RAINBOW CAPITAL (HK) LIMITED
浤博資本有限公司

7 July 2023

To the Independent Board Committee and the Independent Shareholders

Zhejiang Tengy Environmental Technology Co., Ltd
TENGY Industrial Park, Paitou Town,
Zhuji City, Zhejiang Province,
The PRC

Dear Sir or Madam,

MAJOR AND CONNECTED TRANSACTION

INTRODUCTION

We refer to our appointment as the independent financial adviser to the Independent Board Committee and the Independent Shareholders in respect of the Acquisition, details of which are set out in the "Letter from the Board" (the "**Letter from the Board**") contained in the circular issued by the Company to the Shareholders dated 7 July 2023 (the "**Circular**"), of which this letter forms a part of. Unless the context otherwise requires, capitalised terms used in this letter shall have the same meanings as those defined in the Circular.

On 25 May 2023 (after trading hours of the Stock Exchange), the Company entered into the Agreement with the Vendor, pursuant to which the Company conditionally agreed to acquire and the Vendor conditionally agreed to sell the Sale Capital for the consideration of RMB51.2 million (subject to downward adjustment) (the "**Consideration**"). Prior to entering into the Agreement, the Company and the Vendor has entered into a memorandum of understanding (the "**Memorandum**") in relation to the Acquisition, pursuant to which the Company has paid to the Vendor an amount of RMB3 million as refundable earnest money, which shall be applied for payment for part of the Consideration upon Completion.

The Sale Capital represents 95% of the equity interest in the Target Company, which is principally engaged in solar power generation business in the PRC. Upon Completion, the Target Company shall become a subsidiary of the Company and the financial results of the Target Company shall be consolidated into the consolidated financial statements of the Company.

As at the Latest Practicable Date, the Vendor is the controlling shareholder (as defined under the Listing Rules) of the Company, holding approximately 30.0% of the issued share capital of the Company. As such, the Vendor is a connected person of the Company under Chapter 14A of the Listing Rules. Accordingly, the Acquisition constitutes a connected transaction for the Company under Chapter 14A of the Listing Rules. As the highest applicable percentage ratio (as defined under Rule 14.07 of the Listing Rules) in respect of the Acquisition exceeds 25% but is less than 100%, the Acquisition also constitutes a major transaction for the Company under Chapter 14 of the Listing Rules. The Acquisition is therefore subject to the reporting, announcement and the Independent Shareholders' approval requirements under Chapter 14 of the Listing Rules. The Company will seek approval from the Independent Shareholders in respect of the Acquisition by way of a poll at the EGM. To the best of the Directors' knowledge, information and belief, having made all reasonable enquiries, (i) the Vendor who holds approximately 30.0% of the Company's share capital and its close associates including each of Mr. Bian Yu, Ms. Bian Shu and Mr. Bian Jianguang who holds approximately 5.70%, 2.03% and 2.85% of the Company's share capital, respectively, as at the Latest Practicable Date, are required to abstain from voting on the resolution to be proposed at the EGM; and (ii) no other close associates of the Vendor or Shareholder is required to abstain from voting on the resolution to be proposed at the EGM.

The Independent Board Committee, comprising all the three independent non-executive Directors, namely Mr. Zhang Bing, Mr. Fung Kui Kei and Mr. Li Jiannan, has been formed to advise the Independent Shareholders on whether (i) the Acquisition is conducted in the ordinary and usual course of business of the Group; and (ii) the terms of the Agreement are on normal commercial terms which are fair and reasonable and in the interests of the Company and the Shareholders as a whole, and advise the Independent Shareholders as to voting. We, Rainbow Capital, have been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in this regard.

As at the Latest Practicable Date, we did not have any relationships or interests with the Group and the Vendor that could reasonably be regarded as relevant to our independence. We have acted as the independent financial adviser to the independent board committee and the independent shareholders of the Company in relation to (i) the acquisition of 40% equity interest in Zhejiang Tianjie Magnetic Materials Co., Ltd, details of which are set out in the circular of the Company dated 29 June 2021; and (ii) the acquisition of properties, details of which are set out in the circular of the Company dated 8 February 2022. Other than that, there was no engagement or connection between the Group or the Vendor and us in the last two years. Apart from normal professional fees paid or payable to us in connection with this appointment as the independent financial adviser, no arrangements exist whereby we had received any fees or benefits from the Group or the Vendor. Accordingly, we are qualified to give independent advice in respect of the Acquisition.

BASIS OF OUR OPINION

In formulating our opinion and advice, we have relied on (i) the information and facts contained or referred to in the Circular; (ii) the information supplied by the Group; (iii) the opinions expressed by and the representations of the Directors and the management of the Group; and (iv) our review of the relevant public information. We have assumed that all the information provided and representations and opinions expressed to us or contained or referred to in the Circular were true, accurate and complete in all respects as at the date thereof and may be relied upon. We have also assumed that all statements contained and representations made or referred to in the Circular are true at the time they were made and continue to be true as at the Latest Practicable Date and all such statements of belief, opinions and intentions of the Directors and the management of the Group and those as set out or referred to in the Circular were reasonably made after due and careful enquiry. We have no reason to doubt the truth, accuracy and completeness of the information and representations provided to us by the Directors and the management of the Group. We have also sought and received confirmation from the Directors that no material facts have been withheld or omitted from the information provided and referred to in the Circular and that all information or representations provided to us by the Directors and the management of the Group are true, accurate, complete and not misleading in all respects at the time they were made and continued to be so until the date of the Circular.

We consider that we have reviewed sufficient information currently available and corroborated and substantiated any public information referred to in this letter 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 any independent verification of the information provided, representations made or opinion expressed by the Directors and the management of the Group, nor have we conducted any form of in-depth investigation into the business, affairs, operations, financial position or future prospects of the Group and the Vendor or their respective substantial shareholders, subsidiaries or associates.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In considering whether the terms of the Agreement and the transaction contemplated thereunder are fair and reasonable, we have taken into account the principal factors and reasons set out below:

1. Background information on the Group

As an integrated atmospheric pollution control solution provider, the Group is principally engaged in (i) sales of environmental protection equipment, primarily three types of precipitators, i.e. electrostatic precipitators, bag filter precipitators and electrostatic-bag composite precipitators; (ii) sales of materials, including raw materials, spare parts and components and scrap materials; and (iii) rendering of services, including repair and replacement, and on-site engineering and maintenance services for those projects which were not constructed by the Group.

The tables below set forth a summary of the consolidated financial information of the Group for the three years ended 31 December 2022 ("**FY2020**", "**FY2021**" and "**FY2022**", respectively) as extracted from the annual reports for FY2021 and FY2022 (the "**2022 Annual Report**") of the Company:

(i) Financial performance

	FY2022 *RMB'000* (Audited)	**FY2021** *RMB'000* (Audited)	**FY2020** *RMB'000* (Audited)
Revenue	**472,471**	**763,165**	**607,078**
– Sales of environmental protection equipment	442,739	744,011	580,530
– Sale of materials	29,549	18,878	25,491
– Rendering of services	183	276	1,057
Gross profit	**67,439**	**110,990**	**110,954**
Other income	120,820	13,717	11,445
Distribution and selling expenses	(15,834)	(14,109)	(14,017)
Administrative expenses	(63,279)	(74,643)	(102,688)
Other expenses	(3,814)	(904)	(124)
Profit from operations	**105,332**	**35,051**	**5,570**
Finance costs	(7,668)	(6,443)	(7,066)
Share of (loss)/profits of associates	(21,894)	(2,884)	1,999
Profit before tax	**75,770**	**25,724**	**503**
Income tax (expenses)/credit	(22,165)	(5,112)	3,986
Profit attributable to the Shareholders	**53,605**	**20,612**	**4,489**

FY2022 compared to FY2021

Revenue of the Group decreased by approximately 38.1% from approximately RMB763.2 million for FY2021 to approximately RMB472.5 million for FY2022. Such decrease was mainly due to more completion of the small-scale projects and fewer completion of the large-scale projects in FY2022 which result in the decrease in the scale of business. Sales of environmental protection equipment amounted to approximately RMB744.0 million and RMB442.7 million, accounting for approximately 97.5% and 93.7% of total revenue for FY2021 and FY2022, respectively.

In line with the decrease in revenue, gross profit of the Group decreased by approximately 39.2% from approximately RMB111.0 million for FY2021 to approximately RMB67.4 million for FY2022.

The Group's profit from operations increased significantly by approximately 200.5% from approximately RMB35.1 million for FY2021 to approximately RMB105.3 million for FY2022, primarily attributable to (a) the increase in other income by approximately RMB107.1 million deriving from the one-off gain on disposal of property, plant and equipment and right-of-use assets; and (b) the decrease in administrative expenses by approximately RMB11.4 million mainly due to (1) the turnaround from loss on disposal of investment at fair value through profit or loss in 2021 to gain in 2022; and (2) the decrease in the research and development expenses by approximately RMB3.2 million as a result of the decrease in the number of technicians employed by the Group and the related efforts in research and development during FY2022. Such increase was partially offset by the decrease in total revenue and gross profit as mentioned above.

Profit attributable to the Shareholders amounted to approximately RMB53.6 million for FY2022, representing an increase of approximately 160.1% from approximately RMB20.6 million for FY2021. Such increase was primarily attributable to the increase in profit from operations as mentioned above, which was partially offset by (a) the increase in share of loss of associates by approximately RMB19.0 million; and (b) the increase in income tax expenses by approximately RMB17.1 million.

FY2021 compared to FY2020

Revenue of the Group increased by approximately 25.7% from approximately RMB607.1 million for FY2020 to approximately RMB763.2 million for FY2021. Such increase was mainly due to the completion of certain large-scale projects during FY2021. Sales of environmental protection equipment amounted to approximately RMB580.5 million and RMB744.0 million, accounting for approximately 95.6% and 97.5% of total revenue for FY2020 and FY2021, respectively.

Gross profit of the Group remained stable at approximately RMB111.0 million for FY2020 and FY2021. The gross profit margin of the Group decreased from approximately 18.3% for FY2020 to approximately 14.5% for FY2021, primarily due to the increase in the price of steel, being one of the major raw materials of the products produced by the Group.

The Group's profit from operations increased significantly by approximately 529.3% from approximately RMB5.6 million for FY2020 to approximately RMB35.1 million for FY2021, mainly attributable to the decrease in administrative expenses by approximately RMB28.0 million as a result of (a) the decrease in impairment losses for trade receivables for FY2021; and (b) the decrease in research and development expenses by approximately RMB7.9 million as a result of the decrease in the number of technicians employed by the Group and the related efforts in research and development during FY2021.

Profit attributable to the Shareholders amounted to approximately RMB20.6 million for FY2021, representing an increase of approximately 359.2% from approximately RMB4.5 million for FY2020. Such increase was primarily attributable to the increase in profit from operations as mentioned above, which was partially offset by (a) the share of loss of associates of approximately RMB2.9 million for FY2021 as compared to the share of profits of associates of approximately RMB2.0 million for FY2020; and (b) the income tax expenses of approximately RMB5.1 million for FY2021 as compared to the income tax credit of approximately RMB4.0 million for FY2020.

(ii) Financial position

	As at 31 December		
	2022	**2021**	**2020**
	RMB'000	*RMB'000*	*RMB'000*
	(Audited)	(Audited)	(Audited)
Non-current assets, including:	**196,297**	**324,423**	**252,564**
Property, plant and equipment	27,963	81,160	72,320
Deferred tax assets	43,878	52,102	56,045
Investment in associates	122,671	144,565	75,499
Current assets, including:	**1,339,429**	**1,263,918**	**1,248,007**
Inventories	291,288	321,372	226,636
Trade and bills receivables	700,899	796,124	791,571
Bank and cash balance	241,041	9,373	104,548
Total assets	**1,535,726**	**1,588,341**	**1,500,571**
Current liabilities, including:	**701,505**	**807,725**	**740,567**
Trade and bills payables	200,711	327,716	265,819
Contract liabilities	354,675	264,251	247,049
Bank loans	55,000	115,158	122,809
Net current assets	**637,924**	**456,193**	**507,440**
Total liabilities	**701,505**	**807,725**	**740,567**
Equity attributable to the Shareholders	**834,221**	**780,616**	**760,004**

Total non-current assets of the Group decreased by approximately 39.5% from approximately RMB324.4 million as at 31 December 2021 to approximately RMB196.3 million as at 31 December 2022, which mainly comprised (a) property, plant and equipment of approximately RMB28.0 million, primarily consisting of buildings and plant and machinery; (b) deferred tax assets of approximately RMB43.9 million; and (c) investment in associates of approximately RMB122.7 million.

Total current assets of the Group increased by approximately 6.0% from approximately RMB1,263.9 million as at 31 December 2021 to approximately RMB1,339.4 million as at 31 December 2022, which mainly comprised (a) inventories of approximately RMB291.3 million; (b) trade and bills receivables of approximately RMB700.9 million; and (c) bank and cash balance of approximately RMB241.0 million.

Total liabilities of the Group decreased by approximately 13.2% from approximately RMB807.7 million as at 31 December 2021 to approximately RMB701.5 million as at 31 December 2022, which mainly comprised (a) trade and bills payables of approximately RMB200.7 million; (b) contract liabilities of approximately RMB354.7 million; and (c) bank loans of approximately RMB55.0 million.

As at 31 December 2022, the Group had net current assets of approximately RMB637.9 million and equity attributable to the Shareholders of approximately RMB834.2 million.

(iii) Overall comment

Revenue of the Group fluctuated in recent years, primarily affected by the timetable and the scale of the projects undertaken by the Group. The financial performance of the Group is largely dependent on the sales of environmental protection equipment which accounted for over 90% of total revenue of the Group for FY2020, FY2021 and FY2022. Nevertheless, as the PRC government issued the 14th Five-Year Comprehensive Work Plan for Energy Conservation and Emission Reduction which made an overall deployment for energy conservation and emission reduction, the Company anticipates that there would be increasing demand for environmental protection products which would promote the development of the Group. Following the disposal of land in 2022, the financial position of the Group improved with the net proceeds, and recorded net current assets and bank and cash balance of approximately RMB637.9 million and RMB241.0 million as at 31 December 2022, respectively. As stated in the 2022 Annual Report, the Group will continue to actively seek appropriate acquisition projects to expand its capabilities of research and development, manufacturing and sales, as well as to access new domestic and international markets.

2. Information on the Target Company

(i) Business of the Target Company

The Target Company is a company established in the PRC and is principally engaged in solar power generation business in the PRC. As at the Latest Practicable Date, the Target Company holds a 12 MWp distributed photovoltaic power generation project and has entered into an electricity sale contract with 國網浙江諸暨市供電有限公司 (State Grid Zhejiang Zhuji Power Supply Company Limited*), a stated owned enterprise, for a term of three years and automatically renewed for another term of three years expiring in December 2023.

As at the Latest Practicable Date, (a) the Target Company is owned as to 95% by the Vendor and 5% by Mr. Yang Boming（楊波明）; and (b) the Target Company has a registered capital of RMB20 million which has been fully paid up. The Vendor acquired its 95% equity interest in the Target Company at the original costs of RMB19 million.

(ii) Financial information of the Target Company

The following discussion of the financial performance and position of the Target Company is based upon and should be read in conjunction with the accountants' report on the Target Company set out in Appendix II to the Circular:

Financial performance

	Three months ended 31 March 2023	Three months ended 31 March 2022	FY2022	FY2021
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
	(Audited)	(Unaudited)	(Audited)	(Audited)
Revenue	**764**	**1,024**	**5,581**	**7,185**
Cost of sales	(750)	(660)	(2,703)	(2,662)
Gross profit	**14**	**364**	**2,878**	**4,523**
Other income, gains and losses, net	146	–	1,292	(42)
Administrative expenses	(79)	(9)	(104)	(71)
Finance costs	(344)	(462)	(1,623)	(2,305)
(Loss)/profit before tax	**(263)**	**(107)**	**2,443**	**2,105**
Income tax expenses	–	–	–	–
Net (loss)/profit	**(263)**	**(107)**	**2,443**	**2,105**

FY2022 compared to FY2021

Revenue of the Target Company is mainly derived from sales of electricity arising from the photovoltaic power generation project. The Target Company's revenue decreased by approximately 22.3% from approximately RMB7.2 million for FY2021 to approximately RMB5.6 million for FY2022. Such decrease was mainly due to the reduction of solar energy resources and utilisation hours of the solar panels arising from rainy days and decreased the operation time. Given that the supplier of the solar panels did not provide a detailed clean-up instruction, the existing operator did not regularly and properly maintain and cleanup the solar panels of the Target Company since its operation in 2018, leading to the existence of dust issue and low performance over time. In FY2022, the solar panel of the Target Company has been working in even lower capacity as there was construction work in the area beside the solar farm since 2022, which led to thick layer of dust covering the solar panels and worsened the dust issue, and thereby further affected the performance of transforming solar energy to power.

Cost of sales mainly represented the Target Company's depreciation charges on property, plant and machinery and right-of-use assets, which remained stable at approximately RMB2.7 million for FY2021 and FY2022.

In line with the decrease in revenue and the stable cost of sales, gross profit of the Target Company decreased by approximately 36.4% from approximately RMB4.5 million for FY2021 to approximately RMB2.9 million for FY2022.

Net other income and gains mainly represented the municipal government grants for photovoltaic power generation project and interest income from the cash balance, which amounted to approximately RMB1.3 million for FY2022 as compared to net other losses of approximately RMB0.04 million for FY2021, primarily attributable to the one-off unexpected assembling and dismantling costs incurred for equipment of approximately RMB1.7 million in FY2021, which was non-recurring in FY2022.

Administrative expenses mainly represented office expenses, service fee and equipment insurance expenses, which increased slightly from approximately RMB0.07 million for FY2021 to approximately RMB0.1 million FY2022.

Finance costs mainly represented interest on lease liabilities which decreased from approximately RMB2.3 million for FY2021 to approximately RMB1.6 million for FY2022, mainly due to the repayment of lease liabilities and reduction of accrued interest expenses.

Net profit of the Target Company increased from approximately RMB2.1 million for FY2021 to approximately RMB2.4 million for FY2022, primarily attributable to the increase in net other income and gains and the decrease in finance costs as mentioned above.

Three months ended 31 March 2023 ("3M2023") compared to three months ended 31 March 2022 ("3M2022")

Revenue of the Target Company decreased by approximately 25.4% from approximately RMB1.0 million for 3M2022 to approximately RMB0.8 million for 3M2023. Such decrease was mainly due to the fact that the state government subsidies have not yet been paid by the state government in 3M2023. The government grants received by the Target Company were from three levels, namely, state level, province level and municipal level, among which the government grants from state level and province level were recognised under revenue while the government grants from municipal level were recognised under other income. For 3M2022 and 3M2023, the Target Company received national and provincial subsidies of approximately RMB544,000 and RMB139,000, respectively.

Cost of sales increased slightly from approximately RMB0.7 million for 3M2022 to approximately RMB0.8 million for 3M2023, primarily attributable to the increase in depreciation of right-of-use assets arising from a new lease agreement entered into by the Target Company in November 2022.

In line with the decrease in revenue and the relatively stable cost of sales, gross profit of the Target Company decreased by approximately 96.2% from approximately RMB0.4 million for 3M2022 to approximately RMB14,000 for 3M2023.

Net other income and gains increased from nil for 3M2022 to approximately RMB0.1 million for 3M2023, primarily attributable to the fact that the government grants are in general paid irregularly which were not paid in 3M2022.

Administrative expenses increased from approximately RMB9,000 for 3M2022 to approximately RMB79,000 for 3M2023, primarily attributable to the cleaning expense, which categorised as repair and maintenance expenses, for power generation equipment incurred in 3M2023.

Finance costs decreased slightly from approximately RMB0.5 million for 3M2022 to approximately RMB0.3 million for 3M2023.

Net loss of the Target Company increased from approximately RMB107,000 for 3M2022 to approximately RMB263,000 for 3M2023, primarily attributable to the decrease in revenue and gross profit as mentioned above.

Financial position

	As at 31 March 2023	As at 31 December 2022	2021
	RMB'000	*RMB'000*	*RMB'000*
	(Audited)	(Audited)	(Audited)
Non-current assets:	**46,279**	**47,029**	**46,123**
Property, plant and equipment	15,923	16,169	17,157
Right-of-use asset	30,356	30,860	28,966
Current assets:	**11,621**	**1,801**	**15,434**
Trade and other receivables	1,348	1,410	14,568
Pledged bank deposits	10,000	–	–
Bank and cash balance	273	391	866
Total assets	**57,900**	**48,830**	**61,557**
Current liabilities:	**35,870**	**43,190**	**55,579**
Other payables	18,093	35,177	47,857
Bank and other borrowings	9,900	–	–
Lease liabilities	7,877	8,013	7,722
Net current liabilities	**(24,249)**	**(41,389)**	**(40,145)**
Non-current liabilities:	**5,235**	**6,609**	**9,390**
Lease liabilities	5,235	6,609	9,390
Total liabilities	**41,105**	**49,799**	**64,969**
Net assets/(liabilities)	**16,795**	**(969)**	**(3,412)**

As at 31 March 2023, non-current assets of the Target Company amounted to approximately RMB46.3 million, mainly comprised the Target Company's plant and machinery in relation to solar power plant and right-of-use assets.

As at 31 March 2023, current assets of the Target Company amounted to approximately RMB11.6 million, mainly comprised (a) pledged bank deposits of approximately RMB10.0 million which was pledged to secure bank and other borrowings of the Target Company; and (b) bank and cash balance of approximately RMB0.3 million.

As at 31 March 2023, total liabilities of the Target Company amounted to approximately RMB41.1 million, mainly comprised (a) other payables of approximately RMB18.1 million, among which approximately RMB8.3 million were amount due to ultimate holding company; (b) bank and other borrowings of approximately RMB9.9 million which carried an effective interest rate of 3% per annum; and (c) lease liabilities of approximately RMB13.1 million.

Net current liabilities and net assets of the Target Company amounted to approximately RMB24.2 million and RMB16.8 million as at 31 March 2023, respectively.

3. Reasons for and benefits of the Acquisition

As disclosed in the Letter from the Board, the Board believes that the Acquisition will provide an investment opportunity for the Company to diversify its business portfolio by entering into the new energy market in the PRC. The Company has tapped into wind power market in the PRC in 2020. The Acquisition, if materialised, will allow the Company to tap into the solar power market in the PRC and further consolidate its position in the new energy market in the PRC. The Board believes that by entering into the Agreement, the Group can meet its business development strategy to enhance its competitiveness and capture the opportunities in the environmental protection sector of the PRC. Taking into consideration that there has been a trend in governmental policies and regulations to encourage and enforce environmental protection, the Directors are of the view that the Acquisition will provide a good investment opportunity for the Group to participate in the promising and growing new energy industry in the PRC and the Acquisition can further enhance the value of the Group and maximise returns to the Shareholders.

Following Completion, the Group is capable to manage the business of the Target Company in view of that, one of the executive Directors, namely Mr. Zhang Yuanyuan, is also a director of the Target Company and is responsible for the operational strategies of the Target Company. He has approximately 15 years of experience in the wind power and solar power business and will continue to manage the Target Company assisted by a competent team with extensive experience in the field of engineering and power generation if the Acquisition materialised.

Set out below are the gross domestic product ("**GDP**") and generation of solar power of the PRC during the period from 2018 to 2022:

	2018	**2019**	**2020**	**2021**	**2022**	**CAGR**
GDP *(RMB' billion)*	91,928	98,652	101,357	114,924	121,021	7.1%
Generation of solar power *(100 million kWh)*	894.5	1,172.2	1,421.0	1,836.6	2,290.0	26.5%

Source: National Bureau of Statistics of China

As shown in the table above, Chinese GDP has increased from approximately RMB91,928 billion in 2018 to approximately RMB121,021 billion in 2022 with a compound annual growth rate ("**CAGR**") of approximately 7.1%, indicating a solid economic foundation in the past 5 years. According to the "World Economic Outlook: A Rocky Recovery" released by International Monetary Fund in April 2023, China's economy will continue to grow with a projected GDP growth rate of approximately 5.2% and 4.5% in 2023 and 2024, respectively.

The generation of solar power in the PRC also recorded a booming upward trend after 2018, increasing from approximately 89.5 billion kWh in 2018 to approximately 229.0 billion kWh in 2022, representing a CAGR of approximately 26.5%. Such significant increase indicated the rapid development of the domestic solar power market in the recent years. As disclosed in the "14th Five-Year Plan on Renewable Energy Development"(十四五可再生能源發展規劃) released by the National Development and Reform Committee in June 2022, the Chinese government targets a 50 percent increase in renewable energy generation from 2020 to 2025 and directs that 50 percent of China's incremental electricity and energy consumption shall come from renewables over the period from 2021 to 2025. In addition, according to the "Notice on the promotion of synergistic development of the supply chain of the photovoltaic industry"(關於促進光伏產業鏈供應鏈協同發展的通知) jointly issued by the General Office of Ministry of Industry and Information Technology, the General Office of State Administration for Market Regulation and the General Administration Department of the National Energy Administration in August 2022, it emphasises the importance to support the optimisation of establishing a national photovoltaic market and the development of the photovoltaic supply chain market in the PRC, and thereby promote the development of high quality photovoltaic industry. With the promulgation of favourable government policies to support the development of the photovoltaic market in the PRC which drives strong potential demand on renewable energy, the solar power market in the PRC is expected to grow in a fast pace.

Taking into account that (i) the Acquisition is in line with the development strategy of the Group; and (ii) the positive market outlook of the solar power market in the PRC, the Acquisition represents an opportunity for the Group to diversify its business into the solar power industry with high growth potential, which could in turn generate return to its Shareholders. Accordingly, we concur with the Directors that although the Acquisition is not conducted in the ordinary and usual course of the Group, the Acquisition is fair and reasonable and in the interest of the Company and Shareholders as a whole.

4. Principal terms of the Agreement

Set out below is a summary of the principal terms of the Agreement. Independent Shareholders are advised to read further details of the Agreement as disclosed in the Letter from the Board:

Date	:	25 May 2023 (after trading hours of the Stock Exchange)
Parties	:	(i) The Company, as the purchaser; and (ii) The Vender
Subject matter	:	The Sale Capital, representing 95% of the equity interest in the Target Company
Consideration	:	The Consideration shall be RMB51.2 million (subject to downward adjustment), of which: (i) RMB3 million has been paid to the Vendor as refundable earnest money pursuant to the Memorandum, which shall be applied for payment for part of the Consideration upon Completion; (ii) the RMB27 million shall be payable by the Company in cash to the Vendor within five Business Days from the date of Completion; and (iii) the remaining Consideration in the amount of RMB21.2 million shall be payable by the Company in cash to the Vendor within one year after the Completion. The Consideration will be financed by the internal resources of the Group. The Consideration will be adjusted downward in the following circumstances: (i) if upon Completion there is any liabilities not disclosed in the management accounts of the Target Company or not approved in advance by the Company, the Company is entitled to deduct the relevant amount from the total Consideration or if the total Consideration has already been paid, the Vendor shall pay the relevant amount to the Company within one month upon notification from the Company;

(ii) if the account receivables of the Target Company have remained overdue for more than twelve months, such account receivables will be considered as bad debts of the Target Company and the Company is entitled to deduct the relevant amount from the total Consideration or if the total Consideration has already been paid, the Vendor shall pay the relevant amount to the Company within one month upon notification from the Company;

(iii) all account payables, costs and expenses and/or financial loss incurred by the Target Company due to any payment, litigation, arbitration, administrative penalty or other legal proceedings resulting from any non-compliance incidents of the Target Company that occurred before the Completion Date will be borne by the Vendor and the Company is entitled to deduct the relevant amount from the total Consideration or if the total Consideration has already been paid, the Vendor shall pay the relevant amount of the Company within one month upon notification from the Company; and

(iv) the Vendor will be responsible for timely and full payment of taxes incurred with respect or the transactions contemplated under the Agreement in accordance with the relevant PRC laws, regulations and the other regulatory documents. If the Company or the Target Company suffers any loss due to the above tax obligation, the Company is entitled to deduct the relevant amount from the total Consideration or if the total Consideration has already been paid, the Vendor shall pay the relevant amount to the Company within one month upon notification from the Company.

There is no determination date or time limit for the Consideration adjustment.

		As disclosed in the Letter from the Board, the Consideration was determined after arms' length negotiations between the parties with reference to, among other things, the valuation of 100% equity interest in the Target Company of RMB53.9 million as at 31 March 2023 conducted by Roma Appraisals Limited, an independent professional valuer, by way of the income approach with the use of the discounted cash flow method (the "**Valuation**").
Conditions precedent	:	Completion is conditionally on, among other things, the passing by the Independent Shareholders at the EGM of the necessary relevant resolution(s) to approve the Agreement and the transactions contemplated thereunder in accordance with the requirements under the Listing Rules. For details of the other conditions precedent, please refer to the paragraph headed "Conditions precedent" in the Letter from the Board.
Completion	:	Completion shall take place within 15 Business Days after fulfilment (or waiver, as the case may be) of all the conditions precedent under the Agreement. After Completion, the Target Company shall be owned as to 95% by the Company and 5% by Mr. Yang Boming (楊波明). Upon Completion, the Target Company will become a subsidiary of the Company and the financial results of the Target Company will be consolidated into the financial accounts of the Company.
Profit guarantee	:	From 1 January 2023 to 31 December 2027, the Vendor undertakes with the Company that the Target Company will meet the following profit guarantee in each of the five financial years as follows: (i) the reviewed annual net profit after tax for the year ending 31 December 2023 shall be not less than RMB4,150,917; (ii) the reviewed annual net profit after tax for the year ending 31 December 2024 shall be not less than RMB5,669,158; (iii) the reviewed annual net profit after tax for the year ending 31 December 2025 shall be not less than RMB5,669,158;

(iv) the reviewed annual net profit after tax for the year ending 31 December 2026 shall be not less than RMB5,669,158; and

(v) the reviewed annual net profit after tax for the year ending 31 December 2027 shall be not less than RMB5,594,158.

An auditor appointed by the Company shall review the financial report prepared by the Target Company in accordance with the China Accounting Standards for Business Enterprises for the relevant periods and issue the review report within three months after the end of the relevant periods respectively, and such review reports shall then be final, conclusive and binding on the Vendor and the Company.

If the reviewed annual net profit of the Target Company for any of the above-mentioned financial year is lower than the corresponding annual guaranteed net profit as agreed, the Company shall be entitled to request the Vendor to fulfill its obligation to pay the full amount of compensation for the difference between the actual net profit of the Target Company and the guaranteed net profit for the relevant financial year within seven working days from the date of the review report for that financial year. If the Target Company records net loss for any of the above-mentioned financial year, the reviewed annual net profit of the Target Company for the financial year should be treated as zero and the Vendor is liable to pay the full amount of the guaranteed net profit for the relevant financial year in the same manner as detailed above. For the avoidance of doubt, in calculation of the net profit of the Target Company, all the extraordinary items shall be excluded.

The Company will comply with the relevant disclosure requirements (including Rules 14.36B and 14A.63 of the Listing Rules) in the event that the actual performance of the profit guarantee as set out above fails to meet the relevant guarantee.

As discussed above, the Vendor provides the profit guarantee in favour of the Company in respect of the annual net profit after tax from 1 January 2023 to 31 December 2027 and will compensate for the shortfall on dollars for dollars basis within seven working days from the date of the review report for each financial year. Although the profit guarantee in aggregate only represents approximately 52.3% of the Consideration, taking into account that (i) the amount of the guaranteed net profit is determined with reference to the projected net profit for the five years ending 31 December 2027 adopted in the Valuation; (ii) the Consideration of RMB51.2 million is determined with reference to the valuation of 100% equity interest of the Target Company of RMB53.9 million as at 31 March 2023 as appraised by the Valuer by way the income approach with the use of the discounted cash flow method and represents an equivalent amount to the Valuation after taking into account the 95% of the equity interest in the Target Company to be acquired under the Acquisition; (iii) based on our independent work performed on the Valuation with details discussed in the section headed "Valuation of the Target Company" below, the Valuation is considered to be carried out on a fair and reasonable basis by the Valuer; (iv) the provision of profit guarantee by the Vendor demonstrated its confidence in the Target Company's performance in the near future; (v) the risk profile of the Target Company is considerably low considering the profit-making position of the Target Company for the past two years; (vi) the growth potential and prospect of the Target Company in view of the favourable governmental policies to support the development of the photovoltaic market in the PRC and the reasons for and benefits of the Acquisition as discussed in the section headed "Reasons for and benefits of the Acquisition" above; and (vii) the Company would be able to secure a cash compensation from the Vendor if the profit guarantee cannot be achieved and the compensation is calculated as the shortfall on dollars for dollars basis and will be paid each year, we consider that the aggregated profit guarantee provided by the Vendor can sufficiently protect the interest of the Company and the Shareholders as a whole.

As disclosed in the Letter from the Board, the Vendor is a company established in the PRC with limited liability and is principally engaged in the business of, among other things, manufacturing and sale of machineries and spare parts, the sale of steel, building materials and other chemical products and scrap metals recycling and the construction. We have obtained and reviewed the audit reports of the Vendor for FY2021 and FY2022 and noted that for FY2021 and FY2022, the Vendor recorded revenue of approximately RMB10,703.6 million and RMB8,158.9 million, respectively and net profit attributable to the shareholders of approximately RMB183.6 million and RMB184.7 million, respectively. As at 31 December 2022, net current assets, equity attributable to the shareholders and cash and cash equivalents of the Vendor amounted to approximately RMB2,059.7 million, RMB3,001.2 million and RMB618.4 million, respectively. In addition, based on the management account of the Vendor as at 31 May 2023, the cash and cash equivalents balance of the Vendor was approximately RMB442.1 million. Having considered (i) the cash and cash equivalents balance of the Vendor is significantly higher than the aggregated amount of the profit guarantee (i.e. a sum of approximately RMB26.8 million); and (ii) the profit-making position of the Vendor in recent years, we consider that the Vendor is capable to fulfill its obligation when it is asked to compensate for the shortfall under the profit guarantee.

Taking into account (i) the reasons for and benefits of the Acquisition as stated above; (ii) the Consideration is determined with reference to the valuation of 100% equity interest of the Target Company of RMB53.9 million as at 31 March 2023 as appraised by the Valuer by way of the income approach with the use of the discounted cash flow method; (iii) the profit guarantee provided by the Vendor is in favour of the Company; and (iv) the financial performance and position of the Vendor which supported the Vendor's capability to fulfill its obligation under the profit guarantee, we consider that the terms of the Agreement are on normal commercial terms which are fair and reasonable and in the interests of the Company and the Shareholders as a whole.

5. Valuation of the Target Company

As stated in the Letter from the Board, the Consideration is determined with reference to the valuation of 100% equity interest of the Target Company of RMB53.9 million as at 31 March 2023 as appraised by the Valuer by way of the income approach with the use of the discounted cash flow method. The full text of the valuation report (the "**Valuation Report**") is set out in Appendix V to the Circular, and the Independent Shareholders are recommended to read in full.

In assessing the fairness and reasonableness of the Valuation, we have taken into the following factors:

(i) The qualification and scope of work of the Valuer

We have conducted an interview with the Valuer to enquire to their qualification and experience in valuing similar energy companies in the PRC and their independence. From the mandate letter and other relevant information provided by the Valuer, we noted that the Valuer is a qualified valuation firm to perform valuation works complying with International Valuation Standard, and the responsible person of the Valuer is a charterholder of the Chartered Financial Analyst and international certified valuation specialist of International Association of Certified Valuation Specialists who possesses sufficient qualifications and experience in valuing similar companies in the PRC. We have also enquired with the Valuer as to their independence from the Group, the Vendor and the Target Company, and were given to understand that the Valuer is independent to the Group, the Vendor and the Target Company. The Valuer confirmed that apart from normal professional fees paid or payable to them in connection with their appointment as the Valuer, no arrangements exist whereby they will receive any fees or benefits from the Group, the Vendor and the Target Company. We have also reviewed the terms of engagement of the Valuer, in particular to their scope of work. We noted that their scope of work is appropriate to form the opinion required to be given and there are no limitations on the scope of work which might adversely impact on the degree of assurance given by the Valuer in the Valuation Report. We have also performed work as required under note (1)(d) to Rule 13.80 of the Listing Rule in relation to the Valuer and its work as regards to the Valuation. Based on the above, we are satisfied with the terms of engagement of the Valuer as well as their qualification and experience for performing the Valuation, and we are of the view that the scope of work of the Valuer is appropriate. We therefore consider it is appropriate to rely on their work and opinion.

(ii) Valuation methodologies

We have discussed with the Valuer and understand that the Valuer has considered three generally accepted approaches, namely, market approach, income approach and asset-based approach. The Valuer adopted the discounted cash flow ("**DCF**") methodology of the income approach in the Valuation due to the following consideration:

(a) the selection of the valuation approach in valuing the Target Company is based on, among other criteria, the quantity and quality of the information provided, accessibility to available data, availability of relevant market information, professional judgment and technical expertise;

(b) income approach takes the future growth potential and firm-specific characteristics of the Target Company into consideration;

(c) the DCF method, which begins with an estimation of the annual cash flows that a market participant acquirer would expect the asset to generate over a discrete projection period, is appropriate because the purpose of purchasing and subscribing for shares in the Target Company is for the Company to benefit from the future income to be generated by the Target Company. Therefore, the prospect of future income-generating is the central factor to consider when it comes to gauging the value of the Target Company from the perspective of the Company;

(d) market approach is not considered because valuation multiples derived from comparable companies and transactions might not reflect the risk and return characteristics of the Target Company, and there is insufficient information on the important assumptions of the comparable transactions, such as discount or premium on the transaction prices or considerations. Further, the differences in location, sunlight durations, model of the sunlight board, operation and maintenance will affect the financial performance of the comparable companies and the consideration of the comparable transactions, and thus the valuation. Given that the details and information of these aforementioned factors are generally not publicly available, market approach was not adopted; and

(e) asset-based approach is not considered because information for the calculation of fair values of the assets and liabilities of the Target Company was insufficient. In addition, it could not capture the future earning potentials and thus market value of the Target Company.

Based on the factors above, we concur with the Valuer that the income approach was the most appropriate valuation methodology to conduct a fair and reasonable valuation.

(iii) Application of the DCF methodology

Under the income approach, the appraisal value of the Target Company represents the present worth of future economic benefits expected to be generated from the Target Company. The Valuer applied the DCF method to discount the free cash flow ("**FCF**") of the Target Company at a discount rate to calculate the fair market value of the Target Company.

In our assessment in the valuation, we have reviewed the following key quantitative assumptions:

(a) Forecasted revenue

In assessing the reasonableness of the forecasted revenue for the nine months ending 31 December 2023 and 19 years ending 31 December 2042 (the "**Forecast Period**"), we have discussed with the Valuer on the basis and assumptions underlying the projections and reviewed the detailed working documents, and noted that the projected revenue for the Forecast Period is derived by multiplying expected electricity generation amount each year with the unit electricity price for each of those that will be purchased by companies and/or factories located near the solar farm and those will be purchased by local electricity supply company, and the unit government subsidy.

In respect of the expected electricity generation amount of 9.5 million kWh each year during the Forecast Period, it is estimated based on (1) the historical electricity generation of approximately 9.5 million kWh, 9.0 million kWh and 9.0 million kWh in 2018, 2019 and 2020, respectively; (2) the estimated growth of the electricity generation capacity, which is determined based on Company's plan to optimise the operation of the Target Company's solar farm after completion of the Acquisition; and (3) the expected sunshine duration during the Forecast Period. As advised by the management of the Company, the relatively lower electricity generation of approximately 7.7 million kWh and 6.6 million kWh in FY2021 and FY2022 was primarily attributable to the construction work in the area beside the solar farm which led to thick layer of dust covering the solar panels and affected the performance of transforming solar energy to power and decreased the operation efficiency. The construction work in the area beside the solar farm was commenced in 2022 and is expected to complete in 2023 based on the recent communication between the management of the Target Company and the management of the factory. The electricity generation is expected to recover to the historical level of approximately 9.5 million kWh per annum after the construction work and regular and proper cleanup will be maintained. Upon Completion, the Company plans to optimise the operation of the Target Company's solar farm and improve the transformation rate of the solar panels during the Forecast Period through (1) increasing the frequency of regular cleaning and maintenance; (2) assigning its own engineers to closely monitor the daily operation of the solar farm; and (3) capital investment in an aggregate amount of RMB4.0 million during the Forecast Period for daily maintenance and repair of solar panels. As such, the electricity generation amount is expected to resume to a normal level similar to that in 2018 of approximately 9.5 million kWh per annum, which has been taken into account in the forecasted revenue.

Among the 9.5 million kWh electricity generation, it is expected that 90% of it will be purchased by companies and/or factories located near the solar farm and the remaining 10% will be purchased by local electricity supply company during the 19 years ending 31 December 2042. As advised by the management of the Company, there is one company principally engaged in the development, production and sales in non-metallic inorganic new materials which is constructing its new plant near the solar farm. That company had represented to the Target Company that it would constantly purchase electricity from the Target Company when its new plant commences operation as the unit electricity price of the Target Company is cheaper than market rate, especially during peak time. It is expected that the construction of the new plant will be completed by the end of 2023 and the new materials company will start to purchase electricity from the Target Company since 2024.

In respect of the unit electricity price, the unit price of electricity supplied to the local electricity supply company is estimated based on its historical average selling price from FY2020 to FY2022 which was a constant guideline price determined by the Price Bureau of Zhejiang Province under 浙江省物價局關於電價調整有關事項的通知（浙價資[2016]2號）(Notice of the Price Bureau of Zhejiang Province on matters related to the adjustment of electricity prices (Zhejizi [2016] No. 2*). On the other hand, the unit price of electricity supplied to nearby companies and/or factories is estimated based on its historical unit price from FY2020 to FY2022. Since the Target Company used to supply electricity to a related party with a 20% discount, the 20% discount is removed in determining the unit price of electricity supplied to nearby companies and/or factories during the Forecast Period as the Target Company will cease such discount arrangement and supply electricity at the same price to this related party and other independent third parties after Completion.

In respect of the unit government subsidy, it is estimated based on the historical unit government subsidies the Target Company received from FY2020 to FY2022, which was constant and determined by the National Development and Reform Commission. Such unit government subsidy remained constant in FY2023. With the favourable government policies trend to support the development of the photovoltaic market in the PRC, it is expected that such subsidy would continue to be available in the future.

(b) Forecasted cost of revenue

Cost of revenue mainly represents the Target Company's depreciation of property, plant and equipment. As advised by the management of the Company, the Target Company generally did not incur any raw material costs and direct staff costs in its daily operation and thus its cost of revenue would not fluctuate with revenue. In assessing the reasonableness of the forecasted cost of revenue for the Forecast Period, we have discussed with the Valuer on the basis and assumptions underlying the projections and reviewed the detailed working documents, and noted that the forecasted cost of revenue for the Forecast Period is estimated mainly based on the balance of the Target Company's property, plant and equipment as at 31 March 2023, the relevant accounting policies of the Target Company and the capital expenditure and maintenance schedule of the Target Company.

As advised by the management of the Company, there are only two staffs required for the daily operation of the Target Company, which comprised of an accounting staff and a mechanical staff. As the Group has employed certain experienced accounting staff and mechanical staff who have the experience, knowledge and ability to maintain the daily operation of the Target Company, the Company will not hire additional staff to operate the Target Company following Completion and these two staffs will be employed by the Group and be responsible for other responsibilities in the Group. As such, the staff costs will be borne by the Group rather than the Target Company during the Forecast Period. Taking into account that (1) the management of the Company has confirmed that the Group will pay the relevant staff costs; and (2) based on our review of the CVs of the mechanical staff of the Group who are shown to have the relevant experience and knowledge, we consider the forecasted cost of revenue to be fair and reasonable.

(c) Forecasted operating expenses

Operating expenses refer to office expenses, equipment insurance expenses and rental expenses. In assessing the reasonableness of the forecasted operating expenses for the Forecast Period, we have discussed with the Valuer on the basis and assumptions underlying the projections and reviewed the detailed working documents, and noted that the forecasted operating expenses for the Forecast Period is estimated as a proportion of forecasted revenue and the proportion is determined as the average of historical proportion of operating expenses in terms of historical revenue from FY2020 to FY2022.

In addition, based on the rental agreement entered into between the Target Company and the local government in respect of the rooftop area for solar panels used by the Target Company's solar farm, rental expenses are also included in the forecasted operating expenses.

(d) Forecasted tax expenses

As advised by the management of Company, as a solar power electricity generation company, the Target Company is eligible for a three-year exemption (i.e. from 2018 to 2020) and a three-year 50% reduction (i.e. from 2021 to 2023) in corporate income taxes. As such, a tax rate of 12.5% is applied for the nine months ending 31 December 2023 and a tax rate of 25% is applied for the 19 years ending 31 December 2042 in the Valuation.

(e) Forecasted capital expenditure and working capital requirement

Capital expenditures generally comprises of development and expansion capital expenditure, sustaining capital expenditure and rehabilitation capital expenditure. As advised by the management of the Company, although the Target Company is currently operating all necessary infrastructure in place, it is expected to increase the electricity generation capacity of the Target Company through capital investment in an aggregate amount of RMB4.0 million for daily maintenance and repair of solar panels during the Forecast Period. The projected amounts were RMB1.0 million each in 2023, 2027, 2032 and 2037. As such, the forecasted capital expenditure of RMB4.0 million is estimated primarily based on the budgeted sustaining and rehabilitation expenditures of the Company on the Target Company, which represents approximately 19.4% of the balance of the Target Company's plant and machinery of approximately RMB20.6 million as at 31 March 2023 as the majority of the solar panels shall be able to continue to work until 2042 (i.e. the end of its lifespan) and only require regular maintenance and clean-up. With the regular maintenance and clean-up and replacement of heavily broken or obsolete solar panels, the electricity generation capacity of the Target Company shall be resumed to a normal level similar to that in 2018, thus increasing the revenue and profit of the Target Company. The forecasted revenue and profit have taken into account this capital expenditure.

The forecasted working capital is determined with reference to the historical financial information, payment terms, the historical turnover days of the Target Company during FY2020 and FY2022 and the historical working capital needed for maintaining the operation of the Target Company.

(f) Discount rate

The Valuer has considered the followings in determining the discount rate:

(1) the risk-free rate of 2.858% is based on the implied yield rate of 10-year Chinese government bond as at 31 March 2023 as extracted from Bloomberg;

(2) the market risk premium of China of 12.38% is determined with reference to (i) the expected market return of 10-year Chinese government bond as at 31 March 2023 as extracted from Bloomberg; and (ii) the risk free rate of 2.858% as mentioned above;

(3) the levered beta coefficient of the Target Company of 0.77 is determined with reference to the median of the unlevered beta coefficient and debt-to-equity ratio of six comparable companies (the "**Comparable Companies**") which are also engaged in the business of solar power electricity generation in the PRC and publicly listed in stock exchanges in Hong Kong or the PRC for more than two years, with adjustment for differences in corporate tax rates and leverage compositions. We consider that the Valuer's selection criteria is appropriate and sufficient for the Valuation as (i) it enables the Valuer to identify companies with similar business (i.e. solar power electricity generation) in the same geographical region (i.e. the PRC) as the Target Company, with sufficient years of listing and publicly available data for it to conduct the Valuation; and (ii) it has covered the prevailing market conditions and sentiments in Hong Kong and the PRC. Based on the above criteria, we have, based on our search on Bloomberg and the website of the Stock Exchange, identified six comparable companies which are the same as those identified by the Valuer as set out in the Valuation Report. We consider that no other suitable comparable company is omitted as our independent research results are identical to those identified by the Valuer and thus the list of the Comparable Companies to be exhaustive. Based on our independent research on the Comparable Companies, we concur with the Valuer that the list of the Comparable Companies fit the selection criteria and are fair and representative samples;

(4) size premium for micro-cap of 3.05% is determined with reference to the size premium study in Duff & Phelps Cost of Capital Navigator 2022 published by Duff & Phelps, LLC, which is a multinational financial consultancy firm and a reputable and an often-cited source on equity valuations;

(5) other risk premium of 1.00% which is based on the professional judgement of the Valuer to reflect unsystematic risk such as forecast risk of the Target Company. As advised by the management of the Company, the operation of the Target Company only requires minimal active management involvement and the demand of electricity will be bounded by the terms and conditions as stated in the contract signed. The operation risk is relatively low and hence the Valuer considered that the other risk premium of 1.00% is suitable for accounting the forecast and business risk of the Target Company;

(6) the cost of equity of 16.44% based on (1), (2), (3), (4) and (5) above;

(7) the cost of debt after tax of 2.25% is determined with reference to (i) the actual bank borrowing rate of the Target Company as at 31 March 2023 with an effective interest rate of 3% per annum; and (ii) the corporate tax rate of 25%;

(8) the weight of equity (equity/(debt + equity)) of approximately 32.42% is determined with reference to median of those of the Comparable Companies; and

(9) the nominal weighted average cost of capital ("**WACC**") of approximately 6.85% based on the (6), (7) and (8) above.

As such, 6.85% was adopted as the discount rate.

(g) Forecast Period and equity value

The Valuer adopted the Forecast Period of approximately 20 years from 1 April 2023 to 31 December 2042 based on the advice of the management of the economic useful life of the Target Company given that the useful life of the solar panels were approximately 25 years which shall last from 2018 to 2042. According to the Solar Energy Industries Association (https://www.seia.org/initiatives/recycling-end-life-considerations-photovoltaics), founded in 1974, being a national non-profit trade association of the solar energy industry in the United States, we noted that the typical lifespan for solar panels is 20 to 30 years. As such, we consider the Forecast Period to be fair and reasonable. The Valuer calculated (1) the FCF during the Forecast Period with the assumptions stated above; and (2) the present value of the FCF during the Forecast Period with the discount rate of 6.85%. The equity value is then derived by adding the present values of FCF during the Forecast Period and adjusting cash, debt, lease liabilities and net non-operating assets/(liabilities) of the Target Company as at 31 March 2023.

(h) Discount for lack of marketability

Given the Target Company is not a privately held company and the value of a share in a privately held company is usually less than that in a publicly held company, the Valuer adopted a discount for lack of marketability which is a downward adjustment to the value of an investment to reflect its reduced level of marketability.

As stated in the Valuation Report, in determining the discount for lack of marketability of 9.0%, the Valuer has made reference to the result of the restricted stock study published in "Stout Restricted Stock Study 2022" by Stout Risius Ross, LLC, a reputable research company, which is designed to assist the valuation professional in determining discounts for lack of marketability. As advised by the Valuer, the discount for lack of marketability of 9.0% is the median discount for six transactions in respect of companies principally engaged in electricity services or other electricity power generation services.

(iv) Conclusion

Regarding the above assumptions used in the DCF methodology, especially on the forecasted revenue, we have, among others, (a) reviewed the historical financial information of the Target Company for the three years ended 31 December 2022 and the three months ended 31 March 2023; (b) reviewed the management accounts of the Target Company for the two years ended 31 December 2019 to understand the historical electricity generation capacity of the Target Company which amounted to approximately 9.5 million kWh and 9.0 million kWh in 2018 and 2019, respectively; (c) reviewed the historical electricity supply agreements entered between the Target Company and the local electricity supply company as well as its related party to ascertain the relevant pricing terms and noted that the Target Company had maintained a stable business relationship with the local electricity supply company and the unit price of electricity supplied to nearby companies and/or factories applied by the Valuer in the Valuation was consistent with the price stated in the duly signed electricity supply agreement entered with the Target Company's related party; (d) reviewed the government notices and documents regarding local unit electricity price, government subsidies on electricity and relevant tax policy, including but not limited to 浙江省物價局關於電價調整有關事項的通知(浙價資[2016]2號)(Notice of the Price Bureau of Zhejiang Province on matters related to the adjustment of electricity prices (Zhejizi [2016] No. 2*) and 紹興市人民政府辦公室關於推進紹興市家庭屋頂光伏工程建設的實施意見 (Implementation Opinion on of Shaoxing Municipal People's Government Office on Promoting the Construction of Household Roof Photovoltaic Projects in Shaoxing City*) and noted that the local unit electricity price and government subsidies on electricity applied by the Valuer in the Valuation were consistent with those relevant government notices and documents; (e) compared the forecasted operating expenses for the Forecast Period with the historical operating expenses for the three years ended 31 December 2022, and noted that the forecasted operating expenses is mainly determined with its historical proportion in total revenue; (f) reviewed the rental agreement entered by the Target Company as mentioned above and noted that the rental expenses estimated in the Valuation are consistent with the signed agreement; (g) cross-checked the key elements in discount rate and discount for lack of marketability with the Bloomberg, "2022 Valuation Handbook" and "Stout Restricted Stock Study 2022" screenshots provided by the Valuer and no variance is noted; (h) on a best effort basis, conducted our own research in Bloomberg to identify companies which are (1) publicly listed on stock exchanges in Hong Kong or the PRC for more than two years; and (2) principally engaged in the business of solar power electricity generation in the PRC, and identified six comparable companies which are the same as those identified by the Valuer as set out in the Valuation Report; and (i) discussed with the management of the Company on its business plan and future development of the Target Company, especially its plan to optimise the operation of the Target Company's solar farm, and relevant financial impact to the forecasted financial information during the Forecast Period. In particular, we have discussed with the management of the Company on the reasons for the relatively lower electricity generation capacity of the Target Company in 2021 and 2022 and the basis of the ability to restore the electricity generation capacity to the historical level of approximately 9.5 million kWh per annum as driven by its optimisation plan of the Target Company's operation.

After taking into account factors above, in particular, our independent work performed on the Valuation as set out above, we are of the view that (a) the key quantitative assumptions adopted by the Valuer in the Valuation were fair and reasonable; and (b) the calculation of FCF applied by the Valuer is appropriate and the DCF methodology has been reasonably applied in the Valuation.

In addition, having considered that (a) the independence, qualification and experience of the Valuer; and (b) the selection and application of the valuation methodology are reasonably prepared, we are of the view that the Valuation was carried out on a fair and reasonable basis by the Valuer.

In assessing the fairness of the Consideration, we have discussed with the Directors and understood that as illustrated in the table below, the Consideration of RMB51.2 million is determined by reference to the Valuation of 100% equity interest of the Target Company of RMB53.9 million. As the 95% of equity interest of the Target Company would be valued at approximately RMB51.2 million, the Consideration of RMB51.2 million represents an equivalent amount to the Valuation after taking into account the 95% of the equity interest in the Target Company to be acquired under the Acquisition.

The Consideration

The Valuation of 100% equity interest of the Target Company	RMB53.9 million *(A)*
The basis for calculating the Consideration	RMB53.9 million *(B)*
Sale Capital in the Target Company (95% of the total number of issued shares of the Target Company as at the date of the Agreement)	95% *(C)*
The Consideration	RMB51.2 million *(B*C)*
Discount to the Valuation	0.0% *(B/A-1)*

As such, having considered that (i) the Valuation Report has been reasonably prepared; (ii) the Consideration is determined by reference to the Valuation and is equivalent to the Valuation after taking into account the 95% of the equity interest in the Target Company to be acquired under the Acquisition; and (iii) the reasons for and benefits of the Acquisition, we are of the view that the Consideration are fair and reasonable.

6. Financial effect on the Group

Upon Completion, the Target Company shall become a subsidiary of the Company and the financial results of the Target Company will be consolidated into the consolidated financial statements of the Company. The unaudited pro forma financial information of the Enlarged Group (the "**Unaudited Pro Forma Financial Information**") is set out in Appendix III to the Circular.

(i) Earnings

As disclosed in the sections headed "1. Background information on the Group" and "2. Information on the Target Company" above, the Group recorded profit attributable to the Shareholders of approximately RMB53.6 million while the Target Company recorded net profit of approximately RMB2.4 million for FY2022. As the Target Company has been generating revenue and profit in the last three financial years, the Acquisition is expected to contribute to the Group's results upon Completion.

(ii) Net assets

As set out in the Unaudited Pro Forma Financial Information, the pro forma consolidated net assets shall decrease slightly by approximately 0.06% to approximately RMB833.7 million after Completion as compared to that of approximately RMB834.2 million as at 31 December 2022. The pro forma net assets after Completion have taken into account, among other things, the recognition of the Target Company as a subsidiary and the settlement of the Consideration.

(iii) Working capital

Part of the Consideration shall be satisfied by cash payment within five Business Days after Completion which shall be funded by the Group's internal resources. Upon Completion, the net current assets would amount to approximately RMB561.1 million, representing a decrease of approximately 12.0% as compared to approximately RMB637.9 million as at 31 December 2022.

As set out in Appendix I to the Circular, the Directors after due and careful enquiry are of the opinion that, taking into account the financial resources including internally generated fund, the banking facilities available to the Group as well as the effect of the transactions contemplated under the Agreement, the Group will have sufficient working capital to satisfy its present requirements for the next twelve months from the date of the Circular in the absence of unforeseen circumstances.

It should be noted that the aforementioned analyses are for illustrative purpose only and do not purport to represent how the financial performance and position of the Group will be upon Completion.

OPINION AND RECOMMENDATION

Having taken into account the above principal factors and reasons, we consider that the terms of the Agreement are on normal commercial terms which are fair and reasonable so far as the Independent Shareholders are concerned. We also consider that the entering into of the Agreement, while 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. We therefore advise the Independent Board Committee to recommend, and we ourselves recommend, the Independent Shareholders to vote in favour of the ordinary resolution to be proposed at the EGM to approve the Agreement and the transactions contemplated thereunder.

Yours faithfully,
For and on behalf of
Rainbow Capital (HK) Limited

Larry Choi
Managing Director

Mr. Larry Choi is a licensed person and a responsible officer of Rainbow Capital (HK) Limited registered with the Securities and Futures Commission to carry out type 1 (dealing in securities) and type 6 (advising on corporate finance) regulated activities under the SFO. He has over ten years of experience in the corporate finance industry.