八方金融有限公司
OCTAL Capital Limited

26 July 2024

To the Independent Board Committee and the Independent Shareholders

Dear Sirs,

VERY SUBSTANTIAL DISPOSAL AND CONNECTED TRANSACTION IN RELATION TO THE DISPOSAL OF 100% EQUITY INTEREST IN THE TARGET COMPANY

INTRODUCTION

We refer to our engagement as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the Disposal, particulars of which are set out in the letter from the Board (the "**Letter from the Board**") contained in the circular of the Group to the Shareholders dated 26 July 2024 (the "**Circular**"), of which this letter forms part. Unless the context requires otherwise, capitalised terms used in this letter shall have the same meanings as given to them under the definitions section of the Circular.

Reference is made to the announcement of the Company dated 13 June 2024 in relation to the Disposal. The Board announced that on 13 June 2024 (after trading hours), the Vendor and the Purchasers entered into the Sale and Purchase Agreement, pursuant to which the Vendor conditionally agreed to sell, and the Purchasers conditionally agreed to acquire, the Sale Interests, representing the entire issued share capital of the Target Company, at the Consideration of HK$62.0 million, subject to the terms and conditions of the Sale and Purchase Agreement. Upon Completion, the Company will not hold any interest in the Target Company, and each member of the Target Group will cease to be a subsidiary of the Company.

The Independent Board Committee comprising all the independent non-executive Directors, namely Mr. Kong Hing Ki, Mr. Feng Jianzhong and Ms. Leung Yuen Man, has been formed to advise the Independent Shareholders on whether the terms of the Sale and Purchase Agreement are fair and reasonable, on normal commercial terms and in the interests of the Group and the Shareholders as a whole, and advise the Independent Shareholders as to voting. We, Octal Capital Limited, have been appointed as the Independent Financial Adviser with the approval of the Independent Board Committee in accordance with the Listing Rules to advise the Independent Board Committee and the Independent Shareholders in these regards.

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As at the Latest Practicable Date, we are not connected with the Group and the Purchasers, or where applicable, any of their respective substantial shareholders, directors or chief executives, or any of their respective subsidiaries or associates pursuant to Rule 13.84 of the Listing Rules. During the last two years, there has been no other engagement entered into between the Company and us. We are therefore considered suitable to give independent advice to the Independent Board Committee and the Independent Shareholders regarding the Sale and Purchase Agreement.

Apart from normal professional fees payable to us by the Company in connection with this appointment, no arrangement exists whereby we will receive any fees or benefits from the Company or the directors, chief executive and substantial shareholders of the Company, the Group or the Purchasers or any of their respective subsidiaries or associates that could reasonably be regarded as relevant to our independence. Accordingly, we consider that we are independent to act as the Independent Financial Adviser pursuant to Rule 13.84 of the Listing Rules.

In formulating our opinion, we have relied on (i) the Company's annual reports for the two years ended 31 December 2023 (the "**2022 Annual Report**" and "**2023 Annual Report**", respectively); (ii) the Sale and Purchase Agreement; (iii) the announcement of the Company dated 13 June 2024; (iv) the Valuation Report of the Target Properties issued by the Independent Valuer; (v) the information and facts contained in or referred to the Circular; (vi) the information supplied by the Group; (vii) the opinions expressed by and the representations of the professional parties engaged by the Group; and (viii) our review of the relevant public information. We have also relied on the accuracy of the information and representations contained in the Circular and have assumed that all information and representations made or referred to in the Circular were true at the time they were made and continue to be true as at the Latest Practicable Date. We have also relied on our discussion with the Directors and the management of the Group regarding the Disposal, the information and representations contained in the Circular. We have also assumed that all statements of belief, opinion and intention made by the Directors and the management of the Group in the Circular were reasonably made after due enquiry. We consider that we have reviewed sufficient information to reach an informed view, to justify our reliance on the accuracy of the information contained in the Circular and to provide a reasonable basis for our advice. We have no reason to either suspect that any material facts have been omitted or withheld from the information contained or opinions expressed in the Circular or to doubt the truth, accuracy and completeness of the information and representations provided to us by the Directors and management of the Group. We have not, however, conducted an independent in-depth investigation into the business and affairs of the Group and their respective subsidiaries or associates nor have we carried out any independent verification of the information supplied.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion regarding the Disposal, we have considered the following principal factors and reasons:

1. Background information of the Group

The principal business activities of the Group are the design, manufacture, sale and marketing of home furniture products including mainly wood-based furniture, sofa and mattresses and licensing of its own brands and product designs (the "**Furniture Business**"), provision of promotional services relating to layout design, fitting and display of products (the "**Promotion Business**"). Over 85% of the Group's total revenue in the past three years was generated from the United States, Japan, the Middle East, the Southeast Asia and Europe.

Set out below is a summary of the consolidated financial information of the Group for the year ended 31 December 2021 ("**FY2021**"), the year ended 31 December 2022 ("**FY2022**") and the year ended 31 December 2023 ("**FY2023**") as extracted from the 2022 Annual Report and the 2023 Annual Report, respectively.

Consolidated financial results of the Group

	FY2021 *HK$'000* *(audited)*	**FY2022** *HK$'000* *(audited)*	**FY2023** *HK$'000* *(audited)*
Revenue			
– Furniture Business	162,427	88,775	83,109
– Promotion Business	12,583	11,612	11,104
Total Revenue	175,010	100,387	94,213
Gross profit	24,079	24,297	22,405
Gross profit margin	13.8%	24.2%	23.8%
Finance cost	(5,941)	(5,283)	(4,390)
Loss for the year	(5,519)	(26,796)	(11,456)

FY2021 vs FY2022

The Group recorded total revenue of approximately HK$175.0 million and approximately HK$100.4 million for FY2021 and FY2022 respectively, representing a decrease of approximately 42.6%. The revenue from Furniture Business decreased from approximately HK$162.4 million for FY2021 to approximately HK$88.8 million for FY2022, representing a decrease of approximately 45.3%. The decrease in the Group's revenue from the Furniture Business was mainly due to (i) the implementation of COVID-19 preventive measures in the PRC disrupted the supply chain and logistics, leading to delays in product shipments and cancelled orders from the customers; (ii) the trade tensions between the PRC and the United States; and (iii) the depreciation of Japanese Yen further reduced the demand of the Japanese customers for the Group's furniture. The Group engaged in the Promotion Business only through the PRC Company of which the revenue from the Promotion Business slightly decreased from approximately HK$12.6 million for FY2021 to approximately HK$11.6 million for FY2022. The decrease was mainly due to the unfavorable market conditions leading to the decrease in the demand for the Group's services.

The Group introduced new upholstered furniture with higher selling prices during FY2022. As a result, the gross profit of the Group remained at a similar level of approximately HK$24.1 million and HK$24.3 million for FY2021 and FY2022, respectively. The Group recorded net loss of approximately HK$26.8 million for FY2022, representing an increase of approximately HK$21.3 million or approximately 385.5% as compared to that for FY2021. The increase in loss for the year was mainly due to (i) the recognition of impairment of approximately HK$14.9 million against the leasehold improvement of the Target Properties and several vacant office equipment and machinery; (ii) the foreign exchange loss of approximately HK$5.3 million; and (iii) the provision of expected credit loss on trade receivables of approximately HK$5.5 million.

FY2022 vs FY2023

The Group recorded total revenue of approximately HK$94.2 million for FY2023 representing a slight decrease of approximately HK$6.2 million or 6.2% as compared to that for FY2022. The decrease in total revenue was mainly due to the decline in revenue from the Furniture Business. The Furniture Business was affected by the ongoing depreciation of currencies and purchasing power of the Japanese and European customers, hence the demand of the Group's furniture products reduced. The revenue from the Promotion Business for FY2023 remained at a similar level as compared to FY2022.

The gross profit of the Group slightly decreased from approximately HK$24.3 million for FY2022 to approximately HK$22.4 million for FY2023, representing a decrease of approximately 7.8%. The decrease in gross profit was mainly due to the clearance of certain obsoleted inventories of the Group. The Group recorded net loss of approximately HK$11.5 million for FY2023, representing a decrease of approximately HK$15.3 million or approximately 57.2% as compared to that for FY2022. The decrease in loss for the year was mainly due to (i) the decrease in impairment made against the property, plant and equipment and right-of-use asset of approximately $12.5 million; (ii) the decrease in foreign exchange loss of approximately HK$3.8 million; and (iii) the decrease in provision of expected credit loss on trade receivables of approximately HK$3.5 million.

Major items of the consolidated financial position of the Group as at 31 December 2023 extracted from 2023 Annual Report are summarised in the following table.

	As at 31 December 2023 *(Audited)* *HK$'000*
Non-current assets	
Property, plant and equipment	75,448
Right-of-use assets	22,127
	97,575
Current assets	
Trade and other receivables	47,086
Other current assets	37,609
	84,695
Total Assets	**182,270**
Current liabilities	
Bank loans	53,828
Other current liabilities	18,792
	72,620
Net current assets	**12,075**
Non-current liabilities	**2,477**
Total Liabilities	**75,097**
Net Assets	**107,173**
Gearing ratio[Note]	29.5%

Note: The gearing ratio is calculated based on bank loans divided by total assets.

As at 31 December 2023, the Group's property, plant and equipment amounted to approximately HK$75.4 million, of which approximately HK$73.5 million was attributable to the Target Group. The bank loans of the Group were approximately HK$53.8 million as at 31 December 2023 which was wholly attributable to the Target Group. The Group recorded net assets of approximately HK$107.2 million as at 31 December 2023. The gearing ratio of the Group was approximately 29.5% as at 31 December 2023.

2. Background information of Target Group

The Target Group consists of the Target Company, Hanmix Limited and the PRC Company. The Target Company and Hanmix Limited are investment holding companies. The PRC Company is the operating arm of the Target Group.

The major assets of the PRC Company is the Target Properties located at Lot No. G14309-0285, Kengzi Town Industrial Zone, Longgang District, Shenzhen City, Guangdong Province, the PRC which comprises (i) a parcel of land having a site area of approximately 43,817 sq. m.; (ii) a single storey workshop with a gross floor area of approximately 3,050 sq. m.; (iii) a three storey workshop with a gross floor area of approximately 30,173 sq. m.; (iv) a single storey warehouse with a gross floor area of approximately 109 sq. m.; and (v) an eight storey dormitory with a gross floor area of approximately 8,886 sq. m. Prior to the year ended 31 December 2019, the Target Properties used to be the production base of wood-based furniture and showroom of the Group's furniture products. However, the Group ceased the wood-based furniture production in the Target Properties during the year ended 31 December 2019. From April 2020, the Group introduced the Promotion Business through the PRC Company which including layout design, fitting and display of products at certain part of the Target Properties. The scale of the Promotion Business has remained at a small level and accounted for less than 12% of the Group's total revenue for the three years ended 31 December 2023. Following the expiry of the business contract in March 2024, the Promotion Business has ceased. The PRC Company has also been engaging in the sale of home furniture products to customers located in South East Asia (the "**SE Asia Furniture Business**"). The existing customers of the PRC Company has shifted to other subsidiaries of the Remaining Group and the SE Asia Furniture Business continues its operation. As such, the Disposal will not cause any adverse effect on the SE Asia Furniture Business.

As advised by the management of the Company, certain promotional products and equipment, which belong to a third party in connection with the Promotion Business and still occupied certain area of the Target Properties as at the Latest Practicable Date, have been seized by the local court (the "**Incident**"). The court seizure order is made against the owner of the products and equipment who is in financial difficulties. As advised by the PRC legal adviser of the Company, these products and equipment are not allowed to be removed from the site without the approval or authorization from the court. Thus, certain areas of the Target Properties are currently unavailable for other usage. The remaining area of the Target Properties is now vacant, except a small area is still being occupied by the Group for office purpose. After considering the legal opinion provided by the Company's PRC legal adviser, the management of the Company has confirmed that the Disposal will not be affected by the Incident.

Set out below is a summary of the unaudited consolidated financial information of the Target Group for the three years ended 31 December 2021, 2022 and 2023 and for the four months ended 30 April 2023 ("**4M2023**") and 2024 ("**4M2024**") (the "**Review Period**"):

	FY2021	**FY2022**	**FY2023**	**4M2023**	**4M2024**
	HK$000	*HK$000*	*HK$000*	*HK$000*	*HK$000*
	(unaudited)	*(unaudited)*	*(unaudited)*	*(unaudited)*	*(unaudited)*
Revenue from:					
– Promotion Business	12,583	11,612	11,104	4,550	2,737
– SE Asia Furniture Business	26,082	15,452	16,314	3,090	4,081
	38,665	27,064	27,418	7,640	6,818
Finance cost	(5,008)	(4,655)	(3,898)	(1,608)	(979)
(Loss)/Profit for the year/period	(7,811)	(18,754)	(6,995)	109	(440)

The revenue of the Target Group amounted to approximately HK$27.1 million for FY2022, representing a decrease of approximately HK$11.6 million as compared to FY2021. The decrease was mainly attributable to the decrease in revenue from the SE Asia Furniture Business. The depreciation of the local currencies of the overseas customers, who settled the transaction amount in US dollar, resulted in higher cost for procuring the Target Group's products, thereby they have reduced the procurement scale of the Target Group's products. The net loss for the year of the Target Group amounted to approximately HK$18.8 million for FY2022, representing an increase of approximately HK$11.0 million as compared to FY2021. The increase was mainly due to the recognition of impairment losses on the property, plant and equipment of the PRC Company for FY2022.

The revenue of the Target Group for FY2023 remained at a similar level compared to FY2022, amounted to approximately HK$27.4 million. The net loss of the Target Group amounted to approximately HK$7.0 million for FY2023, representing a decrease of approximately HK$11.8 million as compared to FY2022. The decrease was mainly due to the reduction of impairment losses on the property, plant and equipment for FY2023.

The revenue of the Target Group for 4M2024 decreased to approximately HK$6.8 million, representing a decrease of approximately HK$0.8 million as compared to 4M2023. The decrease was mainly due to suspension of the Promotion Business after the business contract ended in March 2024. The Target Group recorded net loss amounted to approximately HK$0.4 million for 4M2024, while the Target Group recorded net profit amounted to approximately HK$0.1 million for 4M2023.

	As at 31 December			As at 30 April
	2021	2022	2023	2024
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
	(unaudited)	*(unaudited)*	*(unaudited)*	*(unaudited)*
Property, plant and equipment	107,073	79,567	73,545	72,758
Right-of-use assets	20,208	17,975	16,762	16,557
Non-current assets	**127,281**	**97,542**	**90,307**	**89,315**
Trade and other receivables	47,414	41,281	20,053	25,397
Other current assets	11,330	6,282	9,984	14,338
Current assets	**58,744**	**47,563**	**30,037**	**39,735**
Total Assets	**186,025**	**145,105**	**120,344**	**129,050**
Bank loans	81,776	70,886	53,828	55,704
Amount due to the Remaining Group	55,239	32,505	38,766	–
Other current liabilities	10,268	12,505	5,465	14,366
Current liabilities	**147,283**	**115,896**	**98,059**	**70,070**
Net current liabilities	**(88,539)**	**(68,333)**	**(68,022)**	**(30,335)**
Net Assets	**38,742**	**29,209**	**22,285**	**58,980**
Gearing ratio[Note]	44.0%	48.9%	44.7%	43.2%

Note: The gearing ratio is calculated based on bank loans divided by total assets.

The assets of Target Group mainly include the Target Properties which is recorded in the property, plant and equipment and right-of-use assets. The liabilities of Target Group mainly include bank loans and amount due to the Remaining Group.

The property, plant and equipment of the Target Group decreased from approximately HK$107.1 million as at 31 December 2021 to approximately HK$79.6 million as at 31 December 2022 was mainly due to the impairment made against the leasehold improvements of the Target Properties and the vacant office equipment and machinery and further decreased to approximately HK$73.5 million as at 31 December 2023 due to the impairment made against the building elements of the Target Properties. As at 30 April 2024, the net carrying amount of the building elements and the land use rights of the Target Properties was approximately HK$69.9 million and HK$16.6 million, respectively.

The bank loans of the Target Group exhibited a continuous decrease during the Review Period as a result of adhering to the repayment schedule for loan repayments. The bank loans as at 30 April 2024 amounted to approximately HK$55.7 million. As at the Latest Practicable Date, the bank loans were secured by pledge of the Target Properties, personal guarantee provided by Mr. Chan and Mr. Huang and the Existing Corporate Guarantee. Upon Completion, the Company would have been released from and discharged of all its obligations and liabilities under the Existing Corporate Guarantee and the Second Facility Agreement by the Bank.

As at 30 April 2024, the Target Group recorded net assets of approximately HK$59.0 million. As disclosed in the Letter from the Board, the Target Group has completed the inter-company balance capitalisation in April 2024, reducing the total liabilities of the Target Group by approximately HK$37.1 million as at 30 April 2024.

3. Reasons for and benefits of the Disposal and intended use of proceeds

Prior to the year ended 31 December 2019, the Target Properties served as production bases for manufacturing wood-based furniture and showrooms for the Group's furniture products. However, due to the outbreak of the coronavirus disease in the PRC, the utilisation of production capacity in the PRC Company decreased as some sales orders and furniture-related projects were cancelled. Moreover, there were material change in the promotion and marketing channel of the Group in which the customers changed to view the furniture products using online platforms or video conferencing with virtual graphics display for furniture viewing and selection, and thus there was a significant reduction in the physical usage of showroom. Considering the changing operating environment and aiming to reduce operating and maintenance costs, the Group suspended all production activities at the Target Properties and outsourced the production of wood-based furniture to independent manufacturers in the PRC.

Subsequent to April 2020, the PRC Company commenced the Promotion Business which generated revenue of approximately HK$12.6 million, HK$11.6 million and HK$11.1 million for FY2021, FY2022 and FY2023, respectively. The Promotion Business has been suspended after March 2024 as the service agreement with the only customer has been expired. Certain area in the single storey workshop and three-storey workshop of the Target Properties has been used for showroom and storage purposes by the customer. In addition, the Incident occurred in the second half of 2023 and all the products and equipment of the third party placed in the Target Properties were seized by the local court of the PRC. Due to the Incident, certain portions of the Target Properties are currently restricted for use and the PRC Company is still awaiting further instructions from the local court. As advised the management of the Company, it remains uncertain as to until when such products and equipment of the third party could be released from seizure and vacant the Target Properties.

As disclosed in the Letter from the Board, the Company had difficulties to find potential buyers to acquire the Target Group and/or Target Properties. The Company has approached independent third parties to seek their interests in buying the PRC Company which in turn holds the Target Properties, however, no interested buyer could be secured so far due to the reasons that (i) the Target Group have incurred a high level of liabilities in terms of the bank loans; (ii) the use of the Target Properties is restricted due to the Incident; and (iii) there are many similar properties (without restriction of usage) available for sale in the market. We have performed a search through the search engines (namely Google and Baidu) and are unable to find any information in relation to the completed sales and purchases transactions of industrial properties in Pingshan District. We have further conducted a search on the PRC property website (https://sz.58.com/house.shtml) for the industrial properties in Pingshan District which are listed for sale (the "**Properties Research**"), and noted that there are industrial properties which comprise of workshop, warehouse and dormitory listed on the website asking for sale. We have also enquired the property agents and were advised that properties listed on the website are freely transferable without any restrictions and the property transactions with transferability restrictions is limited in the market and would be difficult to approach potential buyers who are willing to acquire properties through equity transfer. As such, we concur with the Directors that the Target Group holding the Target Properties was more difficult to dispose to independent third parties and the Disposal to the Purchasers is the most immediate option for the Company to realise the idle Target Properties for cash under the prevailing market circumstances.

Regarding the SE Asia Furniture Business, as advised by the Company, the Group has informed the customers of SE Asia Furniture Business that all future purchase orders should be placed to other subsidiaries of the Remaining Group from 1 June 2024 and thus the Disposal will not disrupt the operation of SE Asia Furniture Business. The SE Asia Furniture Business of the Target Group generated revenue of HK$16.3 million for the year ended 31 December 2023, representing approximately 17.3% of the Group's total revenue for that year. As advised by the management of the Company, the Disposal will have no material effect to the Furniture Business.

In view of the suspension of the Promotion Business and the SE Asia Furniture Business has been transferred to other subsidiaries of the Remaining Group, the Disposal presents a favorable opportunity to monetise an idle asset and generate return and cashflow to the Group. With reference to the 2023 Annual Report, we noted that the Group generated net cash inflow from operating activities of HK$15.9 million, representing sufficient working capital to maintain its normal operation, and recorded cash and cash equivalents of approximately HK$33.5 million as at 31 December 2023. Moreover, the Remaining Group has no plan to obtain new borrowings and no material capital commitment. Having considered that the Group has no cash flow pressure, the proposed declaration of the Special Dividend is to recognise the unwavering support of the Shareholders and provide the Shareholders with an immediate cash benefit from the outcome of the Disposal. We concur with the Board that the net proceed from the Disposal is sufficient for distribution of Special Dividend.

As of 31 December 2023, the Group recorded bank loans of approximately HK$53.8 million, which is entirely attributable to the Target Group. The interest expenses for FY2023 amounted to approximately HK$3.9 million. Upon Completion, the Remaining Group will no longer have bank borrowings or loans, leading to a material improvement in the gearing level and a reduction in interest burdens for the Remaining Group. The gearing level of the Group will be reduced from approximately 29.5% as at 31 December 2023 to zero after the Completion.

As discussed in the Letter from the Board, the Group is operating a leased factory in Pingshan District, for the production of sofa while the production of other furniture have been outsourced to five long-cooperated independent furniture manufacturers in Guangdong Province since 2020. The Group has employed approximately 130 staff engaging in the furniture business including 10 staff who are responsible for export sales and marketing. The Company shifted the SE Asia Furniture Business to other subsidiaries of the Remaining Group in June 2024 and continued its furniture business. The Remaining Group will continue to offer one-stop furniture manufacturing services which cover the whole process of manufacturing, sales and marketing of home furniture products including designing the style and structure of furniture, sample-making, procuring and inspecting quality of raw materials, arranging production of furniture, performing quality examination on final products and arranging logistics services to deliver the final products to the customers' destination worldwide. Following the Completion, the Remaining Group will continue to explore cooperation opportunities with different customers in the PRC while continuously expanding business with overseas customers, especially in the United States, the Middle East and Japan, and the latter has shown positive growth up to the Latest Practicable Date. The Remaining Group will put more effort in research, development and promoting new products and closely monitor the on-going market trend and customers' preference to improve the design and quality of the home furniture products. Taking into account the above, we concur with the Directors that there is no negative impact to the Furniture Business caused by the Disposal.

Based on above, in particular, (i) the proceed from the Disposal will be primarily used for the proposed payment of the Special Dividend to recognise the Shareholders' long-term support; (ii) the Target Properties have no longer been used as the Group's production base since 2020; (iii) the Incident restricted the use of certain areas in the Target Properties which hinders the Group from disposal to other third parties; (iv) the Remaining Group will no longer incur any bank borrowings and finance cost burden is substantially reduced after the Completion; and (v) there is no negative impact to the Furniture Business after the Completion, we consider that the Disposal is commercially justifiable.

4. Principal terms of the Sale and Purchase Agreement

Set out below is a summary of the principal terms of the Sale and Purchase Agreement:

Date

13 June 2024 (after trading hours)

Parties

(i) Great Ample Holdings Limited, as the Vendor; and

(ii) Mr. Sung, Mr. Cheung, Mr. Chan and Mr. Huang, as the Purchasers.

Subject Matter

The Vendor conditionally agreed to sell, and the Purchasers conditionally agreed to acquire, the Sale Shares in the Target Company. The Sale Shares represent 100% of the equity interest in the Target Company.

Consideration and settlement

The Consideration for the Disposal is HK$62.0 million and shall be paid in cash by the Purchasers to the Vendor on the date of the Completion in Hong Kong Dollars, Renminbi or US dollars at a fixed exchange rate of HK$1.00 to RMB0.927 or HK$7.80 to US$1.00.

The Disposal is not conditional upon the Proposed Share Premium Cancellation or the proposed payment of the Special Dividend.

For details of the Sale and Purchase Agreement, please refer to the Letter from the Board.

5. Basis of the Consideration

The Consideration was determined with reference to, among other things, (i) the value of the Target Properties conducted by Independent Valuer in accordance with International Valuation Standards (the "**IVS**") for information purpose, of which the value of land element of the Target Properties was nil and the depreciated replacement cost of the building elements of the Target Properties was RMB61.2 million (equivalent to approximately HK$67.4 million) as at 31 May 2024, as referred to in Appendix IV to the Circular; (ii) the unaudited consolidated net asset value of the Target Group of approximately HK$59.0 million as at 30 April 2024 (including the net book value of the land use rights of the Target Properties of approximately HK$16.6 million, the net book value of the building elements of the Target Properties of approximately HK$69.9 million, the bank loans of the Target Group of HK$55.7 million as at 30 April 2024); and (iii) the factors as discussed in the section headed "3. Reasons for and benefits of the Disposal and intended use of proceeds" above.

In view of the transferability restrictions of the Target Properties, the Disposal will be conducted by transferring the equity interest in the Target Company as a whole, rather than transferring the Target Properties alone. We noted that it is not uncommon to dispose a property through equity transfer. We, on best effort basis, have conducted a search on the website of the Stock Exchange (https://www.hkexnews.hk) but have not been able to identified any transaction in relation to acquisition or disposal of industrial properties in Guangdong Province with restrictions on transferability and leasing similar to that of the Target Properties through equity transfer for the period from 1 July 2023 to 30 June 2024. Furthermore, according to the legal opinion issued by the PRC legal adviser of the Company, since the transfer of equity interests of the Target Company would not change the ownership of the land use rights which would still be held by the PRC Company upon the Completion, the transfer of the Target Group would not violate the transferability restriction of the land use rights. Hence, we consider that the disposal of Target Properties through equity transfer is reasonable.

As referred to in Appendix IV to the Circular, the Independent Valuer assigned no commercial value to the Target Properties due to its non-transferability in nature. For information purpose, the Independent Valuer has indicated in Appendix IV to the Circular that the aggregate value of the Target Properties as at the Valuation Date was RMB61.2 million (i.e. the value of the land element was nil and the depreciated replacement cost of the building elements was RMB61.2 million). The unaudited consolidated net asset value of the Target Group after adjusted with the said value is illustrated below:

	HK$ million
Unaudited consolidated net assets value of Target Group as at 30 April 2024	59.0
Add:	
Depreciated replacement cost of the building elements of the Target Properties as disclosed in Appendix IV to the Circular *Note 1*	67.4
Less:	
Net carrying amount of the building elements of the Target Properties as at 30 April 2024	(69.9)
Valuation deficit	(2.5)
Adjusted net asset value of Target Group as at 30 April 2024 (the "**Adjusted NAV**")	56.5
Consideration	62.0
Premium of the Consideration over the Adjusted NAV	5.5
Premium of the Consideration over the Adjusted NAV (in %)	9.73%

Note:

1. Being RMB61.2 million translated at the exchange rate of HK$1 to RMB0.9077 for illustration purpose.
2. As disclosed in Appendix IV to the Circular, the value of the land element of the Target Properties was nil.

The basis of the Consideration has taken into account the Adjusted NAV which comprise of all assets (including the land use rights and building elements of the Target Properties, the inventories, trade and other receivables and cash and cash equivalents) and all liabilities (including trade and other payable and bank loans) of the Target Group as at 30 April 2024.

From the above calculations, the Consideration of HK$62.0 million implies a considerable premium of approximately HK$5.5 million or 9.73% over the Adjusted NAV as at 30 April 2024.

Even if we only consider the Target Properties at their net book value, the Consideration represents a premium of approximately HK$3.0 million or 5.08% over the unaudited consolidated net assets value of Target Group as at 30 April 2024.

Valuation Report

Having considered that (i) the Target Properties are the major assets held by the Target Group which accounted for approximately 67.0% of its total assets as at 30 April 2024, while the remaining mainly consist of office equipment, inventories, trade and other receivables and cash which have been accounted for in the Adjusted NAV for the determination of the Consideration; (ii) the Target Group have been loss-making for the last three years; (iii) the Target Group has suspended the Promotion Business after the business contract ended in March 2024; (iv) the SE Asia Furniture Business has been transferred to the Remaining Group; and (v) the Target Group are assets holding companies and will not be engaging in any business upon the Completion, we concur with the Board that conducting a property valuation can reflect the status of the Target Group, being purely holding the Target Properties upon the Completion.

In order to assess the valuation as indicated in the Appendix IV to the Circular (the "**Valuation**"), we have performed the works with reference to Note 1(d) to Rule 13.80 of the Listing Rules and paragraph 5.3 of the Corporate Finance Adviser Code of Conduct in respect of the Valuation Report, which included (i) assessment of the Independent Valuer's experiences in assessing assets similar to the Target Properties; (ii) obtaining information on the Independent Valuer's track records on other valuation projects; (iii) inquiry on the Independent Valuer's current and prior relationship with the Group and other parties to the Sale and Purchase Agreement; (iv) review of the terms of the Independent Valuer's engagement, in particular its scope of work, for the assessment of the valuation of the Target Properties; and (v) discussion with the Independent Valuer regarding the bases, methodology and assumptions adopted in the Valuation Report.

Competence of the Independent Valuer

In our due diligence process, we have conducted telephone interview with the Independent Valuer to enquire its experience in valuing similar assets. We noted that the Independent Valuer is a firm of professional surveyors and international valuation consultants. The Independent Valuer started its operation in Hong Kong in 1994 as a professional asset advisory and valuation consultant to multi-national enterprises and listed companies with principal businesses in the PRC and Asia-Pacific regions. The team of the Independent Valuer has obtained professional qualifications from various international valuation professional organisations, such as The Hong Kong Institute of Surveyors ("**HKIS**") and Royal Institution of Chartered Surveyors. During the past three years, the Independent Valuer has engaged in approximately 100 property valuations for the companies listed on the Stock Exchange. In addition, we understand that the signor of the Valuation Report, namely Sr. Joseph Junior Ho, is a Fellow of The HKIS. He has been conducting valuation of various assets including real properties in Hong Kong, Macau, Taiwan, the PRC, Canada, the United Kingdom, France, Singapore, Guyana, Samoa, Argentina and Vietnam since 2010. As such, we are of the view that the Independent Valuer is qualified, experienced and competent in performing the valuation of the Target Properties.

We have enquired and confirmed with the Independent Valuer as to its independence from the Company, the Purchasers, and their associates. The Independent Valuer confirmed to us that it was not aware of any relationship or interest between itself and the Company, the Purchasers, or any other parties that would reasonably be considered to affect its independence to act as an independent valuer for the Company. Apart from normal professional fees payable to it in connection with its engagement for the Valuation, the Independent Valuer confirmed that no arrangements exist whereby it will receive any fee or benefit from the Company and its associates. Given the above, we are of the view that the Independent Valuer is independent from the Company in respect of the Valuation.

Furthermore, we have reviewed the terms of engagement of the Independent Valuer, in particular to its scope of work. We noted that its 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 Independent Valuer in the Valuation Report. We have also performed work as required under Note (1)(d) to the Listing Rules 13.80 in relation to the Independent Valuer and its work in relation to the Valuation.

Methodologies and assumptions adopted in the Valuation

As stated in the Valuation Report, the Valuation is conducted in compliance with the IVS. Based on our discussion with the Independent Valuer, we have not identified any major factors which cause us to doubt the fairness and reasonableness of the principal basis and assumptions used in arriving at the Valuation. We understand that Sr. Joseph Junior Ho of the Independent Valuer carried out physical inspection of the Target Properties on 10 May 2024. The Independent Valuer advised that apart from the Incident, they are not aware of any unusual circumstances during their inspection. The Independent Valuer also made relevant enquiries and searches for the purpose of the Valuation, including but not limited to review on relevant land certificates, legal documents and contact for the grant of state-owned land use rights, searches on the public data adopted in the depreciated replacement cost method under the cost approach.

We have reviewed and discussed with the Independent Valuer the basis adopted in arriving at the value of the Target Properties and noted that the Independent Valuer provided their opinion of value of the Target Properties on the market value basis.

As referred to in Appendix IV to the Circular, the Independent Valuer has assigned no commercial value to the Target Properties due to its transferability restrictions, and reported a value to the Target Properties for information purpose on a non-market value basis.

Methodologies

In assessing the value of the Target Properties, the Independent Valuer has considered the three generally accepted approaches, namely the sales comparison approach (or known as the market approach), the cost approach and the income approach.

As advised by the Independent Valuer, the preconditions for the adoption of the market approach are a developed, fair and active open market with sufficient market information and the availability of comparable transactions in the open market. As the land use rights of the Target Properties are not allowed to be transferred or leased pursuant to the relevant Realty Title Certificates, there are no such comparable transactions in the open market. According to the legal opinion from the PRC legal adviser of the Company, the local government has designated the area where the Target Properties located as an industrial park for furniture business. Unless the local government changes the land usage in that area, it is impossible for the land owner to apply for (i) changing the land usage from industrial purpose to commercial and/or residential usages; or (ii) removing the transferability or leasing restrictions. According to our search in relation to the future development of Pingshan District (including http://www.sz.gov.cn/), there is no notice published in relation to changing land usage or implementing new land development in Pingshan District. The management of the Company confirmed that they did not receive any notice from the local government in this regard. Further, we have conducted a research for land transactions in Pingshan District completed during the period from 1 June 2023 to 31 May 2024 (the "**Review Period**"), being a year prior to the valuation date of the Target Properties. We, on the best effort basis, searched through the search engine (i.e. Google and Baidu), but could only identify information for completed land transactions in Pingshan District from Shenzhen Public Resources Trading Center (https://new.szggzy.com/static/index.html), a public platform owned by a state-owned enterprise under State-owned Assets Supervision and Administration Commission of Shenzhen Municipal People's Government that collect and disclose various types of assets and resource transactions, for the Review Period and noted that there are six industrial land transactions during the Review Period (the "**Land Transactions Research**") that have completed the bidding process, represents an exhaustive list. Based on the Land Transactions Research, we noted that (i) the lands were sold by the local government through bidding; (ii) each transaction has its own requirements for application of the bidding (e.g. potential purchasers with national high-tech enterprise certification, engage in specified industry and specified construction development); and (iii) none of the Land Transactions Research are for furniture business or manufacturing business and with restriction in transferability similar to the Target Properties. Further, we discussed with the Independent Valuer and understood that these transactions are not directly comparable to the land use rights of the Target Properties due to different characteristics such as target market and industry. Given that each piece of land is unique and different requirements were set and sold by the local government, we consider that the Land Transactions Research are not comparable to the condition of the land use rights of the Target Properties. As aforesaid, we have conducted the Properties Research and were advised by the property agents that all of their industrial properties transactions listed in their websites are freely transferable, thus we consider that the Properties Research cannot directly compare to the building elements of the Target Properties. Therefore, we concur with the Independent Valuer that the market approach is not an appropriate methodology for assessing the value of the Target Properties.

The income approach refers to a valuation approach that determines the value of the appraisal subject through discounting expected income and expenses in a future period. As mentioned before, the Target Properties are not allowed to be leased, thus no rental income will be generated from the Target Properties, which has also been reflected in the audited consolidated financial information of the Target Group for the three years ended 31 December 2023. Thus, the income approach is not an appropriate methodology for assessing the value of the Target Properties.

The cost approach was taken to be the principal methodology for assessing the value of the Target Properties. The Independent Valuer advised that the depreciated replacement cost method is the most appropriate method when it is impracticable to identify the market value. The underlying theory of depreciated replacement cost method is the property should, at least, be equivalent to the replacement cost of the remaining service potential of the valued property. It considers the current cost required to construct the same properties from a new green field site, representing the cost for the PRC Company to acquire the Target Properties with the same condition as at the valuation date. For the buildings elements of the Target Properties, the gross replacement cost of the buildings elements of the Target Properties should take into consideration everything which is necessary to complete the construction from a new green field site to provide buildings as they are at the valuation date, and the buildings are fit for and capable of being occupied. The Independent Valuer confirmed that depreciated replacement cost method is a widely accepted and suitable method for assessing the value of the buildings elements of the Target Properties and is in line with the market practice. However, the depreciated replacement cost method is not appropriate to determine the value of the land element of the Target Properties, because every piece of land is unique. We therefore concur with the Independent Valuer that it would be challenging to find a replacement site with the same features and characteristics as the land use rights of the Target Properties, which contributes to the service potential of the building elements (the improvements) within their specific locality to be a representative comparable to build up the cost.

Given that (i) the Target Properties have not generated any rental income due to the leasing restriction; (ii) there is lack of publicly available transaction data in relation to sale and purchase of properties with transferability restrictions which is comparable to the Target Properties; (iii) there are no replacement land with the similar features as the land use rights of the Target Properties; and (iv) the local government has no plan to change the land usage nor remove the transferability restrictions under the Realty Title Certificates, we concur with the Independent Valuer that the depreciated replacement cost method is not appropriate to determine the value of the land element of the Target Properties and the depreciated replacement cost method is the most appropriate method in assessing the value of the building elements of the Target Properties.

Although market approach could normally be adopted by valuer in assessing the market value of the land use rights and income approach is another approach in assessing the market value of the buildings, after considered (i) the transferability restrictions; and (ii) the transactions as in the Land Transactions Research and Properties Research are not comparable to the Target Properties, we concur with the Independent Valuer that both market approach and income approach are not appropriate for the Valuation. Thus, there are no alternative methodologies for the cross-checking of the Independent Valuer's assessment. Based on the limitation of each of the methodology discussed above, we consider that the rationale behind the different valuation approaches is complete and reasonable.

The Independent Valuer have assumed that the conditions of the covered pipe works and building facilities as well as underground water are maintained in normal condition, we have conducted our own site visit at the Target Properties and have not observed any material structural damages to the Target Properties.

Valuation Inputs

To assess the fairness and reasonableness of the key valuation inputs used by the Independent Valuer for the depreciated replacement cost method, we have obtained and reviewed the calculation breakdown for the Valuation provided by the Independent Valuer. We noted that the Independent Valuer has taken into account various factors including, among others, (i) the gross floor area of the Target Properties; (ii) the construction costs per sq. m.; (iii) the remaining life; and (iv) the expected residual rate. We have discussed with the Independent Valuer regarding the major factors taken into consideration in arriving the building elements of Target Properties, and noted that these factors are commonly used parameters when assessing the value of a subject building by adopting depreciated replacement cost method under cost approach.

Estimated construction costs

We noted that the Independent Valuer has referred to the construction and installation project cost index (the "**CIP Cost Index**") in April 2024 published by the Housing and Construction Bureau of Shenzhen Municipality (https://zjj.sz.gov.cn/szzjxx/prcCostIndex/pc/index). We noted that the CIP Cost Index has been classified into six categories according to different type of building and structure, namely multi-storey residential buildings, high-rise residential buildings, multi-storey office buildings, high-rise office building, industrial buildings and public buildings. The Independent Valuer has adopted the CIP Cost Index of industrial buildings for the workshop and warehouse of the Target Properties and the CIP Cost Index of multi-storey residential buildings for the dormitory of the Target Properties. Considering the nature of the building elements of the Target Properties, we consider the categories of the CIP Cost Index adopted by the Independent Valuer is reasonable. The CIP Cost Index of industrial buildings and multi-storey residential buildings for April 2024 was 181.87 and 190.64 (representing 1.8187 times and 1.9064 time to the base value of the relevant categories), respectively. We have also checked to the base value of industrial buildings and multi-storey residential buildings (i.e. RMB1,175 per sq. m. for industrial buildings and RMB1,282 per sq. m. for multi-storey residential buildings) with no irregularities noted. We also recalculated the estimated construction costs per sq. m. by multiplying the CIP Cost Index with the base value of the relevant categories and the outcome of the estimated construction cost per sq. m. for industrial buildings and multi-storey residential buildings was approximately RMB2,140 and RMB2,440 respectively, which is same as those adopted by the Independent Valuer. As referred to Quarterly Construction Cost Review – China and Hong Kong (the "**Construction Cost Review**") (https://www.arcadis.com/en) published by Arcadis NV, a global design, engineering and management consulting company, the approximate building costs in Shenzhen for industrial unit ranged from RMB2,211 per sq. m. to RMB2,717 per sq. m during the first quarter of 2024. The estimated construction cost per sq. m. adopted by the Independent Valuer for the workshop and warehouse of the Target Properties using the CIP Cost Index are within the range of the Construction Cost Review. Taking into account that (i) the CIP Cost Index published by the local government represented the average construction cost in recent months; (ii) the categories of the CIP Cost Index are reasonably selected and the data of the CIP Cost Index has been adopted accurately; and (iii) the estimated construction cost per sq. m. adopted are within the range of the Construction Cost Review, we consider that the estimated construction cost per sq. m. adopted by the Independent Valuer is reasonable.

Remaining life

We noted that the buildings of the Target Properties are estimated with a useful life of 40 years. As advised by the Independent Valuer, the estimated useful life has been referred to Marshall & Swift Valuation Service which is a well-established cost manual for valuation of building and other structures (the "**Manual**") (https://www.boe.ca.gov/CountyPortal/Training/Uploads/Course%20002B/Class%20Materials/Marshall%20and%20Swift/Marshall%20&%20Swift.pdf). We have reviewed the Manual and noted that the average useful life for industrial building ranged from 35 years to 50 years with a median of 40 years. We have reviewed the Realty Title Certificates of the Target Properties and recalculated the remaining useful life of each building of the Target Properties. The construction of the single storey workshop, the single storey warehouse and the eight storey dormitory was completed on 27 November 2009, representing a remaining useful life of approximately 25.5 years, while the construction of the three storey workshop was completed on 16 July 2010, representing a remaining useful life of approximately 26.1 years. We referred to Common Valuation Methods and Parameters for Asset Valuations (資產評估常用方法與參數手冊) (the "**Method and Parameters Manual**") published by China Machine Press (機械工業出版社) in which the useful life of manufacturing building is in the range between 30 years to 70 years with an average of approximately 41 years. The remaining useful life adopted by the Independent Valuer is therefore within the range of the Method and Parameters Manual.

Residual rate

We noted that the Independent Valuer has adopted 2% for each building of the Target Properties with reference to the Manual. As advised by the Independent Valuer, the residual value represents the scrap value of the building upon its removal. We noted that the residual rate for commercial properties ranged from 1% to 3% and the Independent Valuer has adopted the median of 2%. We referred to the Methods and Parameters Manual in which the residual rate of manufacturing building is in the range between 0% to 6% years with an average of approximately 2.8%. The residual rate adopted by the Independent Valuer is therefore within the range of the Method and Parameters Manual.

Based on the above, we consider that the basis and assumptions adopted by the Independent Valuer for determining the value of the building elements of the Target Properties under the depreciated replacement cost method are reasonable.

Conclusion

Given that (i) the Target Properties represent the core and major assets of the Target Group; (ii) the independent valuation of the Target Properties is RMB61.2 million (equivalent to approximately HK$67.4 million) as referred to in Appendix IV to the Circular; and (iii) the Consideration of HK$62.0 million represents a premium of approximately 9.73% over the Adjusted NAV; and (iii) the Disposal does not affect the Furniture Business, we consider that the Consideration is fair and reasonable.

6. Possible financial effect of the Disposal

Upon Completion, the Company will cease to have any interest in the Target Group and the financial information of the Target Group will no longer be consolidated into the consolidated financial statements of the Group. The financial information below is based on the unaudited pro forma financial information of the Remaining Group as set out in Appendix III to the Circular (the "**Pro Forma Financial Information**"). It should be noted that such analysis is for illustrative purposes only and does not purport to represent how the financial position of the Remaining Group will be upon the Completion.

Earnings

With reference to the Pro Forma Financial Information and assuming that the Disposal had taken place on 31 December 2023, the Remaining Group will realise a one-off gain on Disposal of approximately HK$11.1 million, which is determined based on the net proceeds from the Disposal, the net asset value of the Target Group and the release of exchange fluctuation reserve of the Target Group. The Remaining Group will have no bank borrowings and loans after the Completion, the finance cost of the Remaining Group will be substantially reduced.

Net asset value

The audited net asset value of the Company as at 31 December 2023 was approximately HK$107.2 million. Based on the Pro Forma Financial Information and assuming that the Disposal had taken place on 31 December 2023, the unaudited pro forma net asset value of the Company would be increased to approximately HK$108.5 million after the Disposal but before the proposed payment of Special Dividend.

Gearing ratio

The gearing ratio of the Group as at 31 December 2023, calculated as a percentage of bank loans to total assets, was approximately 29.5%. Based on the Pro Forma Financial Information, upon Completion, the Remaining Group would not have any bank loans.

OPINIONS AND RECOMMENDATION

Having considered the following principal factors and reasons, in particular,

(i) the Consideration represents a premium over the Adjusted NAV, which has considered all assets and liabilities of the Target Group although for information purpose, the value of the land element of the Target Properties conducted by Independent Valuer was nil as set out in Appendix IV to the Circular;

(ii) the Target Properties are for industrial use, non-transferable and non-leasable in nature and together with the Incident, which the Company found it difficult to approach potential buyers who are willing to acquire the Target Properties;

(iii) the Group suspended all production activities at the Target Properties since 2020;

(iv) the Remaining Group will continue its Furniture Business including the SE Asia Furniture Business, without materially and adversely affecting its overall business scale and the profitability;

(v) the Remaining Group will have no bank borrowing upon Completion; and

(vi) the net proceed from the Disposal could primarily be used for the settlement of the proposed declaration of the Special Dividend which enables the Shareholders to immediately realise substantial value from their shareholdings in the Company,

we are of the opinion that the entering into the Sale and Purchase Agreement and the transactions contemplated thereunder is not in the ordinary and usual course of business of the Group because of its "one-off" nature. Nevertheless, the terms and conditions of the Sale and Purchase Agreement are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned, and are in the interests of the Company and the Shareholders as a whole.

Accordingly, we recommend the Independent Board Committee to advise the Independent Shareholders and we recommend the Independent Shareholders to vote in favour of the resolution to be proposed at the SGM in respect of the Sale and Purchase Agreement and the transactions contemplated thereunder.

Yours faithfully
For and on behalf of
Octal Capital Limited

Wong Wai Leung
Executive Director

Celina Yuen
Associate Director

Note: Mr. Wong Wai Leung has been a responsible officer of Type 1 (dealing in securities), Type 6 (advising on corporate finance) regulated activities since 2008 and is also a responsible officer Type 9 (asset management) regulated activities. Mr. Wong has accumulated decades of experience in corporate finance and investment banking and has participated in and completed various advisory transactions of listed companies in Hong Kong in respect of the Listing Rules and the Takeovers Code.

Ms. Celina Yuen is a licensed person and a responsible officer of Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities. Ms. Yuen has over 12 years of experience in corporate finance industry and has participated in and completed various advisory transactions of listed companies in Hong Kong in respect of the Listing Rules and the Takeovers Code.