

July 25, 2024

To: *the Independent Board Committee and
the independent Shareholders of SouthGobi Resources Ltd.*

Dear Sirs and Madams,

**(1) DISCLOSEABLE AND CONNECTED TRANSACTIONS
IN RELATION TO
THE MARCH 2024 DEFERRAL AGREEMENT &
THE APRIL 2024 DEFERRAL AGREEMENT
AND
(2) CONNECTED TRANSACTION IN RELATION TO
THE CB AMENDMENT AGREEMENT**

INTRODUCTION

We refer to our appointment as the independent financial adviser to advise the Independent Board Committee and the independent Shareholders in relation to the March 2024 Deferral Agreement, the April 2024 Deferral Agreement, the amendment agreement of the Convertible Debenture (the “**CB Amendment Agreement**”, and collectively, the “**Agreements**”) and the transactions contemplated thereunder, details of which are set out in the letter from the Board (the “**Letter from the Board**”) in the management proxy circular issued by the Company to the Shareholders dated July 25, 2024 (the “**Circular**”), of which this letter forms part. Capitalized terms used in this letter shall have the same meanings as those defined in the Circular unless the context otherwise requires.

On March 13, 2024, the Board resolved by way of a written resolution (with the Directors who are appointed by JDZF pursuant to contractual nomination rights contained in the Securityholders Agreement and certain existing deferral agreements (the “**Existing Deferral Agreements**”, being Mr. Ruibin Xu, Ms. Chonglin Zhu and Mr. Chen Shen (collectively, the “**Deferral Interested Directors**”), who have a material interest in the March 2024 Deferral Agreement, abstaining), among other things, to approve the terms of the Deferral and March 2024 Deferral Agreement and to authorize the execution and delivery of the March 2024 Deferral Agreement, pursuant to which JDZF agreed to grant the Company a deferral of (i) the cash interest, PIK Interest, management fees, and related deferral fees in aggregate amount of approximately US\$96.5 million will be due and payable to JDZF on or before August 31, 2024 pursuant to the March 2023 Deferral Agreement and November 2023 Deferral Agreement; (ii) semi-annual cash interest payment of approximately US\$7.9 million payable to JDZF on May 19, 2024 under the Convertible Debenture; (iii) semi-annual cash interest payment of approximately US\$8.1 million payable to JDZF and US\$4.0 million PIK Interest payment (the “**November 2024 PIK Interest**”), which will in each case, be due and payable on November 19, 2024 under the Convertible Debenture; and (iv) management fees in the aggregate amount of approximately US\$2.2 million payable to JDZF on November 15, 2024 and February 15, 2025, respectively, under the Amended and Restated Cooperation Agreement (collectively, the “**March 2024 Deferred Amounts**”) until August 31, 2025 (the “**March 2024 Deferral**”).

On April 30, 2024, the Company and its subsidiaries, namely SouthGobi Sands LLC and SGQ Coal Investment Pte. Ltd., entered into the April 2024 Deferral Agreement with JDZF, pursuant to which JDZF agreed to grant the Company a deferral of the remaining US\$1.1 million of payment-in-kind interest which was payable on November 19, 2022 under the Convertible Debenture (the “**November 2022 PIK Interest**”), the payment of which was deferred under the November 2022 Deferral Agreement until November 19, 2023, as well as related deferral fees under the November 2022 Deferral Agreement (collectively, the “**April 2024 Deferred Amounts**”, together with the March 2024 Deferred Amounts, the “**Deferred Amounts**”) until August 31, 2025 (the “**April 2024 Deferral**”, together with the March 2024 Deferral, the “**Deferral**”).

On May 13, 2024, the Company and entered into the CB Amendment Agreement with JDZF, pursuant to which the Company and JDZF agreed to certain amendments to the Convertible Debenture, among others, the Company may at any time and from time to time prepay, without penalty, the whole or any part of the principal amount outstanding under the Convertible Debenture, together with accrued cash interest and PIK interest thereon to the date of prepayment.

LISTING RULE IMPLICATION

As at the Latest Practicable Date, JDZF is beneficially interested in 85,714,194 Common Shares, representing approximately 28.93% of the total issued share capital of the Company and also the Convertible Debenture. Accordingly, the JDZF is a substantial Shareholder of the Company and together with its associates are connected persons of the Company. Accordingly, the entering into of the Agreements and the transactions contemplated thereunder constitute connected transactions of the Company under Chapter 14A of the Hong Kong Listing Rules.

As one or more of the applicable percentage ratios (as defined under the Hong Kong Listing Rules) in respect of the transactions contemplated under the Deferral Agreements is/are more than 5% but all of the applicable percentage ratios are less than 25%, the entering into of the Deferral Agreements constitutes discloseable and connected transactions of the Company, which is subject to the reporting, announcement, circular and the independent Shareholders' approval requirements under Chapter 14 and Chapter 14A of the Listing Rules. The entering into of the CB Amendment Agreement also constitutes a connected transaction of the Company, which is subject to the reporting, announcement, circular and the independent Shareholders' approval requirements under Chapter 14A of the Listing Rules. Moreover, according to Rule 28.05 of the Hong Kong Listing Rules, any alterations in the terms of convertible debt securities after issue must be approved by the Hong Kong Stock Exchange, except where the alterations take effect automatically under the existing terms of such convertible debt securities. The Company will apply to the Hong Kong Stock Exchange for approval for the entering into of the CB Amendment Agreement pursuant to Rule 28.05 of the Hong Kong Listing Rules.

The Independent Board Committee, comprising all the independent non-executive Directors, namely Mr. Yingbin Ian He, Mr. Fan Keung Vic Choi and Ms. Jin Lan Quan has been established to consider and make a recommendation to the independent Shareholders on whether the terms of the Agreements are fair and reasonable so far as the independent Shareholders are concerned, whether the transactions contemplated thereunder are in the interests of the Company and the Shareholders as a whole and how the independent Shareholders should vote at the Meeting. We, DL Securities (HK) Limited, have been appointed to advise the Independent Board Committee and the independent Shareholders in this regard.

OUR INDEPENDENCE

In the last two years, save for being the independent financial adviser in relation to the Amended and Restated Cooperation Agreement (details of which are set out in the announcement of the Company dated July 21, 2022) and the March 2023 Deferral Agreement (details of which are set out in the circular of the Company dated July 20, 2023) (collectively, the "**Engagements**"), we did not have any other engagement with the Company as an independent financial adviser. The Engagements were limited to providing independent advisory services to the Independent Board Committee and the independent Shareholders of the Company pursuant to the Listing Rules. Under the Engagements, we received normal professional fees from the Company. Notwithstanding the Engagements, as at the date of this letter, we did not have any relationships or interests with the Company, JDZF or any other parties that could reasonably be regarded as a hindrance to our independence as defined under Rule 13.84 of the Listing Rules. Apart from normal professional fees payable to us in connection with the Engagements, no arrangements exist whereby we will receive any fees or benefits from the Company, JDZF or any other party to the captioned transactions, and therefore we are considered to be eligible to give independent advice on the terms of the Agreements.

BASIS OF OUR OPINION

In formulating our opinion and recommendation to the Board in relation to the terms of the Agreements and the transactions contemplated thereunder, we have reviewed, amongst others, (i) the March 2024 Deferral Agreement, (ii) the April 2024 Deferral Agreement; (iii) the CB Amendment Agreement, (iv) the annual reports of the Company for the two years ended December 31, 2023; and (v) other information as set out in the Circular. We have relied on the information, facts and representations contained or referred to in the Circular, the public information announced by the Company and the information, facts and representations provided by, and the opinions expressed by the Directors and management of the Company (the “**Management**”). We have assumed that all information, facts, opinions and representations made or referred to in the disclosed information and the Circular were true, accurate and complete at the time they were made and continued to be true and that all expectations and intentions of the Directors and the Management, will be met or carried out as the case may be. We have no reason to doubt the truth, accuracy and completeness of the information, facts, opinions and representations provided to us by the Directors and the Management. The Directors jointly and severally accept full responsibility for the accuracy of the Circular and public information disclosed and confirm, having made all reasonable enquiries, that to the best of their knowledge, opinions expressed in the Circular and public information disclosed have been arrived at after due and careful consideration and there are no other facts not contained in the public information disclosed, the omission of which would make any statement in the public information disclosed misleading.

We consider that we have been provided with, and we have reviewed sufficient information to reach an informed view, to justify relying on the accuracy of the information contained in the Circular and to provide a reasonable basis for our opinion. We have no reason to doubt that any relevant material facts have been withheld or omitted from the information provided and referred to in the public information disclosed or the reasonableness of the opinions and representations provided to us by the Directors and the Management. We have not, however, conducted any independent verification of the information provided, nor have we carried out any independent investigation into the business, financial conditions and affairs of the Company or its future prospects.

Based on the foregoing, we confirm that we have taken all reasonable steps, which are applicable to the transactions contemplated under the Agreements, as referred to in Rule 13.80 of the Hong Kong Listing Rules (including the notes thereof) in formulating our opinion and recommendation. This letter is issued for the information for the Board solely in connection with their consideration of the terms of the Agreements and the transactions contemplated thereunder, 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 purposes, without our prior written consent.

PRINCIPAL FACTORS AND REASON CONSIDERED

In arriving at our opinion to the Independent Board Committee and the independent Shareholders, we have considered the following principal factors and reasons:

1. Information of the parties to the Agreements

The Group

The Company is an integrated coal mining, development and trading company. SGQ Coal Investment Pte. Ltd. is a wholly-owned subsidiary of the Company incorporated under the laws of Singapore, which is principally engaged in investment holding activities. SouthGobi Sands LLC is a wholly-owned subsidiary of the Company incorporated under the laws of Mongolia, which is principally engaged in coal mining, development and exploration of properties in Mongolia.

Financial performance and financial position of the Group

The following is a summary of the audited consolidated financial results of the Group for the three years ended December 31, 2023 as extracted from the annual report for the year ended December 31, 2023 (the “**2023 Annual Report**”) and the annual report for the year ended December 31, 2022 (the “**2022 Annual Report**”) respectively:

Table 1: Consolidated financial result of the Group

	For the year ended December 31		
	2023	2022	2021
	US\$'000	US\$'000	US\$'000
	(audited)	(audited)	(audited)
Revenue	331,506	73,084	43,398
Gross profit/(loss)	173,311	15,322	12,094
Profit/(loss) from operations	75,870	13,572	4,377
Profit/(loss) before tax	34,726	(25,751)	(11,735)
Net profit/(loss) attributable to equity holders of the Company	908	(30,419)	(14,373)

With reference to the 2023 Annual Report, the Group’s revenue increased by approximately \$258.4 million or 353.6% from approximately \$73.1 million for the year ended December 31, 2022 (“**FY2022**”) to approximately \$331.5 million for the year ended December 31, 2023 (“**FY2023**”). Such increase was mainly attributable to (i) coal export volumes through the Ceke Port of Entry gradually increased since the second quarter of FY2023; and (ii) the Company experienced an increase in the average selling price of coal from \$65.7 per tonne for FY2022 to \$93.0 per tonne for FY2023, as a result of improved market conditions in China, expansion of its sales network and diversification of its customer base. Given the increased export volume and average selling price, the Group recorded a profit from operations of approximately \$75.9 million for FY2023, representing an increase of approximately 459.0% as compared to a profit from operations of approximately \$13.6 million for FY2022. The Group recorded a net profit attributable to shareholders of approximately \$0.9 million for FY2023 as compared to a net loss attributable to shareholders of approximately \$30.4 million for FY2022.

With reference to the 2022 Annual Report, the Group’s revenue for FY2022 increased by approximately \$29.7 million or 68.4% from approximately \$43.4 million for the year ended December 31, 2021 (“**FY2021**”) to approximately \$73.1 million for FY2022. Such increase was mainly attributable to the reopening of the Chinese-Mongolian border for coal export on a trial basis since May 2022. The Group recorded a profit from operations of approximately \$13.6 million for FY2022, mainly due to the foreign exchange gain of approximately \$4.6 million and the increased sales experienced by the Company following the reopening of the Ceke Port of Entry during the second quarter of 2022. The Group recorded a net loss attributable to shareholders of approximately \$30.4 million for FY2022 as compared to a net loss attributable to shareholders of approximately \$14.4 million for FY2021 mainly due to the absence of finance income as a result of the gain on extinguishment of convertible debenture of approximately \$21.0 million in FY2021.

Table 2: Consolidated financial position of the Group

	As at December 31	
	2023	2022
	<i>US\$'000</i>	<i>US\$'000</i>
	(audited)	(audited)
Current assets		
Cash and cash equivalents	47,993	9,255
Restricted cash	423	725
Inventories	52,927	34,830
Other current assets	14,012	2,685
	<u>115,355</u>	<u>47,495</u>
Non-current assets		
Property, plant and equipment	157,119	135,145
Investment in a joint venture	15,178	15,668
Investment in an associate	8,086	–
	<u>180,383</u>	<u>133,864</u>
Total assets	<u>295,738</u>	<u>181,359</u>
Current liabilities		
Trade and other payables	60,192	59,730
Additional tax and tax penalty	83,897	–
Deferred revenue	65,670	30,282
Convertible debenture	103,150	140,784
Other current liabilities	21,261	1,364
	<u>334,170</u>	<u>232,160</u>
Non-current liabilities		
Convertible debenture	91,150	83,869
Other non-current liabilities	11,750	7,102
	<u>102,900</u>	<u>91,723</u>
Total liabilities	<u>437,070</u>	<u>323,883</u>
Total deficiency in assets	<u>(141,332)</u>	<u>(142,524)</u>

Current assets of the Group as at December 31, 2023 mainly comprised inventories and cash and cash equivalents. As at December 31, 2023, the Group had inventories of approximately \$52.9 million and cash and cash equivalents of approximately \$48.0, together representing more than 87% of the Group's current assets. The non-current assets of the Group was approximately \$180.4 million as at December 31, 2023 which was mainly consisted of mineral properties among the property, plant and equipment.

Current liabilities of the Group as at December 31, 2023 mainly comprised convertible debenture, trade and other payables and deferred revenue. The balance of current liabilities increased to approximately \$334.2 million as at December 31, 2023 from approximately \$232.2 million as at December 31, 2022 mainly due to the fact that approximately \$83.9 million of additional tax and tax penalty has been recognized during FY2023. The non-current liabilities of the Group increased from approximately \$91.7 million as at December 31, 2022 to approximately \$102.9 million as at December 31, 2023. The deficiency in assets of the Group slightly decreased to approximately \$141.3 million as at December 31, 2023 as compared to approximately \$142.5 million as at December 31, 2022.

JDZF

JDZF is an exempted limited partnership formed under the laws of the Cayman Islands, which is principally engaged in investment holding activities. JDZF's general partner and limited partner are JD Dingxing Limited and Inner Mongolia Tianyu Trading Limited, respectively. To the best of the Company's knowledge and belief, the ultimate beneficial owner of the limited partner is Mr. Yong An and that of the general partner is Ms. Chonglin Zhu. Mr. Yong An is the Chairman and founder of Inner Mongolia Tianyu Innovation Investment Group Co. Ltd.* (內蒙古天宇創新投資集團有限公司) ("**Tianyu Group**"), and he has been conducting business in Inner Mongolia region since 1998. Ms. Chonglin Zhu was the Chief Financial Officer of Tianyu Group from March 2015 to September 2022, who was also responsible for managing JDZF. Ms. Chonglin Zhu serves as the executive Director of the Company with effect from September 8, 2022.

2. Reasons and benefits of the Deferral and the CB Amendment

As stated in the Letter from the Board, the Board consider that the March 2024 Deferral Agreement and the April 2024 Deferral Agreement are designed to improve the financial position of the Company which could also provide sufficient audit evidence to the Auditors in respect of the going concern assumption to support the issuance of their unmodified opinion on the 2023 Financial Statements.

As set out in the paragraph headed "Financial performance and position of the Group" under the section headed "1. Information of the parties to the Agreements", the Group has been loss-making and recorded net liabilities in recent years and the situation was even worsen under the influence and economic disruption of the pandemic. Due to the outbreak of COVID-19 in Ejinaqi, a region in China's Inner Mongolia Autonomous Region where the custom and border crossing are located, the local government authorities imposed stringent preventive measures throughout the region, including the temporary closure of the Ceke Port of Entry located at the border of Mongolia and China. Accordingly, the Company's coal exports into China were suspended from November 2021 to May 2022. The revenue, liquidity and profitability of the Group has been adversely impacted. Notwithstanding that the business performance of the Group, in terms of revenue, gross profit and profit from operations, etc., relatively improved in FY2023 as the coal exports into China are gradually resuming and the average selling price of coal increased given the improved market conditions in China, the solvency and liquidity position of the Group remained unhealthy under the impact of the potential additional tax and tax penalty.

With reference to the 2023 Annual Report, we notice that there are several adverse conditions and material uncertainties cast significant doubt upon the Company's ability to continue as a going concern and the going concern assumption used in the preparation of the Company's consolidated financial statements, including but not limited to, (i) the deficiency in assets of approximately \$141.3 million as at December 31, 2023 as compared to a deficiency in assets of \$142.5 million as at December 31, 2022; and (ii) the working capital deficiency (i.e. the net current liabilities) of approximately \$218.8 million as at December 31, 2023 compared to a working capital deficiency of \$184.7 million as at December 31, 2022. In assessing the appropriateness of the use of the going concern basis to prepare the financial statements, the management of the Company has prepared a cash flow projection covering a period of 12 months from December 31, 2023 for which the deferral of interest and management fee payment stipulated under the 2024 March Deferral Agreement has been considered as one of the important measures for improving the liquidity and financial position of the Company. We have also reviewed the cashflow projection of the Company for the 12 months ending December 31, 2024 and noticed that, in the absence of the March 2024 Deferral Agreement, there would be a material uncertainty on whether the Company will have sufficient working capital and financial resources in repaying the cash portion under the March 2024 Deferred Amounts.

Therefore, by entering into of the Deferral Agreements, the Deferral can relieve the imminent need of the Company to repay the Deferred Amounts in light of the Group's recent net current liabilities position, which in turn, can protect the Company from potential default on the Existing Deferral Agreements, the Amended and Restated Cooperation Agreement as well as the Convertible Debenture while enabling the Company to retain the funds for replenishing the Company's working capital to support its existing business operation and allow more financial flexibility for its ongoing business development to improve the business performance and financial position of the Group.

As advised by the management of the Group, the Company has considered other forms of equity financing. However, considering the (i) prevailing relatively low market prices of the Common Shares as compared to the minimum conversion price of the Convertible Debenture; and (ii) the Group has been reporting consecutive net losses attributable to owners of the Company right before the turn around in FY2023, and (iii) the net liabilities position of the Group in FY2023, any types of equity financing, including those that are pro rata in nature such as open offer or rights issue, may not be attractive to the investors and/or the Shareholders without substantial discounts to its Share price. Furthermore, fundraising by way of equity financing will create dilution effect on the shareholding of the non-participating Shareholders. With respect to bank borrowings, the ability of the Group to obtain bank borrowings with loan sizes that are comparable to the Deferred Amounts would largely depend on the Group's profitability, financial position and the then prevailing market condition. However, given the unsatisfactory financial performance and the existing financial position of the Group, it would be difficult for the Group to finance the Deferred Amounts by way of bank borrowings.

On the other hand, the key amendment to the terms of the Convertible Debentures under the CB Amendment Agreement is to provide an early repayment option to the Company at its own discretion to repay the whole or any part of the outstanding principal amount of the Convertible Debenture before its maturity (the “**Early Repayment Option**”). The Early Repayment Option could provide additional flexibility to the Group in early redeeming the whole or any part of the Convertible Debenture before its maturity in case the Group has sufficient financial resources generated from its business operations or is able to procure any better financing options, which could reduce the interest costs and improve the capital structure of the Group.

Upon our enquiry, we were advised by the Company that currently it has no intention to early repay the March 2024 Deferred Amounts, the April 2024 Deferred Amounts, the outstanding principal amount under the Convertible Debenture or any accrued interests for the year ending December 31, 2024. Notwithstanding that the Company, on one hand, entered into the Deferral Agreements to extend the Deferred Amounts, and on the other hand, entered into the CB Amendment Agreement to include the Early Repayment Option, we understand that it is the goal of the Board in long run to improve the business performance and financial positions of the Group so to settle the outstanding principal amount, interest payments and related deferral fees of the Convertible Debenture as soonest as practicable. Having reviewed the cashflow projection of the Company for the 12 months ending December 31, 2024 and considered the current financial positions of the Group, in particular, the March 2024 Deferred Amounts, the April 2024 Deferred Amounts and the outstanding principal amount under the Convertible Debenture, as compared to the current financial resources of the Group, the entering into of the Deferral Agreements could alleviate the immediate liquidity pressure of the Group while the entering into of the CB Amendment Agreement could allow the Group, upon its business performance and financial positions being improved in the future, to early repay part of the outstanding amount of the Convertible Debenture in accordance with the then financial resources of the Group at its own discretion so to reduce the interest burden and the related deferral fees. Therefore, both the Deferral Agreements and the CB Amendment Agreement represent different approaches adopted by the Board in resolving and improving the financial positions of the Group and do not conflict with each other.

Having considered that (i) the Deferral under the Deferral represents one of the key factors in preparing the working capital forecast in justifying the preparation of the financial statement for the year ended December 31, 2023 on a going concern basis; (ii) the Deferral would effectively allow the Company to refinance its payment of the March 2024 Deferred Amounts for a further 6-15 months; (iii) the Deferral can relieve the imminent need of the Company to repay the Deferred Amounts in light of the Group’s recent net current liabilities position; (iv) the Deferral can protect the Company from potential default on the Existing Deferral Agreements, the Amended and Restated Cooperation Agreement as well as the Convertible Debenture; and (v) the Early Repayment Option could provide flexibility to the Group in early repayment the outstanding amount of the Convertible Debenture thus to reduce the interest costs of the Group in the future, we are of the view that entering into of the Deferral Agreements and the CB Amendment Agreement is in the interests of the Company and the Shareholders as a whole.

3. Principal terms of the Deferral Agreements

Under the March 2024 Deferral Agreement, JDZF agreed to grant the Company the Deferral of the following payments until the Deferral Date, i.e. August 31, 2025:

- (i) the cash interest, PIK Interest, management fees, and related deferral fees in aggregate amount of approximately US\$96.5 million will be due and payable to JDZF on or before August 31, 2024 pursuant to the March 2023 Deferral Agreement and November 2023 Deferral Agreement;
- (ii) the semi-annual cash interest payment of approximately US\$7.9 million payable to JDZF on May 19, 2024 under the Convertible Debenture;
- (iii) the semi-annual cash interest payment of approximately US\$8.1 million payable to JDZF and US\$4.0 million PIK Interest payment (the “**November 2024 PIK Interest**”), which will in each case, be due and payable on November 19, 2024 under the Convertible Debenture; and
- (iv) management fees in the aggregate amount of approximately US\$2.2 million payable to JDZF on November 15, 2024 and February 15, 2025, respectively, under the Amended and Restated Cooperation Agreement.

Under the April 2024 Deferral Agreement, JDZF agreed to grant the Company a deferral of the November 2022 PIK Interest, the US\$1.1 million payment-in-kind interest which was payable on November 19, 2022 under the Convertible Debenture, the payment of which was deferred under the November 2022 Deferral Agreement until November 19, 2023, as well as related deferral fees under the November 2022 Deferral Agreement until the Deferral Date.

As consideration for the Deferral, the Company agrees to pay JDZF the Consideration comprising of the Convertible Debenture Consideration and the Cooperation Agreement Consideration.

The Convertible Debenture Consideration represents a deferral fee equal to 6.4% per annum on the Deferred Amounts which relate to payment obligations payable under the Convertible Debenture commencing on the date on which each such Deferred Amounts would otherwise have been due and payable under the Convertible Debenture.

The Cooperation Agreement Consideration represents a deferral fee equal to 1.5% per annum on the Deferred Amounts which relate to the outstanding balance of the payment obligations arising from the Amended and Restated Cooperation Agreement commencing on the date on which each such Deferred Amounts would otherwise have been due and payable under the Amended and Restated Cooperation Agreement.

The due date of the March 2024 Deferred Amounts and April 2024 Deferred Amounts is extended to August 31, 2025 under the Deferral Agreements. We understand that the Deferral Date was determined after arm's length negotiation among the Company and JDZF having taken into account, among others, (i) the current business performance and financial positions of the Group; and (ii) a deferral date extending the respective due dates of those payments of March 2024 Deferred Amounts which would be otherwise become due during the current and coming financial year for approximately 6-15 months could help justifying the going concern assumptions in the Company's audited financial statements. As such, we are of the view that the Deferral Date of August 31, 2025 under the Deferral Agreements is fair and reasonable. Pursuant to the Deferral Agreements, there is no fixed repayment schedule for the Deferred Amounts or related deferral fees. Instead, the Deferral Agreement requires the Company to use its best efforts to pay the Deferred Amounts and related deferral fees due and payable under the Deferral Agreements to JDZF. During the term of the Deferral Agreements, the Company shall provide JDZF with monthly updates of its financial status and business operations, and the Company and JDZF shall on a monthly basis discuss and assess in good faith the amount (if any) of the Deferred Amounts and related deferral fees that the Company may be able to repay to JDZF, having regard to the working capital requirements of the Company's operations and business at such time and with the view of ensuring that the Company's operations and business would not be materially prejudiced as a result of any repayment.

The Deferral Agreements also impose certain covenants on the Company and defines the events of default, details of which are set out in the Letter from the Board.

Deferral fee under the Deferral Agreements

We notice that the deferral fees under the Deferral Agreements, similar to the March 2023 Deferral Agreement, are equivalent to their respective interest rate or fee rate stipulated under the Convertible Debenture and the Amended and Restated Cooperation Agreement. Under the existing terms of the Convertible Debenture, the total interest rate is 8% per annum which comprises of a 6.4% cash interest payable semi-annually and a 1.6% payment in kind interest in form of the Common Shares of the Company payable annually. Upon the completion of the CIC Sale Transaction, JDZF reduced the service fee payable by the Company under the Amended and Restated Cooperation Agreement from 2.5% to 1.5% of all net revenues realized by the Group derived from sales into China.

We have enquired into the Management regarding the existing financing cost of the Group. However, we are given to understand that the Group currently does not have any outstanding bank borrowings. Based on our review of the recent financial statements of the Company, we notice from the interim report of the Company for the six months ended June 30, 2022 that, the latest external financing obtained by the Group was a bank loan obtained by a subsidiary of the Company from a Mongolian bank with a maturity of 3 months and an interest rate of 16.8% per annum. With reference to the data published by CEIC Data Company Ltd., a financial information service firm that specializes in economic databases of emerging and developed markets worldwide, the lending rate for Mongolian banks was reported at 17.004% per annum in February 2024. Therefore, in the absence of the Deferral Agreements whereby the Group may need to obtain bank loans in Mongolia to finance the repayment of the Deferred Amounts, the interest cost to be borne by the Company would be substantially higher than the fee rates of 6.4% and 1.5% per annum under the Deferral Agreements.

In assessing the fee rates to be charged under the Deferral Agreements, we have also reviewed the finance costs of the loans and borrowings of two companies listed on the Main Board of the Hong Kong Stock Exchange which are also principally engaged in coal mining with coal mines or majority of the assets located in Mongolia (the “**Comparable Companies**”). To the best of our knowledge and as far as we are aware of, we have identified the following Comparable Companies which met the said criteria and set out below is the exhaustive list of the Comparable Companies that we found based on our selection criteria:

Company	Stock code	Principal Business	Market Capitalization as at March 19, 2024	Latest Published Financial Information	Financing Cost
Mongolian Mining Corporation	975	Mining, processing, transportation and sales of coal with two open-pit mines of coking coal in Southern Gobi of Mongolia	HK\$10,466.47 million	For the year ended/as at December 31, 2023: Revenue: US\$1,034.82 million Net Profit: US\$240.10 million Net Assets: US\$1,169.87 million	Senior notes: 12.50% per annum
Mongolia Energy Corporation Limited	276	Mining of coal, the production and sales of coal products which is operated by its wholly-owned subsidiary in Mongolia	HK\$114.76 million	For the year ended/as at March 31, 2023: Revenue: HK\$2,905.31 million Net Loss: HK\$1,603.10 million Net Liabilities: HK\$4,336.85 million	Bank loan: 13.2% per annum Convertible notes: 3% per annum Advances from a director: Hong Kong Dollar Prime Rate plus 3% per annum
The Company	1878	Coal mining, development and exploration of properties in Mongolia	HK\$1,724.33 million*	For the year ended/as at December 31, 2023: Revenue: US\$331.51 million Net Loss: US\$0.91 million Net Liabilities: US\$141.33 million	Deferral Fee: 1.5% or 6.4% per annum

Note: Such market capitalization is calculated solely based on the closing price of the Shares quoted from the Hong Kong Stock Exchange on March 19, 2024 and multiplied by the number of total issued Shares, without taking into account the closing price of Shares quoted from TSX-V.

Notwithstanding that the principal activities, market capitalization, profitability and financial position of the Comparable Companies identified may not be the same as, or may even substantially vary from, that of the Company, we consider that their existing financing costs can still provide a general reference on the current market conditions for coal mining listed companies on the Hong Kong Stock Exchange with major assets or operations in Mongolia in issuing debt or obtaining bank financing. With reference to the latest published annual reports of the Comparable Companies, we notice that the existing outstanding loans and borrowings of the Comparable Companies mainly consist of bank loans, convertible notes and senior notes, with interest rates ranging from 3% to 13.20% per annum. Therefore, the deferral fee of 6.4% per annum on the Deferred Amounts which relate to payment obligations payable under the Convertible Debenture is within the range of the finance costs of the Comparable Companies while the deferral fee equal to 1.5% per annum on the Deferred Amounts which relate to the outstanding balance of the payment obligations arising from the Amended and Restated Cooperation Agreement is lower than that of the Comparable Companies.

Furthermore, the Company would have been technically in default pursuant to the terms of the Convertible Debenture and the Amended and Restated Cooperation Agreement should there had no arrangement under the Existing Deferral Agreements and the Deferral Agreements. Based on our review of the terms of the Comparable Transactions (as defined below), we also notice that it is not uncommon for debt instruments including convertible debenture to have a default interest rate that is higher than the coupon interest rate under such debt instruments.

Having taken into account the fact that (i) the deferral fee rates under the Deferral Agreements remain the same as the interest rate and the fee rate under the Convertible Debenture and the Amended and Restated Cooperation Agreement, respectively, without any additional default penalty; (ii) the deferral fee rates are substantially lower than the historical lending interest rate of the Group offered by its bank; and (iii) the deferral fee rates are either within or lower than the range of the finance costs of the Comparable Companies, we are of the view that the terms of the Deferral Agreements are on normal commercial terms and fair and reasonable.

4. Principal terms of the CB Amendment Agreement

Under the CB Amendment Agreement, the Company may, by resolution of the directors, at any time and from time to time prepay, without penalty, the whole or any part of the principal amount of the Convertible Debenture, together with accrued cash interest and PIK interest thereon to the date of prepayment, provided that: (i) the Company has, not later than three (3) Business Days prior to the proposed prepayment date, delivered to JDZF an irrevocable written notice, signed by an independent Director of the Company and setting out (A) the proposed prepayment date, and (B) the amount of the proposed prepayment; (ii) the amount of such prepayment reduces the then outstanding principal amount by an amount that is (I) not less than US\$500,000 and (II) if in excess of US\$500,000, an integral multiple of US\$500,000; and (iii) the proposed prepayment date is a Business Day.

In order to assess the fairness and reasonableness of the Early Repayment Option under the CB Amendment Agreement, we have, on best effort basis, reviewed the issuance of convertible bonds/notes or transactions involving amendments of convertible bonds/notes announced by companies listed on the Hong Kong Stock Exchange with their connected persons or independent third parties during a period of approximately six months from November 1, 2023 to May 13, 2024, being the date of the CB Amendment Agreement. Notwithstanding that the principal activities, market capitalization, profitability and financial position of the issuers identified may not be the same as, or may even substantially vary from, that of the Company, we consider that it could still provide a general reference for and to compare with the recent market practice in relation to the terms of the convertible bonds/notes under similar market condition, in particular, whether is it common for the convertible bonds/notes issued by companies listed on the Hong Kong Stock Exchange to have early repayment option at issuer's discretion. To the best of our knowledge and as far as we are aware of, we have identified the following comparable transactions which met the said criteria and set out below is the exhaustive list of the comparable transactions that we found based on our selection criteria (the “**Comparable Transactions**”):

Date of announcement	Company	Stock code	Principal amount (HK\$)	Annual interest rate	Early repayment option at issuer's discretion	Default interest rate
26-Apr-24	Elate Holdings Limited	76	HK\$21,000,000	Nil	N/A	Not Disclosed/N/A
24-Apr-24	Legendary Education Group Limited	8195	HK\$15,000,000	10%	N/A	Not Disclosed/N/A
24-Apr-24	Green Leader Holdings Group Limited	61	HK\$395,000,000	Nil	Yes	Not Disclosed/N/A
5-Apr-24	MicroPort Scientific Corporation	853	US\$150,000,000	5.75%	N/A	Not Disclosed/N/A
25-Mar-24	China Biotech Services Holdings Limited	8037	HK\$88,000,000	8%	Yes (with prior written consent from the holder(s))	24%
20-Mar-24	Oriental Payment Group Holdings Limited	8613	HK\$3,910,000	7%	N/A	Not Disclosed/N/A
13-Mar-24	Sino Oil and Gas Holdings Limited	702	HK\$1,323,400,000	8%	N/A	12%
7-Mar-24	Huayi Tencent Entertainment Company Limited	419	HK\$120,000,000	10%	Yes (up to 3 times)	Not Disclosed/N/A
6-Mar-24	Grand Field Group Holdings Limited	115	HK\$100,869,000- HK\$101,912,000	6%	Yes	10%
29-Feb-24	Standard Chartered PLC	2888	US\$1,000,000,000	7.875%	Yes	Not Disclosed/N/A
16-Feb-24	Oriental Payment Group Holdings Limited	8613	HK\$4,388,000	7%	N/A	Not Disclosed/N/A
30-Jan-24	China Sandi Holdings Limited	910	HK\$300,000,000	2%	Yes	Not Disclosed/N/A
26-Jan-24	Changyou Alliance Group Limited	1039	HK\$126,000,000	8.00%	Yes	18%
23-Jan-24	Wisdom Wealth Resources Investment Holding Group Limited	7	HK\$39,000,000	HSBC's Hong Kong Dollar Best Lending Rate (as at the announcement date: 5.875%)	N/A	Not Disclosed/N/A
15-Jan-24	CNC Holdings Limited	8356	HK\$385,285,920	0.80%	N/A	Not Disclosed/N/A
3-Jan-24	Zhi Sheng Group Holdings Limited	8370	HK\$12,400,000	Nil	N/A	Not Disclosed/N/A
2-Jan-24	Oriental Payment Group Holdings Limited	8613	HK\$11,850,000	7%/12%	N/A	20%
6-Dec-23	MicroPort Scientific Corporation	853	US\$220,000,000	5.75%	Yes	7.75%

Date of announcement	Company	Stock code	Principal amount (HK\$)	Annual interest rate	Early repayment option at issuer's discretion	Default interest rate
20-Nov-23	Zhongliang Holdings Group Company Limited	2772	US\$140,000,000	3.00%	Yes	Not Disclosed/N/A
16-Nov-23	National United Resources Holdings Limited	254	HK\$80,500,000	6.00%	Yes	Not Disclosed/N/A
16-Nov-23	Prosperity Investment Holdings Limited	310	HK\$5,000,000	8%	Yes (with redemption premium)	Not Disclosed/N/A
8-Nov-23	China Kingstone Mining Holdings Limited	1380	Up to HK\$200,000,000	2.00%	Yes (at 115% of the nominal value)	3% per month accrued on daily basis
5-Nov-23	Global New Material International Holdings Limited	6616	US\$50,000,000	9.00%	Yes	30%

Source: the website of the Hong Kong Stock Exchange

As shown in the table above, early repayment option at the issuer's discretion is available in 12 out of the 23 Comparable Transactions. For those which contain an early repayment option in the convertible bonds/notes, some may also come along with additional redemption prices/penalties. Therefore, based on the recent market practice in relation to the terms of the convertible bonds/notes, it is not uncommon for the Comparable Transactions to include early repayment options at the issuer's discretion.


Pursuant to the CB Amendment Agreement, the Group could propose a prepayment on the outstanding amount of the Convertible Debenture in whole or in part at its own discretion. We notice that currently 3 out of the 8 members of the Board are nominated by JDZF. We have enquired into the Company about the mechanism to avoid any potential conflict of interest in deciding on early repayment of the Convertible Debenture while maintaining a satisfactory liquidity and financial position of the Group. We are given to understand that according to the CB Amendment Agreement, any proposed prepayment will be conditional on the approval of board of directors and the Company delivering a prepayment written notice signed by an independent non-executive Director to JDZF, rather than the Board members nominated by JDZF. Also, in deciding whether to propose such prepayment and its respective prepayment amount, the Company will also consider the then forthcoming payment obligations to its suppliers, local tax authority as well as any other capital commitment, after which the Company shall generally maintain a minimum cash balance of approximately \$10 million for contingency. Based on our review of the cashflow forecast of the Group for the year ending December 31, 2024 and as advised by the Company, the Board currently does not have the intention or plan to make any prepayment on the outstanding principal amount and accrued interests in the financial year ending December 31, 2024.

Having considered that (i) it is not uncommon for companies listed on the Hong Kong Stock Exchange to have early redemption option in their convertible bonds/notes; (ii) the Early Repayment Option could provide flexibility to the Group in reducing its liabilities and interest costs in case the Group has sufficient financial resources for early repayment in the future; and (iii) the timing and amount of prepayment of the Convertible Debenture will be decided and made in accordance with the then financial conditions of the Group, with the independent non-executive Directors signing the early redemption notice, we are of the view that the terms of the CB Amendment Agreement are on normal commercial terms and fair and reasonable.

CONCLUSION

Having considered the above principal factors and reasons, we consider that the Agreements have been entered into in the ordinary and usual course of business of the Group and on normal commercial terms and we are of the view that (i) the terms of the Agreements are fair and reasonable so far as the independent Shareholders are concerned; and (ii) the Deferral under the Deferral Agreements and the Early Repayment Option under the CB Amendment Agreement is in the interests 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 resolutions to be proposed at the Meeting for approving the Agreements and the transactions contemplated thereunder.

Yours faithfully
For and on behalf of
DL Securities (HK) Limited



Tommy Cheng
Managing Director
Corporate Finance Division

Mr. Tommy Cheng is licensed persons under the SFO to carry out Type 6 (advising on corporate finance) regulated activity under the SFO and regarded as responsible officer of DL Securities (HK) Limited. Mr. Tommy Cheng has over 13 years of experience in corporate finance industry.

* For identification purposes only.