,000	63,000	363,000
Utilization rate	c=a/b	36.4%	10.3%	1.9%	29.3%	5.4%	N/A	N/A	N/A

Note: The amount of approximately HK\$3 million represented the historical transaction amount for 3M2023.

- (2) *Analysis on the low utilization rate for FY2019, FY2020, FY2021 and FY2022*

For FY2019, the provision of yarns, cotton and other materials provided by the Chinatex Group to the Group amounted to approximately HK\$23 million, representing approximately 36.4% of the existing annual cap for the same period. The low utilization rate was mainly attributable to the fact that the members of the Group did not purchase as many yarns, cotton and other materials from the Chinatex Group as expected because the price and/or the terms of the yarns, cotton and other materials offered by the independent third parties were more favorable than those provided by the Chinatex Group.

For FY2020, the provision of yarns, cotton and other materials by the Chinatex Group to the Group amounted to approximately HK\$7 million, representing approximately 10.3% of the existing annual cap for the same period. The low utilization rate was mainly attributable to the fact that the frequent implementation of quarantine control measures for the COVID-19 in various cities in PRC caused the suspension of production of the Group. As such, the demand of yarns, cotton and other materials used for manufacturing by the Group was less than expected when determining the annual caps for FY2020.

For FY2021, the provision of yarns, cotton and other materials by the Chinatex Group to the Group amounted to approximately HK\$1 million, representing approximately 1.9% of the existing annual cap for the same period. The low utilization rate was mainly attributable to the fact that the members of the Group did not purchase as many yarns, cotton and other materials from Chinatex Group because the price and/or the terms of the yarns, cotton and other materials offered by the independent third parties were more favorable than those provided by Chinatex Group.

For FY2022, the provision of yarns, cotton and other materials by the Chinatex Group to the Group amounted to approximately HK\$18 million, representing approximately 29.3% of the existing annual cap for the same period. The low utilization rate was mainly attributable to the reduction in the production volume in one of the fabric mills of the Group for FY2022 as a result of the decrease in the sales orders of the Group from European and American markets. As such, the purchase of yarns, cotton and other materials by the Group from the Chinatex Group was less than expected.

(3) *Assessment on the Revised Chinatex Annual Caps*

We noted that the Revised Chinatex Annual Caps for FY2023 and FY2024 have increased by approximately 476.2% as compared to the Existing Chinatex Annual Cap for the same period.

As discussed with the management of the Company, we understand that the volume of the yarns and cotton to be purchased from Chinatex Group is expected to increase for FY2023 and FY2024 despite the fact that the overall demand for the yarns and cotton of the Group will remain stable for the same periods. Such increase in the Chinatex Annual Caps is mainly due to the following reasons:

(i) The members of the Group will be able to save the transportation time and rental cost of warehouses

The members of the Group will be able to save the transportation time relating to yarns and cotton and the rental cost of warehouses when purchasing the above materials from the Chinatex Group as compared to the purchase from independent third parties due to the close proximity between the Chinatex Group and the members of the Group. Chinatex has established warehouses located in the same cities of the factories of the members of the Group in Jiangsu Province and Guangdong Province to provide yarns and cotton to the members of the Group. Due to the close proximity between the above warehouses and the factories of the members of the Group, (a) the distance of the delivery of the yarns and cotton can be substantially reduced and the Group will be able to save the time for delivering the yarns and cottons; and (b) the members of the Group will be able to purchase yarns and cottons from the Chinatex Group on a just-in-time basis when the members of the Group are in need of the above material for manufacturing. As such, the Group does not need to purchase a large volume of the yarns and cotton before the manufacturing process. Therefore, the Group is able to reduce the inventory level and save the rental cost of warehouses.

In terms of the warehouses, we have (a) noted that Chinatex has established several warehouses located in the same cities of the main factories of the Group in Jiangsu Province and Guangdong Province; (b) reviewed the location of the warehouses which have been established by Chinatex; and (c) reviewed the available storage capacity of the established warehouses, which is sufficient to satisfy the needs for storage of yarns and cotton of the factories of the Group. We are advised by the management of the Company that Chinatex will place purchasing orders with independent suppliers of yarns and cotton based on the manufacture plan of the members of the Group. Thereafter, the yarns and cotton purchased by Chinatex will be stored in the abovementioned established warehouses. Whenever the members of the Group need the above material for manufacturing, they will be able to purchase the yarns and cotton from Chinatex which will transport such material from the warehouses to the factories of the Group located in the same cities on a just-in-time basis. As such, instead of delivering the material from the Chinatex Group to the factories of the Group located in different cities in the past, the transportation time of delivering the yarns and cotton from the abovementioned warehouses to the factories of the Group will be reduced. Since the Group will not need to purchase and store excessive yarns and cotton before the manufacturing process, the inventory level of the Group will be reduced and rental cost of warehouses will be lowered.

(ii) The Chinatex Group will provide the yarns and cotton at a fixed price to the members of the Group

The Chinatex Group will provide the yarns and cotton at a fixed price to the members of the Group. The management of the Company considered that the purchase price of yarns and cotton will be volatile due to escalation of Russia-Ukraine wars. As such, the purchase of cotton and yarns from the Chinatex Group at a predetermined fixed price will help the members of the Group to control the cost of manufacturing the products.

In view of the volatility of the purchase price of cotton and yarns as advised by the management of the Company, we have performed research and reviewed a research report in respect of the price trend of the yarns and cotton, namely, Short-term uncertainty of cotton price is large while price may increase in the long run* (《棉花短期不確定性大長期價格重心或上移》(website: https://www.cfachina.org/servicesupport/analygarden/ncpl/mh_5786/202304/P020230404586632847398.pdf) dated 30 March 2023, issued by Galaxy Futures Co., Ltd, a security firm established in the PRC. Pursuant to the above research report, the price of cotton is expected to rise for FY2023 due to the increase in the demand for garments. As such, we concur with the view of the management of the Company that, given the purchase price of yarns and cotton will be volatile, it is expected that purchase of cotton and yarns from the Chinatex Group at a predetermined fixed price will improve the cost control of the Group.

To arrive at our view on the Revised Chinatex Annual Caps, we have reviewed the breakdown of the Revised Chinatex Annual Caps and noted that the Revised Chinatex Annual Caps were determined with reference to:

- (i) the estimated volume of yarns and cotton to be purchased by the members of the Group from the Chinatex Group for FY2023 and FY2024, which is determined based on the volume of yarns and cotton purchased by the member of the Group from the Chinatex Group for FY2022 and the estimated growth rate of the demand for the yarns and cotton of the members of the Group from the Chinatex Group for FY2023 and FY2024; and
- (ii) the estimated price of the yarns and cotton for FY2023 and FY2024, which is determined based on the market price of yarns and cotton as at 31 March 2023.

Regarding the volume of yarns and cotton, we have obtained and reviewed the breakdown of the estimated volume of yarns and cotton to be purchased by the members of the Group under the Revised Chinatex Annual Caps for FY2023 and FY2024 and noted that the above estimated volume will amount to approximately 28.7 million pounds, which is approximately six times the estimated volume of the yarns and cotton purchased by the members of the Company from the Chinatex Group in determining the Existing Chinatex Annual Caps for FY2022. Such estimated volume of yarns and cotton is determined with reference to the lower of (a) the total estimated volume of yarns and cotton to be used for the manufacturing of the products by the Group for FY2023; and (b) the anticipated volume of yarns and cotton which can be provided by the warehouses of the Chinatex Group for FY2023.

Regarding the unit price used to determine the Revised Chinatex Annual Caps, we have performed due diligence work by reviewing a research report in relation to the price of yarns and cotton in March 2023 (website: <https://www.china-cotton.org/app/html/2023/04/20/94686.html>) dated 20 April 2023, issued by China Cotton Association, a Chinese non-profit federation specializing in cotton. According to the aforementioned research report, the average selling price of yarns and cotton ranged from approximately RMB22,000 per ton to approximately RMB24,000 per ton during March 2023. We noted that the estimated purchase prices of yarns and cotton per ton for the Revised Chinatex Annual Cap fall within the above range. Based on the above, we are of the opinion that the unit price used to determine the Revised Chinatex Annual Caps is fair and reasonable.

Having considered all the factors as mentioned above, we are of the view that the Revised Chinatex Annual Caps under the Chinatex Supplemental Agreement for FY2023 and FY2024 are fair and reasonable and in the interests of the Company and Independent Shareholders as a whole.

C. COFCO Finance Supplemental Agreement and revision of the Existing Deposit Annual Cap

1. Background

On 14 July 2022, the Company entered into the Existing Financial Services Agreement with COFCO Finance, pursuant to which COFCO Finance agreed to provide the Deposit Services, the Loan Services and the Other Financial Services to the Group for a term of three years commencing from 14 July 2022 to 13 July 2025.

On 15 May 2023, the Company entered into the COFCO Finance Supplemental Agreement with COFCO Finance to revise the Existing Deposit Annual Cap. Save for the revision of the Existing Deposit Annual Cap, all other terms and conditions under the Existing Financial Services Agreement remain unchanged.

2. Reasons for and benefits of the revision of the Existing Deposit Annual Cap

As stated under the section headed "C. COFCO Finance Supplemental Agreement and revision of the Existing Deposit Annual Cap – 5. Analysis on the Revised Deposit Annual Cap" below, taking into account (i) the expected increase in bank balances and cash of the members of the Group for the three years ending 13 July 2025; and (ii) the provision of more favorable interest rate for deposit by COFCO Finance to the members of the Group, the Directors expected that the amount of deposit placed by the members of the Group at COFCO Finance will increase for the three years ending 13 July 2025. As such, the Existing Deposit Annual Cap for the three years ending 13 July 2025 would be insufficient and needs to be revised upwards to accommodate the latest business development of the Group.

3. Principal terms of the COFCO Finance Supplemental Agreement

(1) Date

15 May 2023

(2) Parties

- (i) the Company; and
- (ii) COFCO Finance

(3) *Subject Matter*

Pursuant to the COFCO Finance Supplemental Agreement, upon the approval by the Independent Shareholders at the AGM, the Existing Deposit Annual Cap shall be revised to the Revised Deposit Annual Cap under the COFCO Finance Supplemental Agreement as follows:

**Maximum daily balance of deposits (including accrued interests)
placed by the Group with COFCO Finance
for the three years ending 13 July 2025**
RMB'000

Existing Deposit Annual Cap	55,000
Revised Deposit Annual Cap	155,000

(4) *Pricing Principles*

The interest rates for the Group's deposits with COFCO Finance will be determined in accordance with the standard deposit rates promulgated by the PBC from time to time. The interest rates on the Deposit Services to be offered by COFCO Finance to the Group will not be lower than the standard deposit rates promulgated by the PBC or the interest rates offered by the major PRC commercial banks for the same type of deposits during the same period. The list of principal PRC commercial banks of the Company and their respective interest rates, which is used for the benchmark of the interest rates, is subject to monthly review by the finance department of the Company.

4. Assessment on the internal control procedures

In assessing the internal control associate with Deposit Services, we have randomly selected two samples for the period from 14 July 2022 to 31 March 2023 in relation to the Deposit Services and noted that the interest rates for deposit paid by COFCO Finance in the two samples were both 0.45%, which was not lower than (i) the standard deposit rate of 0.35% promulgated by the PBC for the same type of deposit for the same period; and (ii) the interest rate of 0.25% offered by the major PRC commercial banks for the same type of deposits during the same period.

We have obtained the list of principal PRC commercial banks of the Company and noted that the finance department of the Company would obtain and compare the interest rates of the banks on the list of systemically important banks* (系統重要性銀行名單) issued by PBC and CBIRC with the interest rates of the principal PRC commercial banks of the Company. We have noted that the finance department of the Company will review the abovementioned list on a monthly basis and update such list when (i) the PBC and CBIRC update the list of systemically important banks; or (ii) when the PBC adjusts the interest rates in relation to the Deposit Services. We have compared the list of principal PRC commercial banks of the Company, which includes Bank of China, Industrial and Commercial Bank of China and China Construction Bank, with the list of systemically important banks issued by PBC and CBIRC in September 2022 and noted that all the principal PRC commercial banks of the Company are included in the list of systemically important banks issued by PBC and CBIRC.

Taking into account the above, we are of the view that the Group has adequate internal control policies and procedures in place to ensure that the Deposit Services would be conducted in accordance with the pricing policy of the Group.

5. Analysis on the Revised Deposit Annual Cap

(1) *The historical transaction amounts, the Existing Deposit Annual Cap and the Revised Deposit Annual Cap*

The following table sets forth (i) the comparison between the maximum daily balance of deposits (including accrued interests) placed by the Group with COFCO Finance under the Existing Financial Services Agreement for the period from 14 July 2022 to 31 March 2023 and the Existing Deposit Annual Cap for the year ending 13 July 2023; and (ii) the comparison between the Existing Deposit Annual Cap and the Revised Deposit Annual Cap:

		For the year ending 13 July					
		2023		2024		2025	
		RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
		Existing	Revised	Existing	Revised	Existing	Revised
Maximum daily balance	a	55,000 (Note)	N/A	N/A	N/A	N/A	N/A
Annual cap	b	55,000	155,000	55,000	155,000	55,000	155,000
Utilization rate	c=a/b	100%	N/A	N/A	N/A	N/A	N/A

Note: The amount of RMB55 million represented the maximum daily balance of deposits (including accrued interests) placed by the Group to COFCO Finance for the period from 14 July 2022 to 31 March 2023.

(2) *Assessment on the Revised Deposit Annual Cap*

We noted that the Revised Deposit Annual Cap for the three years ending 13 July 2023 has increased by approximately 182.8% as compared to the Existing Deposit Annual Cap for the same period.

As discussed with the management of the Company, we understand that, when determining the Revised Deposit Annual Cap, the Company has considered the following:

- (i) up to 31 March 2023, the Existing Deposit Annual Cap has been fully utilized;
- (ii) the Group is expected to increase the amount of deposit placed with COFCO Finance for the purpose of centralising the management of daily funds under the COFCO's regulations;
- (iii) given that the interest rates paid by COFCO Finance to the members of the Group are more favourable as compared with those promulgated by PBC or those offered by the major PRC commercial banks, the Group has the incentive to place more deposit with COFCO Finance to increase the return of the idle funds of the Group; and
- (iv) an appropriate buffer for allowing a more than expected increase in revenue generated by the Group from 2023 to 2025 and thus the deposit amount and deposit interest during the remaining term of the Existing Financial Services Agreement.

To arrive at our view on the Revised Deposit Annual Cap, we have performed the following analysis:

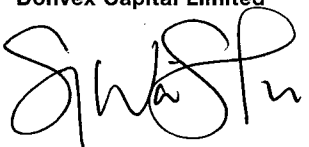
- (i) we have reviewed the basis of the Revised Deposit Annual Cap and noted that it is determined with reference to (a) the average working capital of the Company's subsidiaries operating in the PRC as at 31 December 2020, 2021, and 2022 of approximately RMB145 million (the "**Average Working Capital**"); and (b) a buffer of approximately 10.7% determined with reference to the historical compound annual growth rate of the Group's revenue from FY2020 to FY2022 for allowing a more than expected increase in revenue generated by the Group from 2023 to 2025; and
- (ii) we have reviewed the breakdown of the Average Working Capital. The Existing Deposit Annual Cap of RMB55 million only accounts for approximately 38% of the Average Working Capital. In light of the above, the management of the Company was of the view that the Existing Deposit Annual Cap is insufficient to accommodate the latest business development of the Group and needs to be revised upwards.

Having considered all the factors as mentioned above, we are of the view that the Revised Deposit Annual Cap under the COFCO Finance Supplemental Agreement for the three years ending 13 July 2025 are fair and reasonable and in the interests of the Company and Independent Shareholders as a whole.

RECOMMENDATION

Having taken into consideration the factors and reasons as stated above, we are of the opinion that the Revision of Existing Annual Caps is in the Company's ordinary and usual course of business. The terms of the Supplemental Agreements are on normal commercial terms, fair and reasonable, and in the interest of the Company and the Shareholders as a whole.

Accordingly, we recommend the Independent Board Committee to advise the Independent Shareholders to vote in favor of the resolution(s) to be proposed at the AGM to approve the Supplemental Agreements and the Revision of Existing Annual Caps and we recommend the Independent Shareholders to vote in favor of the resolution(s) in this regard.

Yours faithfully,
For and on behalf of
Donvex Capital Limited

Doris Sy
Director

Ms. Doris Sy is a person licensed to carry out type 6 (advising on corporate finance) regulated activities under the Securities and Futures Ordinance and is a responsible officer of Donvex Capital Limited who has around 21 years of experience in corporate finance advisory.

* For identification purposes only