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*To: the Independent Board Committee of O-Net Technologies (Group) Limited*

Dear Sirs,

**(1) PROPOSAL FOR THE PRIVATISATION OF O-NET TECHNOLOGIES (GROUP) LIMITED BY THE OFFEROR BY WAY OF A SCHEME OF ARRANGEMENT UNDER SECTION 86 OF THE COMPANIES LAW AND (2) PROPOSED WITHDRAWAL OF LISTING OF O-NET TECHNOLOGIES (GROUP) LIMITED**

## I. INTRODUCTION

We refer to our appointment to advise the Independent Board Committee in connection with the Proposal and the Scheme. Details of the Proposal and the Scheme are contained in the Scheme Document dated 2 September 2020, of which this letter forms part. Terms used in this letter shall have the same meanings as those defined in the Scheme Document unless the context otherwise requires.

On 8 July 2020, the Offeror and the Company jointly announced that the Offeror requested the Board to put forward to the Scheme Shareholders the Proposal for the privatisation of the Company by way of the Scheme, being a scheme of arrangement under section 86 of the Companies Law. If the Proposal is approved and implemented, among other things, (a) the Scheme Shares held by the Scheme Shareholders (excluding the Mr. Na Related Shareholders and Kaifa) will be cancelled and extinguished on the Effective Date in exchange for the payment of the Cancellation Price of HK$6.50 in cash for each Scheme Share; and (b) the listing of the Shares on the Stock Exchange will be withdrawn with effect after the Effective Date.

An Independent Board Committee, which comprises all the independent non-executive Directors, namely Mr. Deng Xinping, Mr. Ong Chor Wei and Mr. Zhao Wei, has been established by the Board to advise the Disinterested Shareholders in connection with the Proposal and the Scheme, and in particular as to (i) whether the Proposal and the Scheme are fair and reasonable; and (ii) voting in respect of the Scheme at the Court Meeting. Pursuant to Rule 2.8 of the Takeovers Code, the Independent Board Committee comprises all non-executive Directors who have no direct or indirect interest in the Proposal. Mr. Huang Bin, a non-executive Director, is a director of O-Net BVI and is interested in approximately 0.98% of the total number of issued shares of O-Net BVI (which is an Offeror Concert Party). Mr. Chen Zhujiang, a non-executive Director, is a director of both Kaifa and Shenzhen Kaifa, and is interested in approximately 0.010% of the issued shares of Shenzhen Kaifa. Mr. Mo Shangyun, a non-executive Director, is a senior management member of Shenzhen Kaifa and is interested in approximately 0.008% of the issued shares of Shenzhen Kaifa. Both Kaifa and Shenzhen Kaifa are Offeror Concert Parties. The Board is of the view that Mr. Huang Bin, Mr. Chen Zhujiang and Mr. Mo Shangyun are regarded as being interested in the Proposal for the purposes of Rule 2.8 of the Takeovers Code and are accordingly excluded from being members of the Independent Board Committee. The Independent Board Committee has approved our appointment as the Independent Financial Adviser to advise them as regards their recommendation on the Proposal and the Scheme.

We are not associated with the Company, the Offeror Consortium or any party acting, or presumed to be acting, in concert with any of them and, accordingly, are considered eligible to give independent advice on the Proposal and the Scheme. There has been no business relationship between the Company or its associated companies and us in the past two years. Apart from normal professional fees paid or payable to us in connection with this appointment, no arrangement exists whereby we will receive any fees or benefits from the Company, the Offeror Consortium or any party acting, or presumed to be acting, in concert with any of them. We are not aware of any relationship or interest between us and the Company or other parties that would be reasonably considered to affect our independence to act as an independent financial adviser to the Independent Board Committee in respect of the Proposal and the Scheme.

In formulating our advice and recommendation, we have relied on the information and facts supplied, and the opinions expressed, by the Directors and management of the Group (the "**Management**"), which we have assumed to be true, accurate and complete in all material aspects at the Latest Practicable Date. We have also assumed that all representations contained or referred to in the Scheme Document were true, accurate and complete at the time they were made and remain so at the Latest Practicable Date. The Disinterested Shareholders will be informed of any material change in this regard as soon as possible up to the Effective Date.

We have reviewed, among other things, the Joint Announcement, the Scheme Document, the annual reports of the Company for the years ended 31 December 2017, 2018 and 2019 and the Interim Results Announcement. We have sought and received confirmation from the Directors that no material fact has been omitted from the information supplied and opinions expressed to us by them. We consider that the information we have received is sufficient for us to reach our opinion and advice as set out in this letter. We have no reason to doubt the truth and accuracy of the information provided to us or to believe that any material fact has been omitted or withheld. We have not, however, conducted any independent investigation into the businesses and affairs of the Group, nor have we carried out any independent verification on the information supplied.

## II. TERMS OF THE PROPOSAL

Under the Scheme, if the Proposal is approved and implemented, among other things, (a) the Scheme Shares held by the Scheme Shareholders (excluding the Mr. Na Related Shareholders and Kaifa) will be cancelled and extinguished on the Effective Date in exchange for the payment of the Cancellation Price of HK$6.50 in cash for each Scheme Share; and (b) the listing of the Shares on the Stock Exchange will be withdrawn with effect after the Effective Date. Further details of the terms of the Proposal is set out in the letter from the Board and the Explanatory Statement contained in the Scheme Document.

**In addition, the Cancellation Price will not be increased and the Offeror does not reserve the right to do so.**

## III. CONDITIONS OF THE PROPOSAL

The implementation of the Proposal is, and the Scheme will become effective and binding on the Company and the Scheme Shareholders, subject to the fulfilment or waiver (as applicable) of the Conditions, among other things:

(a) the approval of the Scheme (by way of poll) by a majority in number of the Disinterested Shareholders representing not less than 75% in value of the Shares held by the Disinterested Shareholders, present and voting either in person or by proxy at the Court Meeting, provided that:

   (i) the Scheme is approved (by way of poll) by the Disinterested Shareholders holding at least 75% of the votes attaching to the Shares held by the Disinterested Shareholders that are voted either in person or by proxy at the Court Meeting; and

   (ii) the number of votes cast (by way of poll) by the Disinterested Shareholders present and voting either in person or by proxy at the Court Meeting against the resolution to approve the Scheme at the Court Meeting is not more than 10% of the votes attaching to all the Shares held by all the Disinterested Shareholders;

(b) (i) the passing of a special resolution by a majority of not less than three-fourths of the votes cast by the Shareholders present and voting in person or by proxy at the EGM to approve and give effect to the reduction of the number of issued Shares in the share capital of the Company by cancelling and extinguishing the Scheme Shares; and (ii) the passing of an ordinary resolution by a simple majority of the votes cast by the Shareholders present and voting in person or by proxy at the EGM to immediately thereafter increase the issued Shares to the amount prior to the cancellation and extinguishment of the Scheme Shares and apply the reserve created as a result of the aforesaid cancellation and extinguishment of the Scheme Shares to pay up in full at par such number of new Shares as is equal to the number of Scheme Shares cancelled and extinguished as a result of the Scheme, credited as fully paid, for issuance to the Offeror;

(c) the Grand Court's sanction of the Scheme (with or without modifications) and, to the extent necessary, its confirmation of the reduction of the number of issued Shares in the share capital of the Company, and the delivery to the Registrar of Companies in the Cayman Islands of a copy of the order of the Grand Court for registration;

(d) compliance, to the extent necessary, with the procedural requirements and conditions, if any, under Sections 15 and 16 of the Companies Law in relation to the reduction of the number of issued Shares in the share capital of the Company; and

(e) approval of the Consortium Agreement and transactions contemplated thereunder by shareholders of Shenzhen Kaifa, the holding company of Kaifa, in accordance with the Rules Governing the Listing of Securities on the Shenzhen Stock Exchange having been obtained.

Conditions above cannot be waived in any event. All of the Conditions will have to be fulfilled or waived, as applicable, on or before the Long Stop Date, failing which the Proposal and the Scheme will lapse. Further details of the Conditions are set out in the letter from the Board and the Explanatory Statement contained in the Scheme Document.

As at the Latest Practicable Date, save for Condition (e), none of the Conditions has been fulfilled or waived.

## IV. PRINCIPAL FACTORS AND REASONS CONSIDERED

In formulating our opinion and recommendation with regard to the Proposal and the Scheme, we have taken into consideration the following principal factors and reasons:

### 1. Background and information of the Company

#### *(a) Principal business of the Group*

The Group is principally engaged in the design, manufacturing and sales of optical networking products for the high-speed telecommunications and data communications systems as well as machine vision systems and sensors for smart manufacturing market. The Company has been listed on the Stock Exchange since 2010. The Company has operations in Shenzhen, Beijing, Hangzhou, Hong Kong, North America and Europe under the brand "O-Net".

The operations of the Group consist of two major businesses, namely (i) optical networking business (the "**Optical Networking Business**"); and (ii) industrial and sensing businesses (the "**Industrial and Sensing Businesses**").

The Optical Networking Business sells optical communication and data centre products such as amplifiers, couplers and connectors, intelligent character recognition, etc..

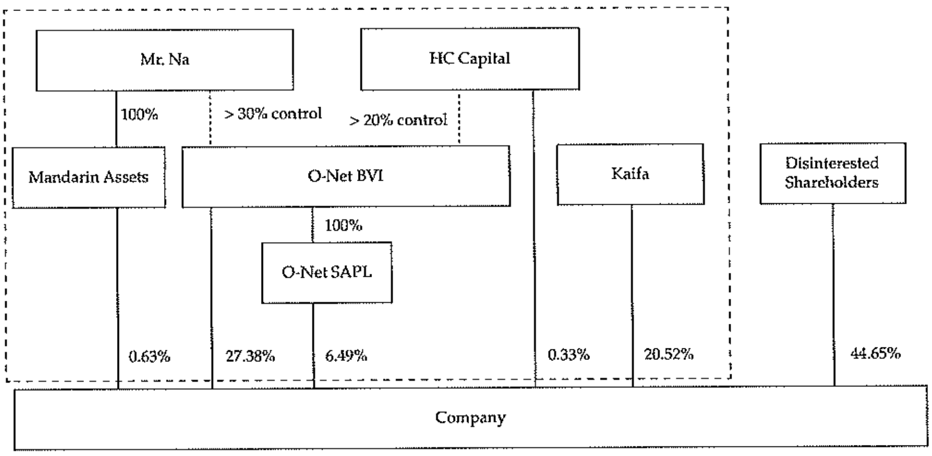
The Industrial and Sensing Businesses comprise (i) the machine vision business; (ii) the automation solutions business for E-cigarettes; (iii) the industrial laser business; (iv) the light detection and ranging ("**LiDAR**") business; and (v) the consumer electronics business. The machine vision business provides solutions to various applications such as cameras for industrial uses, lens, sensors and robotic arms. The automation solutions business for E-cigarettes supplies heating coils and automated E-liquid filling and assembly machines for E-cigarette industry. The industrial laser business supplies high-power fused components and modules for fiber laser systems which are widely applied on macro/micro material processing, marking and engraving and welding. The components and modules in LiDAR business are widely used in the emerging advanced driver assistance systems (ADAS) application. The consumer electronics business provides coating for smartphone components.

*(b)* *Shareholding of the Company*

As at the Latest Practicable Date, the Company had 834,028,240 Shares in issue. The Offeror and Offeror Concert Parties held 461,620,070 Shares, representing approximately 55.35% of the issued share capital of the Company. The Disinterested Shareholders held the remaining balance of 372,408,170 Shares, representing approximately 44.65% of the issued share capital of the Company. As at the Latest Practicable Date, there were no outstanding options, warrants, derivatives or convertible securities issued by the Company.

Set out in the chart below is a simplified shareholding structure of the Company as at the Latest Practicable Date.

**Offeror and Offeror Concert Parties**



(c) *Financial performance of the Group*

Set out in the table below is a summary of the financial results of the Group for the six months ended 30 June 2020 and 2019 and the years ended 31 December 2019, 2018, and 2017.

| | For six months ended 30 June | | For year ended 31 December | | |
|---|---|---|---|---|---|
| | 2020 *(HK$ million) (unaudited)* | 2019 *(HK$ million) (unaudited)* | 2019 *(HK$ million) (audited)* | 2018 *(HK$ million) (audited)* | 2017 *(HK$ million) (audited)* |
| Revenue | 1,491.2 | 1,403.4 | 2,581.0 | 2,516.4 | 2,035.1 |
| Cost of sales | (1,117.7) | (989.2) | (1,830.7) | (1,728.4) | (1,308.6) |
| Gross profit | 373.5 | 414.2 | 750.3 | 788.0 | 726.5 |
| Selling and marketing costs | (46.3) | (45.2) | (81.5) | (79.0) | (76.2) |
| Research and development expenses | (155.5) | (154.8) | (270.8) | (247.6) | (230.8) |
| Administrative expenses | (133.3) | (113.0) | (262.5) | (215.6) | (177.1) |
| Others | 18.4 | 22.1 | 5.0 | 63.6 | 30.4 |
| Operating profit | 56.8 | 123.3 | 140.5 | 309.4 | 272.8 |
| Finance income/(expenses) – net | 4.0 | (15.4) | (17.7) | (26.2) | (23.9) |
| Share of losses of investments accounted for using equity method | (0.9) | (4.6) | (9.5) | (1.1) | - |
| Profit before income tax | 59.9 | 103.3 | 113.3 | 282.1 | 248.9 |
| Income tax expenses | (16.8) | (23.0) | (4.5) | (23.9) | (43.1) |
| Profit for the period/year | 43.1 | 80.3 | 108.8 | 258.2 | 205.8 |
| Profit/(Loss) for the period/year attributable to: | | | | | |
| the Shareholders | 42.8 | 83.1 | 117.4 | 261.8 | 208.9 |
| non-controlling interests | 0.3 | (2.8) | (8.6) | (3.6) | (3.1) |
| | 43.1 | 80.3 | 108.8 | 258.2 | 205.8 |
| *Gross profit margin* | 25.0% | 29.5% | 29.1% | 31.3% | 35.7% |
| *Net profit margin (Note)* | 2.9% | 5.9% | 4.5% | 10.4% | 10.3% |
| *Earnings per Share (basic) for profit attributable to the Shareholders (HK$)* | 0.05 | 0.10 | 0.15 | 0.35 | 0.28 |
| *Dividend per Share (HK$)* | *Nil* | *Nil* | *Nil* | 0.02 | *Nil* |

*Note:* the net profit margin is calculated as the profit attributable to the Shareholders divided by the revenue of the relevant period or year.

(i) Revenue

The revenue of the Group increased from approximately HK$2,035.1 million for the year ended 31 December 2017 by approximately 23.6% to approximately HK$2,516.4 million for the year ended 31 December 2018, and by further approximately 2.6% to approximately HK$2,581.0 million for the year ended 31 December 2019.

The Optical Networking Business has been the core business of the Group, accounting for approximately 78.7%, 83.6%, 84.5% and 89.6% of the total revenue of the Group for the years ended 31 December 2017, 2018 and 2019 and the six months ended 30 June 2020 (the "**Review Period**") respectively. Revenue generated by the Group was derived from various regions in the world. For the year ended 31 December 2019, approximately 38.5%, 28.0%, 16.5% and 17.0% of revenue of the Group were derived from the PRC, Europe, North America and other Asian countries excluding the PRC respectively.

The revenue of the Group for the year ended 31 December 2018 was approximately HK$2,516.4 million, representing an increase of approximately HK$481.3 million or 23.6% as compared with that of HK$2,035.1 million for the year ended 31 December 2017. The increase in revenue for the year ended 31 December 2018 was primarily attributable to the growth in revenue of the Optical Networking Business, which recorded an increase of approximately HK$502.6 million or approximately 31.4%. Such increase was mainly attributable to the demand for components from telecommunication and data-communication sectors. According to the Management, the increasing demand from the telecommunication sectors was seen in 2018 due to the commencement of the spending of capital expenditure in 5G. The Industrial and Sensing Businesses recorded a revenue of approximately HK$412.8 million, representing a year-on-year decrease of approximately HK$21.3 million or 4.9% as compared with that for the year ended 31 December 2017. The decrease was mainly due to the combined effect of: (i) sharp decrease of revenue of consumer electronics business; and (ii) significant growth of revenue generated from other businesses in the Industrial and Sensing Businesses.

The revenue of the Group recorded a modest increase of approximately HK$64.6 million or 2.6% to approximately HK$2,581.0 million for the year ended 31 December 2019 from that of approximately HK$2,516.4 million for the year ended 31 December 2018. The continuing growth in the revenue was chiefly attributable to the increasing demand for the optical networking products in active components of the Optical Networking Business. According to the Management, although the Optical Networking Business remained strong in the first half of 2019, the revenue generated from this business saw a slowdown in the second half of 2019 when the largest customer of the Group experienced a reduced market share among telecommunication operators. The Industrial and Sensing Businesses recorded approximately HK$13.5 million or 3.3% decline in revenue to approximately HK$399.3 million for the year ended 31 December 2019. The decline was mainly due to the sharp decrease of approximately HK$42.6 million in the consumer electronics business as a result of decrease in demand for coating of smartphone manufacturing in China as they were waiting for investment in 5G infrastructure to release 5G compatible phone models.

For the six months ended 30 June 2020, the Group's revenue amounted to approximately HK$1,491.2 million, representing an increase of approximately 6.3% as compared to that for the corresponding period in 2019 of approximately HK$1,403.4 million. The Optical Networking Business recorded a revenue of approximately HK$1,336.3 million, representing an increase of approximately HK$138.5 million from that of approximately HK$1,197.8 million in the corresponding period in 2019. As advised by the Management, the increase in revenue was mainly attributable to the general increase in demand for products of the Optical Networking Business as the downstream customers built up more stocks for preparation of potential supply shortage arising from disruption of industry supply chains as a result of the outbreak of the COVID-19 pandemic.

(ii) Gross profit and gross profit margin

The gross profit of the Group for the year ended 31 December 2018 was approximately HK$788.0 million, representing an increase of approximately HK$61.5 million or approximately 8.5% as compared with that for the year ended 31 December 2017. The increase was in line with the rise in revenue from the Optical Networking Business during the year. However, the gross profit margin dropped to approximately 31.3% for the year ended 31 December 2018 from approximately 35.7% for the year ended 31 December 2017. The decrease in gross profit margin was mainly due to the net effect of (i) the gross profit margin of the Optical Networking Business declined to approximately 30.8% for the year ended 31 December 2018 from approximately 32.9% for the year ended 31 December 2017 as one of the major optical networking products of the Group suffered price cut driven by standardisation of the product and over-supply in the market; and (ii) the sharp decrease in revenue of consumer electronics business during the year.

The gross profit of the Group for the year ended 31 December 2019 declined to approximately HK$750.3 million, representing a decrease of approximately HK$37.7 million or approximately 4.8% from that of approximately HK$788.0 million for the year ended 31 December 2018. The lower gross profit was primarily due to, among others, (i) the write-down of inventories of fiber lasers in the industrial laser business; (ii) provision for impairment loss of machinery of consumer electronics business; (iii) drop of gross profit from Erbium-Doped Fiber Amplifier (EDFA) in the Optical Networking Business; and (iv) decrease in gross profit of consumer electronics business due to the decrease in demand for coating of smartphone manufacturers in China as mentioned above. The gross profit margin further declined to approximately 29.1% for the year ended 31 December 2019 as compared with approximately 31.3% for the year ended 31 December 2018 for the reasons as mentioned above.

The gross profit of the Group for the six months ended 30 June 2020 was approximately HK$373.5 million, representing a decrease of approximately HK$40.7 million or approximately 9.8% from approximately HK$414.2 million for the corresponding period in 2019. The decline in gross profit was mainly due to: (a) the increase in labour cost and cost of raw materials as higher labour cost were incurred during the Chinese New Year and higher demand for raw materials in response to the supply shortage arising from disruption of industry supply chains triggered by the COVID-19 pandemic during the period; and (b) certain products sold by the Group were no longer competitive in the market and had to be written-off due to the rapid development of competing technologies. As a result of the above, the gross profit margin further declined to approximately 25.0% as compared to approximately 29.5% for the corresponding period in 2019.

(iii) Selling and marketing costs

The selling and marketing costs for the year ended 31 December 2018 was approximately HK$79.0 million, representing a year-on-year increase of approximately HK$2.8 million or approximately 3.7% as compared to that for the year ended 31 December 2017. The increase was mainly attributable to the net effects of (i) the increase of the salary costs; (ii) lower freight charges; and (iii) the increase of share options/share awards expenses.

The selling and marketing costs for the year ended 31 December 2019 further increased to approximately HK$81.5 million. The increase was mainly due to the net effects of (i) the increase in salary costs; (ii) the increase in share options/share awards expenses; (iii) the increase in travelling and consumable expenses; and (iv) the decrease in sales commission.

The selling and marketing costs increased slightly from approximately HK$45.2 million for the six months ended 30 June 2019 to approximately HK$46.3 million for the six months ended 30 June 2020, which was driven mainly by the increase in salary costs.

(iv) Research and development ("**R&D**") expenses

The R&D expenses for the year ended 31 December 2018 was approximately HK$247.6 million, which was approximately HK$16.8 million or approximately 7.3% higher than that of approximately HK$230.8 million for the year ended 31 December 2017. Similar to the selling and marketing costs, the rise in R&D expenses was primarily due to the increase in salary costs for the R&D engineers as more R&D engineers were hired as well as higher salaries. Nevertheless, the decrease in raw material consumed in R&D projects during the year partly offset the rise of the salary costs.

The R&D expenses further increased by approximately HK$23.2 million or approximately 9.4% to approximately HK$270.8 million for the year ended 31 December 2019. The increased salary costs of the R&D engineers, as a result of the increase in hiring of R&D engineers and higher salaries, was the main reason for the increased R&D expenses during the year.

The R&D expenses for the six months ended 30 June 2020 was approximately HK$155.5 million, which was generally similar to the level of that for the corresponding period in 2019 of approximately HK$154.8 million.

(v) Administrative expenses

The administrative expenses for the year ended 31 December 2018 was approximately HK$215.6 million, which was approximately HK$38.5 million or approximately 21.7% higher as compared with that approximately HK$177.1 million for the year ended 31 December 2017. The increases in the salary costs, share options/share awards expenses and overall administrative expenses were the main reasons for the increase in administrative expenses during the year.

The administrative expenses for the year ended 31 December 2019 was approximately HK$262.5 million, representing a further increase of approximately HK$46.9 million or approximately 21.7% as compared with that for the year ended 31 December 2018. The increases in salary costs, depreciation and amortisation charges, share options/share awards expenses as well as other administrative expenses contributed to the increment. The administrative expenses raised to approximately 10.2% to total revenue for the year ended 31 December 2019, as compared to that of approximately 8.6% and approximately 8.7% for the years ended 31 December 2018 and 2017 respectively, which was mainly due to the consolidation of 3SP Technologies ("**3SP**"), a French company principally engaged in R&D, manufacturing and sales of chips and laser products in France, acquired by the Group during the year.

The administrative expenses for the six months ended 30 June 2020 was approximately HK$133.3 million, representing an increase of approximately HK$20.3 million or approximately 18.0% from that for the corresponding period in 2019 of approximately HK$113.0 million. The increase was mainly due to increase in number of employees and increase in professional fees for the setting up new branches in Boston, at the United States and Thailand during the period.

(vi) Profit/(Loss) for the period/year attributable to the Shareholders

The Group recorded profit attributable to the Shareholders of approximately HK$208.9 million, approximately HK$261.8 million and approximately HK$117.4 million for the years ended 31 December 2017, 2018 and 2019 respectively.

The increase in the net profit for the year ended 31 December 2018 was mainly due to the increase in revenue and the decrease in income tax expenses, although it has been partly offset by the higher R&D expenses and administrative expenses during the year.

The profit attributable to the Shareholders for the year ended 31 December 2019 declined by approximately 55.2% to approximately HK$117.4 million. The decline in profit was chiefly due to (i) the modest increase in revenue and the decrease in gross profit; (ii) the higher R&D expenses and the administrative expenses; and (iii) the decrease in government grants from approximately HK$41.0 million for the year ended 31 December 2018 to approximately HK$13.7 million for the year ended 31 December 2019.

The profit attributable to the Shareholders for the six months ended 30 June 2020 declined by approximately HK$40.3 million to approximately HK$42.8 million from approximately HK$83.1 million for the corresponding period in 2019. The significant decline was mainly due to the combined effects of: (i) the decrease in gross profit due to the increase in cost of sales; (ii) the increase in administrative expenses; (iii) the increase in net finance income of approximately HK$19.4 million from a net finance expense of approximately HK$15.4 million for the six months ended 30 June 2019 to a net finance income of approximately HK$4.0 million for the six months ended 30 June 2020 as a result of the recognition of a net exchange gain approximately HK$19.9 million for the six months ended 30 June 2020 as compared to a net exchange loss of approximately HK$1.0 million for the corresponding period in 2019; and (iv) the decrease in income tax expenses of approximately HK$6.2 million from approximately HK$23.0 million for the six months ended 30 June 2019 to approximately HK$16.8 million as the profit before tax decreased during the six months ended 30 June 2020.

(vii) Earnings per Share and dividend per Share

Earnings per Share, which is calculated as profit attributable to the Shareholders divided by the weighted average number of ordinary shares in issue, was approximately HK$0.28, HK$0.35, HK$0.15 and HK$0.05 for the years ended 31 December 2017, 2018 and 2019 and for the six months ended 30 June 2020 respectively. The changes in earnings per Share were generally in line with the profit attributable to the Shareholders as discussed above.

Except for a final dividend of HK$0.02 per Share for the year ended 31 December 2018, the Group had not paid any dividend during the Review Period.

*(d)* *Financial position of the Group*

Set out in the table below is a summary of the financial position of Group as at 30 June 2020 and 31 December 2019, 2018 and 2017.

| | As at 30 June | As at 31 December | | |
|---|---|---|---|---|
| | 2020 | 2019 | 2018 | 2017 |
| | *(HK$ million)* *(unaudited)* | *(HK$ million)* *(audited)* | *(HK$ million)* *(audited)* | *(HK$ million)* *(audited)* |
| **Non-current assets** | | | | |
| Property, plant and equipment | 1,092.9 | 1,073.4 | 957.8 | 916.0 |
| Intangible assets | 247.2 | 247.1 | 90.4 | 82.6 |
| Other non-current assets | 201.3 | 183.2 | 340.7 | 324.3 |
| | 1,541.4 | 1,503.7 | 1,388.9 | 1,322.9 |
| **Current assets** | | | | |
| Inventories | 713.2 | 596.4 | 501.0 | 377.5 |
| Trade and other receivables | 1,128.4 | 876.6 | 865.9 | 975.0 |
| Pledged bank deposits and cash and cash equivalents | 456.0 | 491.8 | 407.3 | 405.6 |
| Other current assets | 26.7 | 25.0 | 56.2 | 22.9 |
| | 2,324.3 | 1,989.8 | 1,830.4 | 1,781.0 |
| **Current liabilities** | | | | |
| Trade and other payables | 678.8 | 433.0 | 428.8 | 366.8 |
| Borrowings | 674.2 | 591.0 | 487.8 | 653.7 |
| Other current liabilities | 44.7 | 52.8 | 31.7 | 32.7 |
| | 1,397.7 | 1,076.8 | 948.3 | 1,053.2 |
| **Net current assets** | 926.6 | 913.0 | 882.1 | 727.8 |
| **Non-current liabilities** | | | | |
| Lease liabilities | 32.0 | 37.5 | – | – |
| Other non-current liabilities | 46.3 | 41.3 | 23.6 | 17.6 |
| | 78.3 | 78.8 | 23.6 | 17.6 |
| **Equity** | | | | |
| Equity attributable to the Shareholders | 2,389.7 | 2,348.5 | 2,249.4 | 2,031.5 |
| Non-controlling interests | – | (10.6) | (2.0) | 1.6 |
| | 2,389.7 | 2,337.9 | 2,247.4 | 2,033.1 |
| **Net asset value ("NAV") per Share *(Note)*** | 2.87 | 2.84 | 2.80 | 2.54 |

*Note:* NAV per Share is calculated based on the equity attributable to the Shareholders divided by the number of Shares in issue as at the respective balance sheet date.

(i) Property, plant and equipment

Property, plant and equipment mainly consisted of buildings, machinery, furniture, fitting and equipment and construction in progress of the Group for production purposes. They were largely factories and auxiliary facilities located in the PRC, Europe and North America. The construction in progress mainly comprised costs incurred for a new production plant under construction, which was located in Pingshan, Shenzhen, the PRC. The property, plant and equipment were generally increasing during the Review Period as a result of the Group's acquisitions of furniture, fitting and equipment and machinery.

(ii) Intangible assets

Intangible assets primarily represented the goodwill arising mainly from acquisitions, development expenditure and patent acquired. The increase in intangible assets during the year ended 31 December 2019 was mainly due to the acquisition of 3SP during the year, giving rise to a goodwill of approximately HK$94.8 million.

(iii) Inventories

Inventories represented largely raw materials, work-in-progress and finished goods. The inventories increased in general during the Review Period, which was in line with the increase in revenue during the Review Period and the Group has stocked-up raw materials to avoid any disruption in raw materials purchases due to trade war in near future.

(iv) Trade and other receivables

The trade and other receivables mainly comprises: (i) net trade receivables (i.e. trade receivables less provision for impairment of receivables); (ii) bills receivables; and (iii) prepayments and others. The net trade receivables decreased from approximately HK$707.3 million as at 31 December 2017 to approximately HK$690.1 million as at 31 December 2018 and further declined to approximately HK$638.1 million as at 31 December 2019. The drop in the net trade receivables was chiefly due to the additional provision for impairment of receivables, which has grown from approximately 0.1% of total trade receivables as at 31 December 2017 to approximately 1.3% of the total trade receivables as at 31 December 2019 as required under the revised financial reporting standards. The bills receivables decreased from approximately HK$193.1 million as at 31 December 2017 to approximately HK$87.0 million as at 31 December 2018 and increased to approximately HK$146.3 million as at 31 December 2019. The net trade receivables and bills receivables as at 30 June 2020 were approximately HK$934.0

million and approximately HK$114.9 million respectively. The increase in the total amount of the net trade receivables and bills receivables was largely because the Group has conducted more business with Chinese customers, whose credit period was generally longer than that of the overseas customers.

(v) Trade and other payables

Trade and other payables chiefly comprise trade payables, bills payable and accrued staff cost. Trade payables were largely in line with the inventory levels throughout the Review Period. The majority of the trade payables were payable within 60 days throughout the Review Period. The trade payables increased to approximately HK$461.5 million as at 30 June 2020 from approximately HK$229.1 million as at 31 December 2019. As advised by the Management, the Group has increased purchases of inventories and has managed to negotiate a longer payment terms with its suppliers.

(vi) Borrowings

All bank borrowings of the Group were current during the Review Period. The borrowings of the Group decreased from approximately HK$653.7 million as at 31 December 2017 to approximately HK$487.8 million as at 31 December 2018 and increased to approximately HK$591.0 million as at 31 December 2019. The increase in the bank borrowings in 2019 was mainly due to more capital expenditure required for 3SP, the newly acquired subsidiary in France, and the general increase in working capital requirement of the Group. The gearing ratio, calculated as total borrowings over total equity, was remain at a relatively healthy level of approximately 25.3% as at 31 December 2019. The bank borrowings of the Group as at 30 June 2020 was approximately HK$674.2 million, which was higher than that of approximately HK$591.0 million as at 31 December 2019. The gearing ratio of the Group increased to approximately 28.2% as at 30 June 2020.

(vii) Net assets

As at 31 December 2019, the NAV attributable to the Shareholders was approximately HK$2,348.5 million. The increase in the NAV attributable to the Shareholders as compared with that as at 31 December 2018 was mainly attributable to the profit generated for the year ended 31 December 2019. Based on 826,860,240 Shares and 834,028,240 Shares in issue as at 31 December 2019 and the Latest Practicable Date, the NAV per Share as at 31 December 2019 were approximately HK$2.84 and approximately HK$2.82 respectively.

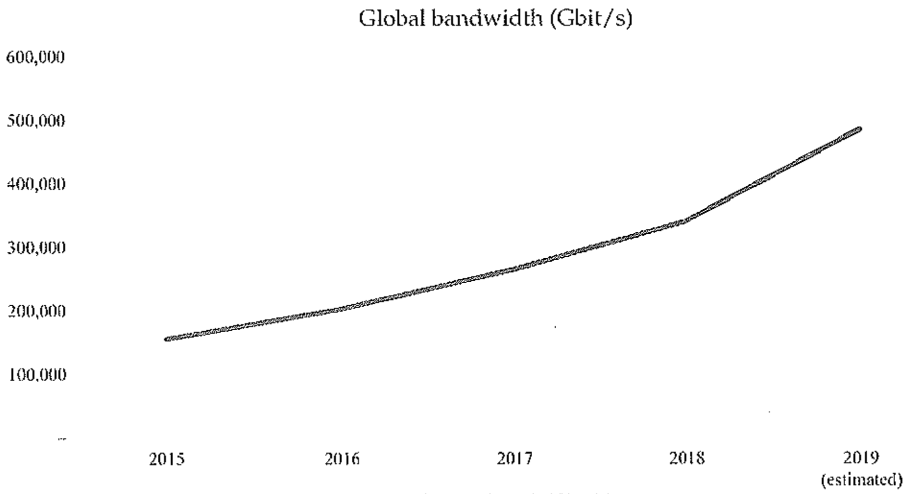
As at 30 June 2020, the NAV attributable to the Shareholders further increased to approximately HK$2,389.7 million, the increase of which was generally in line with the profit attributable to the Shareholders during the six months ended 30 June 2020. Based on the 834,028,240 Shares in issue as at 30 June 2020 and the Latest Practicable Date, the NAV per Share was approximately HK$2.87 as at 30 June 2020.

**2. Industry overview and prospects of the Group**

As the operations of the Group mainly consist of the Optical Networking Business and the Industrial and Sensing Businesses, we have reviewed the trends and outlook of these businesses as set out below.

*(a) The Optical Networking Business*

As discussed in the annual report of the Company for the year ended 31 December 2019 (the "**2019 Annual Report**"), data is growing at a rising rate and the scale of optical communication is anticipated to accelerate to cope with the global demand. According to Statista, one of the leading global providers of market and consumer data, there were approximately 4.57 billion active internet users in the world as of April 2020, accounting for approximately 59% of the global population. Furthermore, according to the International Telecommunication Union ("**ITU**"), a specialised agency of the United Nations that is responsible for issues that concern information and communication technologies, the telecommunication infrastructure had been growing in recent years such that the global bandwidth increased from approximately 152,817 giga bit per second ("**Gbit/s**") in 2015 to approximately 337,498 Gbit/s in 2018 and ITU estimated that the global bandwidth would further increase to approximately 484,968 Gbit/s by 2019. Details of the above are set out in the graph below:




*Source: ITU*

With the potential increase in both the number of internet users and the amount of data created per user, it is expected that the optical communication would benefit from the growing network volume in the long run. Consequently, the demand for and the capital investment in advanced global telecommunications infrastructure is expected to grow in long-term future.

On the other hand, there are a number of challenges in the operating environment of the Group in the short and medium term of the future. First, as advised by the Management, the largest customer of the Group saw shrinking market share in the industry since the second half of 2019. This has indirectly led to the reduction of revenue from this customer for the year ended 31 December 2019 and may jeopardise the growth of revenue from this customer in the near future. Furthermore, according to the Management, certain key customers in China have encountered increasing hawkish trade policies in the first half of 2020 that may impact the Group's long-term growth trajectory. One of the key Chinese customers of the Group, which is a global provider of information and communication technology, faced unprecedented setback in their business after the recent ban from participating in the development of the 5G telecommunication network by the governments of the United States and the United Kingdom. This may also indirectly and potentially affect the revenue of the Group generated from this key Chinese customers in the future. Moreover, the Company's overseas markets are also susceptible to similar trade tensions depending on the future evolution of China US dynamics in trade as well as other aspects.

To make matters worse, the world has been overwhelmed by the outbreak of the COVID-19 pandemic with significant economic contraction. Worldwide slowdown in economic activities and lockdown of cities were observed in first and second quarters of 2020. The dim economic outlook would hinder the commitment in capital expenditure among global telecommunication operators. The pandemic also caused supply shock in the industry where the Group operates as some of the raw materials were less accessible to the Group. Higher production cost is also expected in respond to the precautionary measures for labour force protection.

*(b) The Industrial and Sensing Businesses*

According to the 2019 Annual Report, certain divisions of the Industrial and Sensing Businesses saw expansions to new markets and new geographical areas in 2019. In the long run, more capital investment for automation solutions, machine vision systems and sensing products will provide the chance to tap the opportunities generated for the Group to further penetrate the intelligent, digitalised and networked manufacturing market. The ramping-up of smart factories and emerging applications such as Advanced Driver Assistance Systems and E-cigarettes will foster the growth of certain divisions of the Industrial and Sensing Businesses.

Nonetheless, as advised by the Management, several divisions in the Industrial and Sensing Businesses have faced headwinds since 2019 and the overall performance of these businesses were mixed. For example, the E-cigarette faced a more stringent regulation in the United States. Such push back from the policymakers will adversely affect the sales in the automation solutions business for E-cigarettes. Also, the consumer electronics market is expected to further decline due to lower demand for coating of smartphones in near future.

Although the Management remained cautious on the outlook of the Optical Networking Business and the Industrial and Sensing Businesses, having considered the challenging operating environment faced by the Group and the uncertain economic outlook of the world, we are of the view that there remains uncertainty on the prospect of the Group in the short and medium term.

**3. Reasons for and benefits of the Proposal and the Offeror's intentions in relation to the Group**

The following has been extracted from section 7 of the Explanatory Statement in relation to the reasons for and benefits of the Proposal.

*(a) Low liquidity of the Shares*

The liquidity of the Shares has been at a relatively low level over a prolonged period of time, with an average daily trading volume of 1,491,740 Shares for the 24 months up to and including the Last Trading Day, representing less than 0.18% of the total issued Shares as at the Last Trading Day. Low trading liquidity of the Shares renders it difficult for Shareholders to execute substantial on-market disposals without adversely affecting the price of the Shares. Further, the Directors believe that such low liquidity hinders the Company's ability to raise funds from the public equity market, which no longer serves as a viable source of funding for developing the Group's business.

*(b) Attractive opportunity to realise investments*

The Proposal is intended to provide the Scheme Shareholders with an attractive opportunity to realise their investments and interests in the Company for cash at a premium. The Cancellation Price represents a premium of approximately:

(i) 23.57% over the closing price of the Shares on the Last Trading Day;

(ii) 25.68% over the average closing price of the Shares for the 10 trading days up to and including the Last Trading Day;

(iii) 24.56% over the average closing price of the Shares for the 30 trading days up to and including the Last Trading Day;

(iv) 34.26% over the average closing price of the Shares for the 90 trading days up to and including the Last Trading Day;

(v) 43.18% over the average closing price of the Shares for the 180 trading days up to and including the Last Trading Day;

(vi) 19.27% over the average closing price of the Shares for the 52-week closing high; and

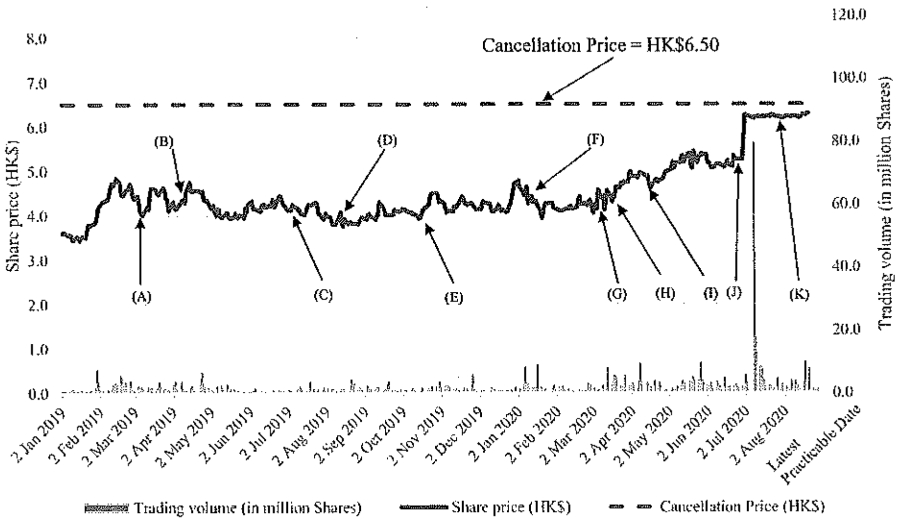
(vii) 128.85% over the audited consolidated net asset value per Share as at 31 December 2019.

As mentioned in the Explanatory Statement, it is the intention of the Offeror that the Group will continue to carry on its current business. The Offeror does not intend to introduce any major changes to the business of the Group (including any redeployment of fixed assets of the Group) or make any significant changes to the continued employment of the employees of the Group as a result of the implementation of the Proposal.

**4. Analysis of Share price**

*(a) Historical Share price performance*

Set out in the chart below is the daily closing price and trading volume of the Shares on the Stock Exchange during the period from 1 January 2019 up to and including the Latest Practicable Date (the "**Share Price Review Period**").




*Source: Bloomberg and the Stock Exchange website*

During the Share Price Review Period, the Company published a number of announcements (as summarised below) that we considered to be crucial in shaping the market price of the Shares.

| | Date of announcement | Description of the event |
|---|---|---|
| (A) | 19 March 2019 | Announcement of annual results for the year ended 31 December 2018 |
| (B) | 23 April 2019 | Announcement of unaudited revenue for the three months ended 31 March 2019 |
| (C) | 15 July 2019 | Announcement of issue of new Shares under general mandate pursuant to the restricted Share award scheme |
| (D) | 20 August 2019 | Announcement of interim results for the six months ended 30 June 2019 |
| (E) | 22 October 2019 | Announcement of unaudited revenue for the nine months ended 30 September 2019 |
| (F) | 16 January 2020 | Announcement of profit warning |
| (G) | 17 March 2020 | Announcement of annual results for the year ended 31 December 2019 |
| (H) | 24 March 2020 | Announcement of temporary suspension of production facilities in Canada |
| (I) | 23 April 2020 | Announcement of unaudited revenue for the three months ended 31 March 2020 |
| (J) | 8 July 2020 | Publication of the Joint Announcement |
| (K) | 4 August 2020 | Announcement of interim results for the six months ended 30 June 2020 |

During the period from 1 January 2019 to the Last Trading Day, the Shares closed between HK$3.44 and HK$5.45, which had been lower than the Cancellation Price of HK$6.50.

The closing Share price saw an upward trend at the beginning of the Share Price Review Period, increasing from HK$3.60 to HK$4.84 by late February 2019. It then lost traction and was fluctuating before the publication of the announcement of unaudited revenue for the three months ended 31 March 2019 and, despite the increase in the aforesaid unaudited revenue in the first quarter of 2019, the Share price dropped gradually to around HK$4.00 in mid-May 2019. Since then, it had started to fluctuate at around HK$4.00 for a sustained period until early 2020. On 16 January 2020, the Company issued a profit warning announcement noting that the net profit of the Group for the year ended 31 December 2019 may decrease by more than 50% as compared with that for the year ended 31 December 2018, following which the Share price dropped from HK$4.65 to HK$3.93 before a notable upward trend was formed in around April 2020 and it reached the highest Share price during the Share Price Review Period (but prior to the publication of the Joint Announcement) of HK$5.45 on 29 May 2020.

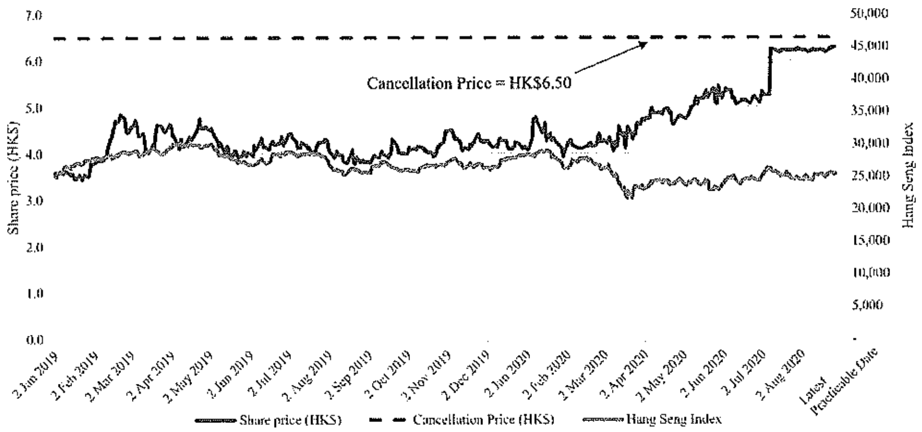
Trading of the Shares was suspended from 6 July 2020 to 8 July 2020 pending for the release of the Joint Announcement. The Shares closed at HK$6.26 on 9 July 2020 (being the first trading day after the release of the Joint Announcement), representing an increase of approximately 19.0% from the last closing price before the trading halt and a discount of approximately 3.7% to the Cancellation Price. Furthermore, it is noteworthy that the Share price had only been higher than the Cancellation Price of HK$6.50 per Scheme Share for a short period of time from mid-March 2017 to early April 2017 ever since the listing of the Shares on the Stock Exchange in 2010. As such, the Disinterested Shareholders should be aware that there can be no assurance that the Shares will trade at or above the Cancellation Price of HK$6.50 per Scheme Share in the future.

Out of the 370 trading days during the period from 1 January 2019 to the Last Trading Day (the "**Pre-Announcement Period**"), the Shares closed at all times below the Cancellation Price of HK$6.50, ranging from HK$3.44 to HK$5.45.

After the release of the Joint Announcement and up to the Latest Practicable Date, the closing price of the Shares was between HK$6.18 and HK$6.29, with an average closing price of HK$6.23. As at the Latest Practicable Date, the price of the Shares closed at HK$6.29.

*(b) Historical Share price performance compared to the Hang Seng Index*

In addition to the above, we have also compared the Share price performance with the Hang Seng Index during the Share Price Review Period.




*Source: Bloomberg and the Stock Exchange website*

We have looked at the possible impact on the Share price in relation to the Company's performance and corporate actions in the sub-section (a) above. In this sub-section, we attempted to examine the possible cause for the fluctuation of the Share price due to the change in the overall market sentiment. As set out in the graph above, we have compared the relative price performance of the Shares and the Hang Seng Index since the beginning of 2019. The Share price had been performing modestly better than the Hang Seng Index in 2019. The performance of the Share price and the Hang Seng Index saw a divergence since late January 2020 when the market crashed as a result of, among other things, the outbreak of the COVID-19 pandemic. The Hang Seng Index had plummeted while the Share price had started an upward trend, which might be potentially influenced by the build-up of market expectation on the increased demand for data usage such that optical network infrastructure would be essential to fulfill the increasing demand. Overall, the Share price performance has outperformed the Hang Seng Index during the same period albeit the worsening general market condition.

*(c) Historical Share price performance and NAV per Share compared to the Cancellation Price of HK$6.50 per Scheme Share*

A comparison of the Cancellation Price of HK$6.50 per Scheme Share with the recent closing prices of the Shares and NAV per Share is set out as follows:

| | Closing price or average closing price of the Shares or NAV per Share | Premium of Cancellation Price of HK$6.50 per Scheme Share over the closing price or average closing price of the Shares or the NAV per Share |
|---|---|---|
| Last Trading Day | HK$5.26 | 23.6% |
| 5 trading days *(Note 1)* | HK$5.21 | 24.8% |
| 10 trading days *(Note 1)* | HK$5.17 | 25.7% |
| 30 trading days *(Note 1)* | HK$5.22 | 24.5% |
| 60 trading days *(Note 1)* | HK$5.08 | 28.0% |
| 90 trading days *(Note 1)* | HK$4.84 | 34.3% |
| 120 trading days *(Note 1)* | HK$4.70 | 38.3% |
| 180 trading days *(Note 1)* | HK$4.54 | 43.2% |
| Latest Practicable Date | HK$6.29 | 3.3% |
| Audited NAV attributable to the Shareholders per Share as at 31 December 2019: | | |
| (i) Based on the total number of issued Shares as at 31 December 2019 *(Note 2)* | HK$2.84 | 128.9% |
| (ii) Based on the total number of issued Shares as at the Latest Practicable Date *(Note 2)* | HK$2.82 | 130.5% |
| Unaudited NAV attributable to the Shareholders per Share as at 30 June 2020 *(Note 2)* | HK$2.87 | 126.5% |

*Source: Bloomberg, the Stock Exchange website, the 2019 Annual Report and the Interim Results Announcement*

*Notes:*

1. Up to and including the Last Trading Day.

2. The total number of issued Shares as at 31 December 2019, 30 June 2020 and the Latest Practicable Date were 826,860,240 Shares, 834,028,240 Shares and 834,028,240 Shares respectively.

The Cancellation Price of HK$6.50 per Scheme Share represents a premium of about 23.6% to 43.2% over the closing Share price on the Last Trading Day and the average closing price of the Shares for the 5-, 10-, 30-, 60-, 90-, 120- and 180-trading day (up to and including the Last Trading Day) before the release of the Joint Announcement. The closing Share price as at the Latest Practicable Date and the corresponding premium were HK$6.29 and 3.3% respectively. We consider that the Share price as at the Latest Practicable Date and the reduced premium are affected by the Proposal.

The Cancellation Price represents a premium in the region of approximately 130% over the NAV attributable to the Shareholders per Share as at 31 December 2019 and approximately 127% over the NAV attributable to the Shareholders per Share as at 30 June 2020.

*(d) Trading liquidity of the Shares*

Set out in the table below are the monthly total trading volume of the Shares and the percentages of such monthly total trading volume to the total issued Shares and the Shares held by the Disinterested Shareholders in the Share Price Review Period:

| | Monthly total trading volume of the Shares | Percentage of the monthly total trading volume of the Shares to the total issued Shares *(Note 1)* | Percentage of the monthly total trading volume to the Shares held by the Disinterested Shareholders *(Note 2)* |
|---|---|---|---|
| **2019** | | | |
| January | 23,543,503 | 2.8% | 6.3% |
| February | 43,309,355 | 5.2% | 11.6% |
| March | 30,825,075 | 3.7% | 8.3% |
| April | 39,535,746 | 4.7% | 10.6% |
| May | 19,049,951 | 2.3% | 5.1% |
| June | 10,033,053 | 1.2% | 2.7% |
| July | 19,369,362 | 2.3% | 5.2% |
| August | 24,082,517 | 2.9% | 6.5% |
| September | 24,271,974 | 2.9% | 6.5% |
| October | 22,552,535 | 2.7% | 6.1% |
| November | 31,253,006 | 3.7% | 8.4% |
| December | 13,502,499 | 1.6% | 3.6% |
| **2020** | | | |
| January | 46,005,502 | 5.5% | 12.4% |
| February | 21,139,554 | 2.5% | 5.7% |
| March | 56,814,124 | 6.8% | 15.3% |
| April | 50,199,106 | 6.0% | 13.5% |
| May | 59,501,912 | 7.1% | 16.0% |
| June | 43,749,160 | 5.2% | 11.7% |
| July *(Note 3)* | 156,153,868 | 18.7% | 41.9% |
| From 1 August 2020 up to and including the Latest Practicable Date | 44,938,550 | 5.4% | 12.1% |

*Source: Bloomberg and the Stock Exchange website*

*Notes:*

1. The calculation is based on the monthly total trading volume of the Shares divided by the total issued Shares of 834,028,240 as at Latest Practicable Date.

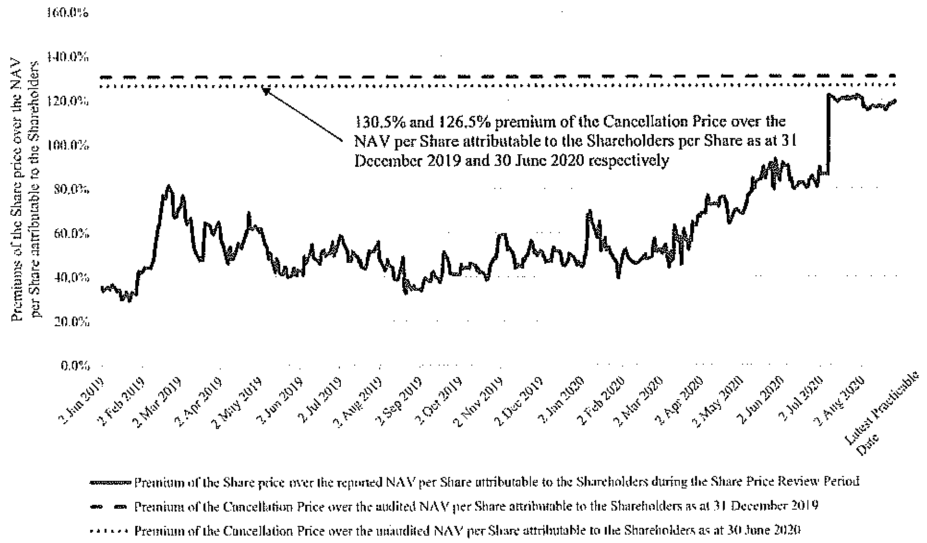
2. The calculation is based on the monthly total trading volume of the Shares divided by the total number of Shares of 834,028,240 as at the Latest Practicable Date after subtracting the total number of Shares of 461,620,070 held by the Offeror and Offeror Concert Parties.

3. Trading in the Shares was suspended from 6 July 2020 to 8 July 2020 pending the release of the Joint Announcement.

Based on the above table, we are of the view that the liquidity of the Shares was generally low during the Share Price Review Period save for the surges in trading volume (i) during the first half of 2020 (except for February 2020) which was generally in line with the increase in turnover of the Hong Kong stock market; and (ii) in July and August 2020 following the release of the Joint Announcement. As the Shares cannot be regarded as having been actively traded, the Proposal provides an exit opportunity for the Scheme Shareholders who would like to realise their investments in the Shares at a fixed cash price (i.e. the Cancellation Price).

(e) *Premium of the Share price over the NAV per Share*

The Cancellation Price of HK$6.50 per Scheme Share represents a premium of approximately 130.5% and 126.5% over the NAV attributable to the Shareholders per Share of approximately HK$2.82 and approximately HK$2.87 as at 31 December 2019 and 30 June 2020 respectively (calculated based on a total of 834,028,240 Shares in issue as at the Latest Practicable Date). We have reviewed the premiums of the Share price over the NAV attributable to the Shareholders per Share (based on the interim and annual results announcements and the monthly returns of the Company) during the Share Price Review Period, which are set out in the following:



As set out in the chart above, the Shares have been trading at premiums over NAV attributable to the Shareholders per Share throughout the Share Price Review Period, ranging from approximately 29.2% to approximately 93.3% during the Pre-Announcement Period and the premium further increased to approximately 122.0% and 118.1% based on the NAV attributable to the Shareholders as at 31 December 2019 and 30 June 2020 respectively on the trading day after the publication of the Joint Announcement. Based on the Cancellation Price of HK$6.50 and the NAV attributable to the Shareholders per Share of approximately HK$2.82 and HK$2.87 as at 31 December 2019 and 30 June 2020 respectively, the Cancellation Price represents premiums of approximately 130.5% and 126.5% respectively, which are significantly higher than the range of that during the Pre-Announcement Period.

## 5. Comparable Companies analysis

The Group is principally engaged in the design, manufacture and sales of optical networking products and machine vision systems and sensors. As mentioned above, since manufacture and sales of optical networking products accounted for in the region of approximately 85% of the Group's total revenue, therefore, we have reviewed and identified companies listed on the mainboard of the Stock Exchange engaging in and having majority of their revenue derived from manufacture and sales of optical networking products (the "**Comparable Companies**"). We consider the Comparable Companies to be exhaustive based on the selection criteria as set out above and, in general, would serve as a fair and representative sample for the purpose of drawing a meaningful comparison to the Cancellation Price. Details of the Comparable Companies are set out below:

| Company (Stock code) | Principal activities | Market capitalisation as at the Latest Practicable Date *(HK$ million)* | Price-to-earnings ratio ("PER") *(times)* *(Note 1)* | Price-to-book ratio ("PBR") *(times)* *(Note 2)* | Dividend yield *(%)* *(Note 3)* |
|---|---|---|---|---|---|
| Yangtze Optical Fibre and Cable Joint Stock Limited Company (6869) | It is principally engaged in the manufacture and sales of optical fiber preforms, optical fibers and optical fiber cables. | 10,519.7 | 15.1 | 1.1 | 2.5% |

| Company (Stock code) | Principal activities | Market capitalisation as at the Latest Practicable Date *(HK$ million)* | Price-to-earnings ratio ("PER") *(times)* *(Note 1)* | Price-to-book ratio ("PBR") *(times)* *(Note 2)* | Dividend yield *(%)* *(Note 3)* |
|---|---|---|---|---|---|
| The Company (877) | The Company is principally engaged in the design, manufacture and sales of optical networking products and machine vision systems and sensors. | 4,387.0 *(Note 4)* | 56.9 | 1.8 | 0.0% |
| Trigiant Group Limited (1300) | It is principally engaged in the manufacture and sales of feeder cable and related products for mobile communications and telecommunication equipment. | 1,612.4 | Not applicable *(Note 5)* | 0.4 | 0.0% |
| Nanfang Communication Holdings Limited (1617) | It is principally engaged in manufacturing and selling a range of optical fiber cable products. | 1,444.8 | 38.4 | 1.6 | 3.0% |
| | | Average | 36.8 | 1.2 | 1.4% |
| | | Median | 38.4 | 1.4 | 1.3% |
| | | Maximum | 56.9 | 1.8 | 3.0% |
| | | Minimum | 15.1 | 0.4 | 0.0% |
| **The Cancellation Price** | | | 70.4 *(Note 6)* | 2.3 *(Note 7)* | 0.0% *(Note 8)* |

*Source:* *Bloomberg, the website of the Stock Exchange, annual reports and interim results announcements of the Comparable Companies*

*Notes:*

1. The PERs of the Comparable Companies are calculated based on the market capitalisation of the respective Comparable Companies as at the Latest Practicable Date (except for the Company, which is based on the closing price of HK$5.26 as at the Last Trading Day) divided by the earnings of the respective Comparable Companies for the trailing 12 months based on their most recently published annual reports and interim results announcements.

2. The PBRs of the Comparable Companies are calculated based on the market capitalisation of the respective Comparable Companies as at the Latest Practicable Date (except for the Company, which is based on the closing price of HK$5.26 as at the Last Trading Day) divided by the NAV attributable to the shareholders of the relevant Comparable Companies based on their most recently published annual reports or interim results announcements.

3. The dividend yields of the Comparable Companies are calculated based on the total dividends per share but excluding special dividend (if any) declared by the relevant Comparable Companies in the past twelve months prior to the Latest Practicable Date divided by the share price of the relevant Comparable Companies as at the Latest Practicable Date (except for the Company, which is calculated using the closing price of HK$5.26 as at the Last Trading Day).

4. Market capitalisation of the Company is calculated as the closing price of HK$5.26 as at the Last Trading Day multiplies by the number of Shares in issue at the Latest Practicable Date.

5. Since Trigiant Group Limited recorded a loss attributable to its shareholders during the trailing 12 months, its PER is not applicable.

6. The implied PER of the Cancellation Price is calculated based on the Cancellation Price of HK$6.50 per Scheme Share divided by the earnings per Share for the trailing 12 months based on the Company's most recently published annual report and interim results announcement.

7. The implied PBR of the Cancellation Price is calculated based on the Cancellation Price of HK$6.50 per Scheme Share divided by the NAV attributable to the Shareholders per Share as referenced from the Company's most recently published interim results announcement.

8. The implied dividend yield of the Cancellation Price is calculated as the total dividends per share but excluding special dividend (if any) declared by the Company in the past twelve months prior to the Latest Practicable Date divided by the Cancellation Price of HK$6.50 per Scheme Share.

*(a) Comparison of the PERs*

As shown in the table above, the implied PER of the Cancellation Price of approximately 70.4 times is higher than the range of the PERs of the Comparable Companies from approximately 15.1 times to approximately 56.9 times and it is higher than both the average and median of the PERs of the Comparable Companies of approximately 36.8 times and approximately 38.4 times respectively.

*(b) Comparison of the PBRs*

As shown in the table above, the implied PBR of the Cancellation Price of approximately 2.3 times is higher than the range of the PBRs of the Comparable Companies from approximately 0.4 times to approximately 1.8 times and it is higher than the average and median of the PBRs of the Comparable Companies of approximately 1.2 times and approximately 1.4 times respectively.

*(c) Comparison of dividend yields*

As shown in the table above, since the Company had not declared any dividend in the past 12 months, the implied dividend yield of the Cancellation Price is 0.0%, which is at the bottom end of the range of the dividend yields of the Comparable Companies which ranged from 0.0% to approximately 3.0%.

**6. Privatisation Precedents**

We have compared the Proposal with privatisation proposals of other companies listed on the Main Board of the Stock Exchange announced since 1 January 2017 and up to the Latest Practicable Date, excluding privatisation proposals which were not or are yet to be approved (or, where applicable, required acceptance level were not or yet to be achieved) or without a pure cash cancellation consideration (the "**Privatisation Precedents**"), which represent an exhaustive list of privatisation proposals we were able to identify from the Stock Exchange's website satisfying the above selection criteria. We selected the Privatisation Precedents in a period of over three years, which is considered sufficient to reflect the pricings of successful privatisation proposals across different business cycles. The Privatisation Precedents were conducted by way of scheme of arrangement or general offer with a view to privatise the relevant company and therefore the Privatisation Precedents are, in our view, comparable to the Proposal. The table below illustrates the premiums or discounts represented by the offer or cancellation consideration over or to the respective last trading day, 10-, 30-, 60-, 90- and 180-trading day (up to and including the last trading day) average share prices and latest NAV per share in respect of such privatisation proposals, respectively. The Privatisation Precedents set out below provide, in our view, a comparison between the cancellation price and the then prevailing market prices and NAV per share of successful privatisation proposals, although the business nature and scale of each company vary and some aspects of pricing may be industry-specific.

**Premium/(Discount) of offer or cancellation price over/(to) the average share price and NAV per share prior to the announcement of privatisation proposal**

| Date of initial announcement | Company (Stock code) | Last trading day[1] (%) | 10 trading days[1] (%) | 30 trading days[1] (%) | 60 trading days[1] (%) | 90 trading days[1] (%) | 180 trading days[1] (%) | Premium/ (Discount) of NAV per share[1][2] (%) |
|---|---|---|---|---|---|---|---|---|
| 21-Jun-20 | China Baofeng (International) Limited (3966) | 27.5 | 61.9 | 52.3 | 42.5 | 38.9 | 30.7 | (5.5) |
| 20-Apr-20 | Allied Properties (H.K.) Limited (56) | 34.3 | 40.2 | 39.1 | 33.3 | 29.7 | 23.1 | (66.3) |
| 3-Apr-20 | Elec & Eltek International Company Limited (1151) | 70.5 | 46.8 | 41.5 | 41.1 | 45.0 | 54.4 | 3.1 |
| 20-Mar-20 | Li & Fung Limited (494) | 150.0 | 135.9 | 95.2 | 72.7 | 62.1 | 43.8 | 8.2 |
| 20-Jan-20 | BBI Life Sciences Corporation (1035) | 16.3 | 31.4 | 42.5 | 46.1 | 47.9 | 56.7 | 98.9 |
| 12-Dec-19 | Joyce Boutique Group Limited (647) | 91.8 | 100.0 | 82.2 | 62.7 | 47.4 | 32.2 | 19.9 |
| 27-Nov-19 | China Agri-Industries Holdings Limited (606) | 34.1 | 40.9 | 53.2 | 64.7 | 72.5 | 70.0 | (22.8) |
| 1-Nov-19 | Springland International Holdings Limited (1700) | 63.1 | 64.4 | 56.8 | 55.4 | 53.3 | 48.6 | (18.1) |
| 20-Oct-19 | Dah Chong Hong Holdings Limited (1828) | 37.6 | 42.3 | 54.8 | 56.1 | 54.2 | 41.2 | (28.2) |
| 2-Oct-19 | AVIC International Holdings Limited (161) | 29.1 | 58.1 | 81.3 | 88.6 | 100.0 | 92.1 | 18.4 |
| 2-Sept-19 [3] | Huaneng Renewables Corporation Limited (958) | 46.1 | 56.2 | 55.4 | 51.0 | 51.0 | 45.4 | (4.5) |
| 12-Aug-19 | TPV Technology Limited (903) | 41.4 | 50.8 | 54.5 | 74.7 | 87.4 | 138.8 | (24.8) |
| 27-Jun-19 | Asia Satellite Telecommunications Holdings Ltd. (1135) | 23.4 | 33.4 | 44.4 | 50.4 | 56.5 | 71.0 | 10.0 |
| 18-Jun-19 | C.P. Lotus Corporation (121) | 10.0 | 12.0 | 29.4 | 30.3 | 26.5 | 21.9 | 57.1 |
| 3-May-19 [3] | China Automation Group Limited (569) | 24.0 | 36.4 | 47.1 | 47.1 | 47.1 | 42.9 | 27.9 |
| 4-Apr-19 | China Hengshi Foundation Company Ltd. (1197) | 10.6 | 16.8 | 17.4 | 19.1 | 24.4 | 27.6 | 42.1 |

| Date of initial announcement | Company (Stock code) | Last trading day[1] (%) | 10 trading days[1] (%) | 30 trading days[1] (%) | 60 trading days[1] (%) | 90 trading days[1] (%) | 180 trading days[1] (%) | Premium/ (Discount) of NAV per share[1][2] (%) |
|---|---|---|---|---|---|---|---|---|
| 28-Mar-19 | China Power Clean Energy Development Company Ltd. (735) | 41.9 | 60.8 | 78.1 | 94.0 | 101.9 | 88.6 | (35.1) |
| 5-Dec-18 | Hopewell Holdings Limited (54) | 46.7 | 51.6 | 55.5 | 54.1 | 49.6 | 43.7 | (35.6) |
| 30-Oct-18 | Advanced Semiconductor Manufacturing Corporation Limited (3355) | 66.7 | 97.4 | 100.0 | 92.3 | 89.9 | 85.2 | 89.9 |
| 27-Sep-18 | Sinotrans Shipping Ltd. (368) | 50.0 | 54.3 | 42.9 | 37.8 | 32.4 | 28.0 | (25.2) |
| 10-Jun-18 | Hong Kong Aircraft Engineering Company Limited (44) | 63.2 | 65.1 | 62.4 | 60.3 | 57.0 | 50.0 | 99.3 |
| 7-Jun-18 | Portico International Holdings Ltd. (589) | 50.2 | 53.0 | 49.1 | 45.4 | 45.9 | 49.6 | (9.9) |
| 10-Nov-17 | Welling Holding Ltd. (382) | 30.4 | 30.4 | 33.8 | 35.5 | 28.8 | 22.6 | 22.6 |
| 3-Jul-17 | China Assets (Holdings) Limited (170) | 61.5 | 73.9 | 76.6 | 77.1 | 76.6 | 73.9 | (53.8) |
| 19-Jun-17 | Bloomage BioTechnology Corporation Limited (963) | 14.0 | 23.4 | 24.4 | 30.3 | 33.7 | 32.5 | 215.3 |
| 29-May-17 | China Metal International Holdings Inc. (319) | 27.5 | 26.5 | 25.9 | 22.9 | 24.4 | 18.5 | 27.5 |
| 28-Apr-17 | Belle International Holdings Ltd. (1880) | 19.5 | 23.5 | 21.4 | 23.1 | 28.3 | 26.5 | 75.5 |
| 20-Apr-17 | TCC International Holdings Limited (1136) | 38.5 | 42.9 | 51.3 | 66.7 | 76.5 | 88.5 | (4.0) |
| 29-Mar-17 | Goldin Properties Holdings Limited (283) | 14.2 | 31.4 | 33.7 | 31.4 | 33.3 | 44.0 | 101.3 |
| 7-Mar-17 | Yingde Gases Group Company Limited (2168) | (3.5) | 8.1 | 20.0 | 45.6 | 57.1 | 74.9 | 46.7 |
| 10-Jan-17 | Intime Retail (Group) Company Limited (1833) | 42.3 | 47.9 | 51.8 | 53.6 | 52.7 | 53.6 | 60.9 |

| Date of initial announcement | Company (Stock code) | Last trading day[1] (%) | 10 trading days[1] (%) | 30 trading days[1] (%) | 60 trading days[1] (%) | 90 trading days[1] (%) | 180 trading days[1] (%) | Premium/ (Discount) of NAV per share[1][2] (%) |
|---|---|---|---|---|---|---|---|---|
| | Average | 41.1 | 49.0 | 50.8 | 51.8 | 52.6 | 52.3 | 22.3 |
| | Maximum | 150.0 | 135.9 | 100.0 | 94.0 | 101.9 | 138.3 | 215.3 |
| | Minimum | (3.5) | 8.1 | 17.4 | 19.1 | 24.4 | 18.5 | (66.3) |
| Cancellation Price | HK$6.50 per Scheme Share | 23.6 | 25.7 | 24.6 | 28.0 | 34.3 | 43.2 | 126.5[4] |

*Source:* *Bloomberg and the Stock Exchange website*

*Notes:*

1. Unless otherwise stated, the above percentages are calculated based on the closing share price on or up to and including the last trading day prior to the publication of the Rule 3.5 announcement or Rule 3.7 announcement (where applicable) and they are subject to round differences.

2. It represents the premium/(discount) of offer or cancellation price over or (to) the NAV per share quoted from the respective privatisation documents without taking into account any adjustments arising from, amongst other, revaluation of properties set out therein.

3. Date of Rule 3.7 announcement.

4. Premium of the Cancellation Price over the NAV attributable to Shareholders per Share of approximately HK$2.87 as at 30 June 2020 was approximately 126.5%.

*(a) Premiums over the prevailing share price*

The premiums/(discount) of the above Privatisation Precedents ranged from (3.5)% to 150.0%, 8.1% to 135.9%, 17.4% to 100.0%, 19.1% to 9.4%, 24.4% to 101.9% and 18.5% to 138.3% over/(to) their respective average share prices on/over last trading day, 10-, 30-, 60-, 90- and 180-trading day (up to and including the last trading day) with average premiums of 41.1%, 49.0%, 50.8%, 51.8%, 52.6% and 52.3%, respectively.

The premiums offered by the Cancellation Price over the Last Trading Day, 10-, 30-, 60-, 90- and 180-trading day (up to and including the Last Trading Day) average Share price are 23.6%, 25.7%, 24.6%, 28.0%, 34.3% and 43.2%, respectively. Although the aforesaid premiums are lower than the respective average premiums but they are within the range of the respective premiums represented by the Privatisation Precedents.

*(b) Discount to the NAV per Share*

The Cancellation Price of HK$6.50 per Scheme Share represents premiums of approximately 130.5% and 126.5% over the NAV per Share of approximately HK$2.82 and approximately HK$2.87 as at 31 December 2019 and 30 June 2020 respectively.

From the Privatisation Precedents, we have observed a wide range of the cancellation consideration as compared with the respective NAV ranging from a discount of 66.3% to a premium of 215.3%. Out of the 31 Privatisation Precedents, the cancellation consideration in 18 cases represent premiums ranging from 3.1% to 215.3% over the respective NAV per share and 13 cases represent a discount ranging from 4.0% to 66.3% to the respective NAV per share.

## V. DISCUSSION AND ANALYSIS

In forming our opinion and recommendation below, we have taken into account the factors set out under the section headed "Principal factors and reasons considered" above as a whole. We would like to draw the attention of the Scheme Shareholders in particular to the points summarised below:

### (1) Premium over market price

The realisable value of the Shareholders' investment in the Company depends on the Share price, particularly when the Company has paid little or no dividend in recent years. One of the most important factors when assessing the fairness of the Cancellation Price has been the premium of the Cancellation Price over recent Share prices, which is substantial. The Cancellation Price is higher than the closing Share prices in all trading days during the Share Price Review Period of over one and a half year. Based on the discussion as set out in the section headed "*4. Analysis of Share price – (c) Historical Share price performance and NAV per Share compared to the Cancellation Price of HK$6.50 per Scheme Share*" above, the Cancellation Price compares favourably to the closing Share prices, with a range of premium of approximately 23.6% to 43.2% over different periods before the Last Trading Day. Furthermore, based on our review the Share price performance since the listing of the Shares on the Stock Exchange in 2010, it is noteworthy that the Share price had only been higher than the Cancellation Price of HK$6.50 per Scheme Share for a short period of time in 2017.

The Proposal is to be implemented at the Cancellation Price of HK$6.50 per Scheme Share in cash. The Company will not increase the Cancellation Price for the Proposal and does not reserve the right to increase the Cancellation Price. If the Proposal fails, the Company cannot in normal circumstances put forward another such proposal for at least twelve months.

**(2) Declining financial performance**

The Group is principally engaged in the design, manufacturing and sales of optical networking products for the high-speed telecommunications and data communications systems as well as machine vision systems and sensors for smart manufacturing market. The operations of the Group consist of two major businesses, namely the Optical Networking Business and the Industrial and Sensing Businesses. The Optical Networking Business is the core business of the Group as it accounted for a significant majority of the Group's revenue in the recent past.

The financial performance of the Group has been satisfactory and the revenue of the Group has grown by over 20% each year until 2018. However, the revenue has only increased by approximately 2.6% for the year ended 31 December 2019 as the largest customer of the Group experienced a reduced market share among telecommunication operators. Furthermore, the gross margin of the Group squeezed in 2019 to approximately 29.1%, which was below the 30-plus percentages achieved in prior years, as a result of, among other things, the drop of gross profit of EDFA in the Optical Networking Business due to the lower demand and weak demand in certain segments of the Industrial and Sensing Businesses. Coupled with escalated costs for selling and marketing, R&D as well as administration, the net profit of the Group attributable to the Shareholders has slashed by over one half to approximately HK$117.4 million for the year ended 31 December 2019 as compared to that in prior year. The net profit margin, being the net profit attributable to the Shareholders divided by revenue, has alarmingly declined to only 4.5% for the year ended 31 December 2019, as compared with that of over 10% for the years ended 31 December 2018 and 2017.

The financial performance for the six months ended 30 June 2020 continued in a downward trend with the net profit attributable to the Shareholders slashed by almost half to approximately HK$42.8 million from approximately HK$83.1 million for the corresponding period in 2019. The significant decline was mainly due to higher cost of sales arising from, among other things, disruption of industry supply chains triggered by the outbreak of the COVID-19 pandemic. As a result, both the gross profit margin and the net profit margin for the first half of 2020 squeezed to approximately 25.0% and approximately 2.9% respectively, representing considerable decreases as compared to those of approximately 29.5% and approximately 5.9% for the corresponding period in 2019.

**(3) Industry outlook remains challenging**

Given the historical rising trend of the global data usage and the potential increases in both the number of internet users and the amount of data created per user, there is no doubt that the global demand for data transmission and hence the demand for the optical communication products will grow in long run.

Having said that, there are a number of challenges in the operating environment of the Group in the short and medium term. In particular, the largest customer of the Group saw a shrinking market share in the industry since the second half of 2019 and a key Chinese customer of the Group also faced setback in their business after the ban from participating in the development of the 5G telecommunication network in certain important overseas markets including the United States and the United Kingdom. Also, the Company's overseas markets are also susceptible to similar trade tensions depending on the future evolution of China US dynamics in trade as well as other aspects. Furthermore, the outbreak of the COVID-19 pandemic has resulted in significant economic contraction worldwide and the uncertain economic outlook might hinder the commitment in capital expenditure among global telecommunication operators. Moreover, the pandemic caused supply shock in the industry where the Group operates as some of the raw materials were less accessible to the Group. Last but not least, higher production cost is expected in respond to the precautionary measures for labour force protection. All the aforesaid factors may eventually have a negative impact on the financial performance of the Group in short and medium term of the future. Accordingly, there remains a significant uncertainty on the prospect of the Group in the short and medium term.

**(4) The Scheme presents a good opportunity to realise the Shares given the low trading volume**

Since the beginning of 2019 and up to the release of the Joint Announcement, we are of the view that the liquidity of the Shares was generally low. There were surges in trading volume recorded during (i) the first half of 2020 (except for February 2020) which was generally in line with the increase in turnover of the Hong Kong stock market; and (ii) in July 2020 following the release of the Joint Announcement. Otherwise, we are however of the view that the Shares cannot be regarded as having been actively traded. Accordingly, the Proposal provides an exit opportunity for the Scheme Shareholders (especially those with relatively sizeable shareholdings) who would like to realise their investments in the Shares at a fixed cash price without disturbing the market price.

**(5) The Cancellation Price represents a premium over NAV per Share and it is higher than the historical premium during the Share Price Review Period**

The Cancellation Price represents premiums of approximately 130.5% and 126.5% over the NAV per Share of HK$2.82 and HK$2.87 as at 31 December 2019 and 30 June 2020 respectively. Such premiums have been consistently higher than the premiums over NAV attributable to the Shareholders per Share, ranging from approximately 29.2% to approximately 93.5% during the Pre-Announcement Period. The premium of the closing Share price over the NAV per Share narrowed after the Company issued the Joint Announcement, in our view, may not be sustainable at the current level if the Proposal and the Scheme lapse.

(6) **Cross check against the Comparable Companies**

The Cancellation Price of HK$6.50 per Scheme Share represents a PER of 70.4 times (based on the net profit attributable to the Shareholders for the trailing 12 months), which is higher than both the average and median of that of the four Comparable Companies of approximately 36.8 times and 38.4 times as at the Latest Practicable Date. Similarly, the implied PBR of the Cancellation Price of approximately 2.3 times is higher than the range of the PBRs of the Comparable Companies from approximately 0.4 times to approximately 1.8 times and the average and median of the PBRs of the Comparable Companies of approximately 1.2 times and approximately 1.4 times respectively. Both ratios indicate that the Cancellation Price compares favourably against pricing of the Comparable Companies in general.

The Company has paid dividend only once in the last few years. As the Company had not paid any dividend in the last twelve months, the dividend yield implied by the Cancellation Price was nil, as compared to the average of the Comparable Companies of approximately 1.4%. On this basis, the Disinterested Shareholders may, if they wish, reinvest the proceeds from the Proposal in the Comparable Companies or other listed Hong Kong companies to achieve a higher yield.

(7) **Privatisation Precedents**

The premiums offered by the Cancellation Price over the Last Trading Day and the 10-, 30-, 60-, 90- and 180-trading day (up to and including the Last Trading Day) average Share price are 23.6%, 25.7%, 24.6%, 28.0%, 34.3% and 43.2%, respectively. These premiums are lower than the respective average premiums, which may due to the surge of the Share price in the last few months prior to the Joint Announcement. Nevertheless, the aforesaid premiums offered by the Cancellation Price are still within the range of the premiums of the Privatisation Precedents, which represent all privatisation proposals approved or accepted by the independent shareholders of the relevant company.

The Cancellation Price of HK$6.50 per Scheme Share represents a premium of approximately 130.5% and 126.5% over the NAV per Share as at 31 December 2019 and 30 June 2020 of approximately HK$2.82 and approximately HK$2.87. The Privatisation Precedents show a very wide range, from a discount of approximately 66.3% to a premium of approximately 215.3% over NAV per share. The wide range of premiums over and discounts to the NAV per share across the Privatisation Precedents as mentioned above, in our view, suggests that no concrete conclusion can be drawn from the comparison between their cancellation price and their respective NAV per share. In addition, none of the Privatisation Precedents engaged in the same business as those of the Group. Hence, the comparison of cancellation consideration to the NAV in the Privatisation Precedents, in our view, may not be of immediate relevance to our analysis.

## VI. OPINION AND RECOMMENDATION

Based on the above analysis, we consider the terms of the Proposal and the Scheme to be fair and reasonable so far as the Disinterested Shareholders are concerned and advise the Independent Board Committee to recommend the Disinterested Shareholders to vote in favour of the relevant resolutions to be proposed at the Court Meeting and the EGM to approve and implement the Proposal and the Scheme.

The closing Share price at the Latest Practicable Date was HK$6.29 per Share, below the Cancellation Price of HK$6.50 per Scheme Share. However, there is still a possibility, not in our view likely, that the Share price may exceed the Cancellation Price in the period up to 5 October 2020, being the expected last day for trading in the Shares on the Stock Exchange. Accordingly, the Disinterested Shareholders are reminded to monitor the trading price and liquidity of the Shares during this period and, having regard to their own circumstances, consider selling their Shares in the open market, if the net proceeds obtained from such disposal of the Shares (after deducting all transaction costs) would be higher than the net proceeds expected to be received under the Scheme.

Yours faithfully,
for and on behalf of
**SOMERLEY CAPITAL LIMITED**

**Danny Cheng**
*Director*

*Mr. Danny Cheng is a licensed person registered with the SFC and a responsible officer of Somerley Capital Limited, who is licensed under the SFO to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities. He has over 15 years of experience in the corporate finance industry.*