



PELICAN FINANCIAL LIMITED

15/F, East Exchange Tower, 38-40 Leighton Road, Causeway Bay, Hong Kong

2 December 2020

*To the Independent Board Committee and the Independent Shareholders of
Forgame Holdings Limited*

Dear Sirs,

**(I) MAJOR AND CONNECTED TRANSACTION
INVOLVING OFF-MARKET SHARE BUY-BACK
AND
(II) SPECIAL DEAL RELATING TO LOAN ASSIGNMENT**

INTRODUCTION

We refer to our appointment as the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders in respect of the terms of the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment, with the Loan Assignment constituting a special deal in accordance with Rule 25 of the Takeovers Code), details of which are set out in the letter from the Board (the “**Board Letter**”) contained in the circular of the Company dated 2 December 2020 (the “**Circular**”), of which this letter forms a part. Terms used in this letter shall have the same meanings as those defined in the Circular unless the context requires otherwise.

With reference to the Board Letter, on 12 November 2020 (after trading hours), among others, the Company, the Investor, Beijing Xigua, Shanghai Dacheng, the KongZhong Group and Guangzhou Feidong entered into the Transfer Agreement, pursuant to which: (i) the Company shall dispose of the 69.84% equity interest in Beijing Xigua to KongZhong China (or its designated third party) (i.e. the Equity Disposal) and the Consideration Shares shall be transferred from Shanghai Dacheng through the Escrow Agent to the Company (i.e. the Share Buy-back); and (ii) the Company shall assign the Outstanding Sum to KongZhong China (or its designated third party) originally due to Guangzhou Feidong (i.e. the Loan Assignment).

Upon Completion, pursuant to the Share Buy-back, the Consideration Shares will be cancelled and the number of Shares in issue following the Share Buy-back will be reduced from 159,379,238 (being the number of issued Shares as at the Latest Practicable Date) to 137,110,330 and the shareholding interest of the Shareholders will be increased proportionally. The percentage interest in the issued Shares of all other Shareholders including KongZhong (whose percentage interest in the issued Shares will increase from approximately 6.40% to 7.44%), will be proportionally increased following the Share Buy-back as a result of the reduction in the number of issued Shares. Meanwhile, Shanghai Dacheng will no longer hold any Shares upon the Completion.

As one or more of the applicable percentage ratios in respect of the Transfer exceed 25% but is less than 75%, the Transfer constitutes a major transaction of the Company under Chapter 14 of the Listing Rules. As at the Latest Practicable Date, (i) Beijing Xigua is a non-wholly owned subsidiary of the Company; (ii) Shanghai Dacheng is interested in 22,268,908 Consideration Shares being held in an account managed by the Escrow Agent, representing approximately 13.97% of the issued share capital of the Company; and (iii) the KongZhong Group is interested in 10,202,168 Shares, representing approximately 6.40% of the issued share capital of the Company. Accordingly, each of Beijing Xigua, Shanghai Dacheng and the KongZhong Group is a connected person of the Company, and the Transfer therefore constitutes a connected transaction for the Company and is subject to the reporting, announcement, circular and Independent Shareholders' approval requirements under Chapters 14 and 14A of the Listing Rules.

The Share Buy-back constitutes an off-market share buy-back by the Company under the Share Buy-back Code. The Company has made an application to the Executive for approval of the Share Buy-back pursuant to Rule 2 of the Share Buy-back Code. The Executive's approval, if granted, will normally be conditional upon, among other things, the approval of the Share Buy-back by at least three-fourths of the votes cast on a poll by the Independent Shareholders present in person or by proxy at the EGM.

The Board currently comprises three executive Directors, one non-executive Director and four independent non-executive Directors. The Listing Rules IBC, which currently comprises all the independent non-executive Directors, Mr. WANG Dong, Mr. WONG Chi Kin, Mr. CUI Yuzhi and Mr. LU Xiaoma, and the Takeovers Code IBC, which currently comprises all the aforementioned independent non-executive Directors and the non-executive Director Mr. ZHANG Qiang, have been established to advise the Independent Shareholders as to the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment). We have been appointed by the Company as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in this respect and such appointment has been approved by the Independent Board Committee.

We are not connected with the Directors, chief executive or substantial Shareholders of the Company or any of their respective associates and also there is no relationships or interests with the Company or any other parties that could reasonably be regarded as relevant to our independence to act as independent financial adviser to the Company and therefore we considered that we are suitable to give independent advice to the Independent Board

Committee and the Independent Shareholders. In the last two years, there was no other engagement between the Company and us. Apart from normal professional fees payable to us in connection with this appointment, no arrangement exists whereby we will receive any fees or benefits from the Company or the Directors, chief executive or substantial Shareholders of the Company or any of their respective associates.

Our role is to provide you with our independent opinion and recommendation as to (i) whether the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment, with the Loan Assignment constituting a special deal in accordance with Rule 25 of the Takeovers Code) are fair and reasonable, in the ordinary and usual course of business of the Group, on normal commercial terms and in the interests of the Company and the Independent Shareholders as a whole; and (ii) how the Independent Shareholders should vote in respect of the resolution to be proposed at the EGM to approve the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment).

BASIS OF OUR OPINION

In formulating our opinion to the Independent Board Committee and the Independent Shareholders, we have performed relevant procedures and those steps which we deemed necessary in forming our opinions. Our procedures include, among other things, review of relevant agreements, documents as well as information provided by the Company and verification of such information, to an extent, to the relevant public information, statistics and market data, the relevant industry guidelines and rules and regulations as well as information, facts and representations provided, and the opinions expressed, by the Company and/or the Directors and/or the management of the Group. The documents reviewed include, but are not limited to, the Investment Agreement, the Transfer Agreement, the 2019 Annual Report, the 2020 Interim Report, the Announcements and the Circular. We have assumed that all statements of belief, opinion, expectation, and intention made by the Directors in the Circular were reasonably made after due enquiry and careful consideration. We have no reason to suspect that any material facts or information have been withheld or to doubt the truth, accuracy and completeness of the information and facts contained in the Circular, or the reasonableness of the opinions expressed by the Company, its management and/or the Directors, which have been provided to us.

The Directors jointly and severally accept full responsibility for the accuracy of the information contained in the Circular and confirm, having made all reasonable enquiries, that to the best of their knowledge, opinions expressed in the Circular have been arrived at after due and careful consideration and there are no other facts not contained in the Circular, the omission of which would make any statement in the Circular misleading.

We consider that we have been provided with sufficient information to reach an informed view and to provide a reasonable basis for our opinion. We have not, however, conducted any independent verification of the information included in the Circular and provided to us by the Directors and the management of the Group nor have we conducted any form of an in-depth investigation into the business and affairs or the future prospects of the Group.

PRINCIPAL FACTORS TAKEN INTO CONSIDERATION

In formulating our opinion in respect of the terms of the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment, with the Loan Assignment constituting a special deal in accordance with Rule 25 of the Takeovers Code), we have considered the following principal factors and reasons:

1. Background information of the Group, Beijing Xigua, the KongZhong Group and Shanghai Dacheng

(a) *The Group*

The Company is an investment holding company. The Group is principally engaged in developing and publishing domestic and overseas webgames and mobile games as well as offering virtual reality game in physical stores (the “**Game Business**”) and providing internet micro-credit service (the “**Internet Micro-credit Business**”) in the PRC.

The Investor, the subscriber of the 69.84% equity interest in Beijing Xigua under the Investment Agreement, is a direct wholly-owned subsidiary of the Company and a company established under the laws of the PRC with limited liability. It is principally engaged in the development of software and design of game software.

Guangzhou Feidong, the lender of a loan to Beijing Xigua under the Loan Agreement, is an indirectly wholly-owned subsidiary of the Company. It is principally engaged in the development of webgames.

Set out below is a summary of the financial information of the Group for the two financial years ended 31 December 2019 and the six months ended 30 June 2019 and 2020, as extracted from the 2019 Annual Report and the 2020 Interim Report, respectively.

	For the six months ended 30 June		For the financial year ended 31 December	
	2020	2019	2019	2018
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
	(Unaudited)	(Unaudited)	(Audited)	(Audited)
				(Restated)
<i>Revenue</i>				
The Game Business	22,294	37,358	83,578	90,886
The Internet Micro-credit Business	6,633	16,084	40,701	38,554
Total Revenue	28,927	53,442	124,279	129,440
 Gross Profit	 9,402	 35,444	 30,417	 81,749
 (Loss)/profit for the year/period	 (28,361)	 9,856	 (260,260)	 (320,022)

The total revenue of the Group for the financial years ended 31 December 2018 and 2019 amounted to approximately RMB129.4 million and RMB124.3 million respectively, representing a slight decrease of approximately 4.0%. For the financial year ended 31 December 2019, revenue generated from the Game Business decreased by approximately 8.0% as compared to the previous financial year, which was mainly due to the decrease in revenue generated from the legacy online game business and the revenue generated from the new VR game business operated by offline stores of Beijing Xigua under the Group. As a result of the Group's venture into the VR game business, its cost of revenue increased significantly by approximately 96.8% as compared to the previous financial year, leading to the significant decrease in the Group's gross profit by approximately 62.8% from approximately RMB81.7 million to RMB30.4 million between the two financial years ended 31 December 2018 and 2019. According to the 2019 Annual Report, the Group recognised a net loss of approximately RMB320.0 million and RMB260.3 million for the two years ended 31 December 2019, respectively. Despite the positive gross profit and revenue for the year ended 31 December 2019, the Group recorded a net loss for the year primarily due to the impairment of goodwill and identifiable intangible assets arising from the Acquisition, the allowance for impairment for outstanding loan receivables of the Internet Micro-credit Business and that for the receivables from the disposal of the equity interest in the JLC Group, which was acquired partially as to approximately 55% by the Company in 2017 and disposed by the Company in 2019. On the other hand, the net loss for the year ended 31 December 2018 as compared to the positive gross profit and revenue was primarily attributable to the operational difficulties in JLC Group, which resulted in an after-tax impairment on the goodwill and identifiable intangible assets of approximately RMB320.5 million.

According to the 2020 Interim Report, the revenue of the Group decreased by approximately 45.9% from approximately RMB53.4 million for the six months ended 30 June 2019 to approximately RMB28.9 million for the six months ended 30 June 2020, which was mainly attributable to (i) the decrease in online game business revenue as the Group continued to shift its business focus from online web game to offline VR games and reduced its resources in developing and promoting its online web games, some of which had already entered into the mature stage of their lifecycles; and (ii) the decrease in the average balance of loan of the Internet Micro-credit Business in the first half of 2020, as the Group maintained a controllable size of outstanding loans and took cautious measures in originating new loans given the increased market risks triggered by the Epidemic. As a result of the decrease in its revenue and its cost of revenue which had remained a high level, the Group recorded a gross profit of approximately RMB9.4 million, representing a decrease of approximately 73.5% compared to the corresponding period of the previous year. In view of the above, the Group recorded a loss for the period of approximately RMB28.4 million as compared to a profit for the period of approximately RMB9.9 million for the period ended 30 June 2019.

Set out below is a summary of the consolidated assets and liabilities of the Group as at 31 December 2019 and 30 June 2020, as extracted from the 2019 Annual Report and the 2020 Interim Report, respectively.

	As at 30 June 2020 RMB'000 (Unaudited)	As at 31 December 2019 RMB'000 (Audited)
Total assets		
— non-current assets	129,224	149,788
— current assets	627,374	663,570
Total liabilities		
— non-current liabilities	8,786	22,614
— current liabilities	114,896	126,781
Net current assets	512,478	536,789
Net assets	632,916	663,963
Equity attributable to owners of the Company	660,926	687,359

As at 31 December 2019, the non-current assets of the Group amounted to approximately RMB149.8 million, of which approximately RMB136.4 million comprised right-of-use assets, investments in associates and equity investments at fair value through other comprehensive income. The current assets of the Group amounted to RMB663.6 million, of which approximately RMB318.0 million were

cash and cash equivalents and approximately RMB155.4 million were loan receivables. Meanwhile, as at 30 June 2020, the non-current assets of the Group amounted to approximately RMB129.2 million, more than 90% of which were right-of-use assets, investments in associates and equity investments at fair value through other comprehensive income. The current assets of the Group amounted to approximately RMB627.4 million, of which approximately RMB451.6 million were cash and cash equivalents.

As at 31 December 2019, the non-current liabilities of the Group amounted to approximately RMB22.6 million, nearly all of which were lease liabilities. The current liabilities of the Group amounted to approximately RMB126.8 million, of which approximately RMB76.1 million were other payables and accruals, approximately RMB28.2 million were lease liabilities and the remaining balance of approximately RMB22.5 million were trade payables, contract liabilities and income tax liabilities. Meanwhile, as at 30 June 2020, the non-current liabilities of the Group amounted to approximately RMB8.8 million, all of which were lease liabilities. The current liabilities of the Group amounted to approximately RMB114.9 million, of which approximately RMB78.3 million were other payables and accruals, approximately RMB14.5 million were lease liabilities, and the remaining balance of approximately RMB22.1 million were trade payables, contract liabilities and income tax liabilities.

Finally, as at 31 December 2019, the net current assets and net assets of the Group were approximately RMB536.8 million and RMB664.0 million respectively. The current ratio, which is calculated as current assets over current liabilities, was approximately 5.2 times as at 31 December 2019, while the gearing ratio was nil, which means the group didn't have any borrowing balance as at 31 December 2019. Meanwhile, as at 30 June 2020, the net current assets and net assets of the Group were approximately RMB512.5 million and RMB632.9 million respectively. The current ratio was therefore approximately 5.5 times as at 30 June 2020, while the gearing ratio remained to be nil as at 30 June 2020.

(b) Beijing Xigua

Beijing Xigua is a company established under the laws of the PRC with limited liability. Beijing Xigua is principally engaged in offering self-developed games as well as exclusively licensed games in its physical stores that are equipped with space positioning technology and virtual reality devices. As at the Latest Practicable Date, Beijing Xigua is owned as to 69.84% by the Investor, 4.54% by Shanghai Wangyu, 18.14% by Mr. Jiang, 6.12% by Mr. Sheng and 1.36% by the Shanghai Dacheng.

Set out below is a summary of the unaudited consolidated financial information of Beijing Xigua as prepared in accordance with IFRS for the years ended 31 December 2018 and 2019:

	For the year ended 31 December 2018 RMB (unaudited)	For the year ended 31 December 2019 RMB (unaudited)
Net loss before taxation	5,402,953	87,238,980
Net loss after taxation	5,402,953	87,238,980

As at 31 December 2019, Beijing Xigua has audited consolidated net liabilities of approximately RMB73,702,000 (*Note*). *As at 30 June 2020, Beijing Xigua has unaudited consolidated net liabilities of approximately RMB89,522,000.*

Pursuant to Rule 14.58 of the Listing Rules, the Company is required to disclose the net profits and book value of Beijing Xigua set out above (the “**Unaudited Beijing Xigua Financial Information**”). **However, in light of the qualified opinion issued by the Auditor in the 2019 Annual Report set out below, the Directors are of the view that the Unaudited Beijing Xigua Financial Information may not be true and accurate.**

Meanwhile, pursuant to Rule 10 of the Takeovers Code, the Unaudited Beijing Xigua Financial Information constitutes a profit forecast and must be reported on by the Auditor and the Company’s financial adviser(s) in accordance with the Takeovers Code and such report must be lodged with the Executive in accordance with Rule 10.4 of the Takeovers Code. However, as discussed above, **the Auditor has issued a qualified opinion in relation to the financial information of Beijing Xigua for the period from 26 June 2019, being the date of the completion of the Acquisition, to 31 December 2019, in the 2019 Annual Report, and hence the Auditor would not be able to provide an assurance on the compilation of the Unaudited Beijing Xigua Financial Information. Accordingly, the Unaudited Beijing Xigua Financial Information would not be reported on by the Auditor and financial adviser of the Company in accordance with Rule 10.4 of the Takeovers Code.**

Shareholders and potential investors of the Company should note that the Unaudited Beijing Xigua Financial Information does not meet the standard required by Rule 10 of the Takeovers Code and has not been reported on in accordance with the Takeovers Code. In addition, Shareholders and potential investors of the Company should not rely on the Unaudited Beijing Xigua

Note: As the consolidated statement of financial position of Beijing Xigua only concerns a given point in time (i.e. 31 December 2019), it was audited by the Auditor together the consolidated statement of financial position of the Group. On the other hand, the consolidated statement of profit or loss and other comprehensive income of Beijing Xigua for the year ended 31 December 2019 is unaudited as Beijing Xigua only entered the Group in June 2019 and its accounts prior to that are not audited by the Auditor.

Financial Information when they deal or contemplate dealing in the Shares or other securities (if any) of the Company. Shareholders and potential investors of the Company should also exercise caution in placing reliance on the Unaudited Beijing Xigua Financial Information in assessing the merits and demerits of the Transfer Agreement and the transactions contemplated thereunder (including the Equity Disposal, the Share Buy-back and the Loan Assignment, with the Loan Assignment constituting a special deal in accordance with Rule 25 of the Takeovers Code).

Please refer to the section headed “Information about Beijing Xigua” in the Board Letter for more details in this regard.

(c) The KongZhong Group and Shanghai Dacheng

KongZhong is a company incorporated under the laws of the Cayman Islands with limited liability and is an investment holding company. KongZhong China is a company established under the laws of the PRC with limited liability and is wholly-owned by KongZhong. It is principally engaged in the development of computer software and the provision of integrated technical advisory services relating to the use of computer systems.

Shanghai Dacheng is a company established under the laws of the PRC with limited liability. It is principally engaged in the publication of internet games and is owned as to 98.54% by KongZhong by way of certain contractual arrangements. Regarding the shareholding structure of the KongZhong Group and Shanghai Dacheng, please refer to the section headed “Information about the KongZhong Group and Shanghai Dacheng” in the Board Letter.

2. Background of, reasons for and benefits of entering into the Transfer Agreement

As set out in the Board Letter, the purpose of entering into the Transfer Agreement is to unwind the Acquisition and resolve the issues therefrom which associate with (a) the non-fulfilment of the Profit Guarantee; (b) the deteriorating operational performance of Beijing Xigua; (c) the qualified opinion in relation to the financial information of Beijing Xigua issued by the Auditor in the 2019 Annual Report; and (d) the protection of the interests of the Company and the Shareholders as a whole.

Pursuant to the Investment Agreement dated 24 April 2019, the relevant actual net profits of Beijing Xigua, being the target under the Investment Agreement, for the period from 1 June 2019 to 31 December 2019, the year ending 31 December 2020 and the year ending 31 December 2021 should not be less than the Threshold, otherwise Shanghai Dacheng, being the previous vendor under the Investment Agreement, the KongZhong Group, of which KongZhong is the 98.54% shareholder of the Shanghai Dacheng by way of certain contractual arrangements and KongZhong China is wholly-owned by KongZhong, and Beijing Xigua on a joint and several basis shall compensate for the shortfall either by (a) a compensation in a combination by way of cash and reduction in

the actual number of Consideration Shares to be released to Shanghai Dacheng, or (ii) Full Cash Compensation in the amount of RMB150,152,857. The two compensation options are disclosed in details in the section headed “Background” in the Board Letter.

Meanwhile, subsequent to the completion of the Investment Agreement on 26 June 2019, as Beijing Xigua needed financing to open more stores for its business expansion, the Loan Agreement was entered into, among others, Beijing Xigua and Guangzhou Feidong (a wholly-owned subsidiary of the Company), pursuant to which Guangzhou Feidong agreed to grant the loan in the amount of no more than RMB53,000,000 to Beijing Xigua. As a result, the loan in the total amount of RMB32,300,000 was granted by Guangzhou Feidong to Beijing Xigua, among which RMB14,000,000 was granted on 21 November 2019, RMB10,000,000 was granted on 31 December 2019, and RMB8,300,000 was granted on 7 March 2020. As at the Latest Practicable Date, a sum of RMB4,222,400 has been repaid by Mr. Jiang and Mr. Sheng, the shareholders of Beijing Xigua who are jointly liable to certain extent for the repayment under the Loan Agreement, and Beijing Xigua is still indebted to Guangzhou Feidong the Outstanding Sum of RMB30,599,878, being the outstanding principal and accumulated interest prior to the parties’ entering into of the Transfer Agreement.

As disclosed in the 2019 Annual Report, based on the management accounts of Beijing Xigua, Beijing Xigua recorded a loss for the period from 1 June 2019 to 31 December 2019, falling short of over RMB43,000,000 as compared to the relevant Actual Net Profit for such period of RMB43,000,000 as originally contemplated and guaranteed pursuant to the Investment Agreement. As a result of such non-fulfilment of the Profit Guarantee, the Company has elected to request Shanghai Dacheng, the KongZhong Group and Beijing Xigua for the Full Cash Compensation. As disclosed in the announcement dated 10 March 2020, the Company has instructed its PRC legal adviser to issue a demand letter to each of Shanghai Dacheng and the KongZhong Group demanding for the Full Cash Compensation. However, as disclosed in the announcement dated 23 October 2020, the Company was given to understand that the aforementioned two parties have difficulties in raising capital to settle the Full Cash Compensation.

In view of the above situation, the Board considered that the best way to protect the interests of the Company and the Shareholders as a whole was to unwind the Acquisition and recover the consideration with respect to the Acquisition as well as the Outstanding Sum. Accordingly, upon various rounds of negotiations and discussions, the parties to the Investment Agreement eventually agreed to enter into the Transfer Agreement, which involves (a) the unwinding of the Acquisition (by way of the Equity Disposal and the Share Buy-back); and (b) the Loan Assignment.

As discussed further in the below section of this letter, the Implied Transfer Consideration under the Transfer Agreement would only allow the Group to recover in full the consideration for the Acquisition of RMB150,152,857, but not the Outstanding Sum of RMB30,599,878 given that the consideration for the Loan Assignment of RMB5,519,280 only accounts for about 18.0% of the Outstanding Sum. As discussed in the Board Letter, such settlement term was arrived at because despite the Company’s repeated attempts to recover the Outstanding Sum, Beijing Xigua has failed to fulfil its

repayment obligation given its financial difficulties. The Company had considered commencing legal proceedings against Beijing Xigua in order to recover the Outstanding Sum, yet given that a substantial amount of legal expenses as well as time and resources would likely be involved, and that the Company may lose the priority to other creditors when claiming and realising the remaining assets of Beijing Xigua, which likely would not be much, the Board is of the view that commencing legal proceedings against Beijing Xigua may not be in the interests of the Company and the Shareholders as a whole, and that a better approach would be to recover the Outstanding Sum as much as it could and to resolve the issues quickly and amicably. The Group had also discussed with the KongZhong Group the possibility of the latter repaying the Outstanding Sum in instalments over a longer period time. However, given the KongZhong Group's financial difficulties as further discussed below, the KongZhong Group had not been open to such arrangement. Given that the Board is of the view that it is more prudent for the parties to enter into a mutually agreeable and viable settlement promptly so that the Group can allocate its time and resources to other more fulfilling ventures, after having reviewed the latest financial statements of the KongZhong Group, the Company and the KongZhong Group arrived at the consideration for the Loan assignment, which despite being comparatively lower than the Outstanding Sum, is understood by the Company to be already the highest amount that can be offered by the KongZhong Group for it to ensure its fulfilment of such repayment obligation.

We have reviewed the consolidated financial results of the KongZhong Group and noted that it was in a net liability position both as at 31 December 2019 and 30 June 2020. The KongZhong Group also had been making losses for the year ended 31 December 2019 and for the six months ended 30 June 2020. In respect of the assets of the KongZhong Group, as at the Latest Practicable Date, the KongZhong Group owned (i) 36,235,351 shares of Ourgame International Holdings Limited (stock code: 6899), all of which have been pledged to other third parties; and (ii) 32,471,076 Shares of the Company, of which only 1,851,568 Shares have not been pledged to other third parties. Accordingly, the KongZhong Group has agreed to deliver such 1,851,568 Shares (equivalent to approximately HK\$4,221,575 and HK\$4,147,512 calculated by using the closing prices of HK\$2.28 and HK\$2.24 per Share as quoted on the Stock Exchange on the Last Trading Day and on the Latest Practicable Date, respectively) to a third party escrow agent jointly appointed by itself and the Company for security purpose that in the event of default in the repayment of the Cash Consideration, such third party escrow agent is allowed to dispose of such 1,851,568 Shares and apply the sale proceeds to pay the relevant amount due. Given that instant repayment of either the Outstanding Sum or the Cash Consideration is not realistic due to the financial difficulties faced by Shanghai Dacheng, the KongZhong Group and Beijing Xigua, and that the KongZhong Group did not have sufficient assets to provide additional securities per the Company's request, we are of the view that the current arrangement under the Transfer Agreement is already the optimal solution in resolving the issues amicably and that despite the value of the pledged Shares is lower than the Cash Consideration, it could still serve as security to a certain degree with respect to the repayment by instalment of the Cash Compensation offered by the KongZhong.

Given the above, we concur with the Directors that the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment, with the Loan Assignment constituting a special deal in accordance with Rule 25 of the Takeovers Code) are in the interest of the Company and the Shareholders as a whole given that (i) Shanghai Dacheng, the KongZhong Group and Beijing Xigua have difficulties in raising capital to settle the Full Cash Compensation and the Outstanding Sum; (ii) the terms of the Transfer Agreement are generally in line with the original terms under the Investment Agreement; (iii) it is a good opportunity for the Company to buy-back and cancel a significant block of Shares in a single transaction without significantly affecting the normal trading of the Shares in terms of price and volume as opposed to conducting a large number of daily on-market buy-back transactions under a general buy-back mandate over a period of time; (iv) the Share Buy-back is expected to improve the net asset value per Share; (v) time to be spent by the management of the Group, as well as the cost implications and enforcement outcome in the event of litigation among the Company, the KongZhong Group and Beijing Xigua, may have a negative impact on the operation and financial performance of the Group; (vi) the Company expects to recognise a disposal gain of approximately RMB74.7 million (before tax and transaction costs) upon Completion; and (vii) the cessation of Beijing Xigua being a subsidiary of the Company upon Completion will not only improve the financial position of the Group, but will also remove the qualified opinion issued by the Auditor in relation to the financial information of Beijing Xigua in the future.

3. Principal terms of the Transfer Agreement

(a) Principal terms

On 12 November 2020 (after trading hours), among others, the Company, the Investor, Beijing Xigua, Shanghai Dacheng, the KongZhong Group and Guangzhou Feidong entered into the Transfer Agreement, pursuant to which (i) the Company shall dispose of the 69.84% equity interest in Beijing Xigua to KongZhong China (or its designated third party) (i.e. the Equity Disposal) and the Consideration Shares shall be transferred from Shanghai Dacheng through the Escrow Agent to the Company (i.e. the Share Buy-back); and (ii) the Company shall assign the Outstanding Sum in the amount of RMB30,599,878 to KongZhong China (or its designated third party) originally due to Guangzhou Feidong (i.e. the Loan Assignment).

For details on the principal terms of the Transfer Agreement, please refer to the section headed “Transfer Agreement” in the Board Letter.

Meanwhile, Completion is conditional upon the satisfaction of conditions precedent as set out in the sub-section headed “Conditions precedent” of the section headed “Transfer Agreement” in the Board Letter. As at the Latest Practicable Date, save for conditions (i) and (vi), none of these conditions precedent has been fulfilled.

(b) Consideration

As set out in the Board Letter, after rounds of negotiations and discussions between the relevant parties for the purpose of resolving all outstanding issues amicably which have eventuated to the Transfer Agreement:

- (i) KongZhong China has agreed to pay the Company in cash in the amount of RMB20,000,000, equivalent to the amount of consideration that the Company paid to subscribe for 9.30% equity interest in Beijing Xigua in the form of new registered capital under the Investment Agreement;
- (ii) KongZhong China has agreed to pay the Company in cash in the amount of RMB5,519,280 for the Loan Assignment; and
- (iii) Shanghai Dacheng shall through the Escrow Agent deliver 22,268,908 Consideration Shares to the Company for cancellation.

The aggregate Cash Consideration of RMB25,519,280 (including item (i) and item (ii) above) shall be paid by KongZhong China (or its designated third party) in the following manner:

- (i) a sum of RMB1,000,000 in cash shall be paid within 10 days of the date where all the conditions precedent under the Transfer Agreement have been satisfied or waived (if applicable), or by the end of 31 December 2020, whichever is earlier;
- (ii) a sum of RMB2,519,280 in cash shall be paid by the end of 31 March 2021; and
- (iii) thereafter, a sum of RMB2,000,000 in cash shall be paid at least quarterly by the end of June, September, December and March per year starting from 2021 until the balance of RMB22,000,000 has been paid in full.

Among the 10,202,168 Shares that KongZhong is interested in as at the Latest Practicable Date, 1,851,568 Shares (equivalent to approximately HK\$4,221,575 calculated by using the closing price of HK\$2.28 per Share as quoted on the Stock Exchange on the Last Trading Day) has been agreed by the KongZhong Group to be delivered to a third party escrow agent jointly appointed by the KongZhong Group and the Company for security purpose that in the event of default in the payment of the Cash Consideration, such third party escrow agent is allowed to dispose of such 1,851,568 Shares and apply the sale proceeds to pay the relevant amount due.

The Implied Transfer Consideration is RMB155,672,137 (i.e. Cash Consideration of RMB25,519,280 and a consideration of RMB130,152,857 in the form of 22,268,908 Consideration Shares to be returned to the Company for cancellation), which is equivalent to the sum of consideration for the Acquisition (i.e. RMB150,152,857) and consideration for the Loan Assignment (i.e. RMB5,519,280).

As the Transfer Agreement aims to unwind the Acquisition, the implied Buy-back Price for transfer of the Consideration Shares is HK\$6.876, which is equivalent to the issue price per Consideration Share under the Investment Agreement. For illustrative purpose, the Buy-back Price represents:

- (i) a premium of approximately 201.6% over the closing price of HK\$2.280 per Share as quoted on the Stock Exchange on the Last Trading Day;
- (ii) a premium of approximately 178.8% over the average of the closing prices of approximately HK\$2.466 per Share for the last five trading days up to and including the Last Trading Day;
- (iii) a premium of approximately 177.3% over the average of the closing prices of approximately HK\$2.480 per Share for the last ten trading days up to and including the Last Trading Day;
- (iv) a premium of approximately 164.6% over the average of the closing prices of approximately HK\$2.599 per Share for the last thirty trading days up to and including the Last Trading Day;
- (v) a premium of approximately 134.4% over the average of the closing prices of approximately HK\$2.934 per Share for the last ninety trading days up to and including the Last Trading Day;
- (vi) a premium of approximately 119.5% over the average of the closing prices of approximately HK\$3.133 per Share for the last 180 trading days up to and including the Last Trading Day;
- (vii) a premium of approximately 197.7% over the closing price of HK\$2.310 per Share as quoted on the Stock Exchange on 12 November 2020, being the date of the Transfer Agreement and the relevant announcement;
- (viii) a premium of approximately 207.0% over the closing price of HK\$2.24 per Share as quoted on the Stock Exchange on the Latest Practicable Date; and
- (ix) a premium of approximately 52.5% over the unaudited consolidated net asset value attributable to the Shareholders of approximately HK\$4.51 per Share (based on the unaudited consolidated net assets attributable to the Shareholders as at 30 June 2020 of approximately RMB632,916,000 (equivalent to approximately HK\$719,223,000 based on an exchange rate of RMB0.88: HK\$1) and 159,379,238 Shares in issue as at the Latest Practicable Date.

4. Evaluation of the principal terms of Transfer Agreement

(a) Equity Disposal

Pursuant to the Transfer Agreement, the parties to the Investment Agreement shall unwind the Acquisition by way of the Equity Disposal and the Share Buy-back. Given that under the Equity Disposal arrangement, the Group shall dispose of 69.84% equity interest in Beijing Xigua (i.e. the same amount of equity interest in Beijing Xigua the Group previously acquired pursuant to the Investment Agreement) to KongZhong China (or its designated third party), we are of the view that the Equity Disposal is fair and reasonable so far as the Independent Shareholders are concerned.

(b) Share Buy-back

As the Share Buy-back is part and parcel to the Equity Disposal, we have evaluated the fairness and reasonableness of Share Buy-back through conducting the following market comparable analyses on the Buy-back Price. We have made reference to the announcements of listed issuers on the Stock Exchange which have proposed off-market share buy-back transactions of their shares listed on the Stock Exchange (the “**Comparable Transaction(s)**”) during the period from 1 November 2018 up to and including the Latest Practicable Date (the “**Review Period**”). We consider the two-year Review Period a sufficient period of time to reflect the recent market practice in respect of such transactions, and on a best-effort basis, we have identified an exhaustive list of eight Comparable Transactions, details of which are summarised in the table below.

Company Name	Stock code	Date of announcement	Premium/ (discount) of the share buy- back price over/(to) the share price as at the respective last trading day	Premium/ (discount) of the share buy- back price over/(to) the respective original issue/ subscription share price	Reason(s) for the transaction	Basis of determination of the consideration
Medicskin Holdings Limited	8307	2020/3/19	13.64%	(80.71%)	To minimise the downward pressure on the share price as a substantial shareholder revealed the intention to dispose its shares	(i) The recent closing price of the share; and (ii) the previous subscription price for the shares paid by the vendor

Company Name	Stock code	Date of announcement	Premium/ (discount) of the share buy-back price over/(to) the share price as at the respective last trading day	Premium/ (discount) of the share buy-back price over/(to) the respective original issue/ subscription share price	Reason(s) for the transaction	Basis of determination of the consideration
Huan Yue Interactive Holdings Limited (formerly named Xingye Alloy Materials Group Limited (“Huan Yue”))	505	2020/1/23	25.00%	(11.11%)	To unwind a previous acquisition transaction	(i) The volume-weighted average share price; (ii) the issue price of the consideration shares; (iii) the unaudited consolidated net asset value attributable to the shareholders; and (iv) the comparable companies’ price-to-book ratios
China Development Bank Financial Leasing Co., Ltd.	1606	26/9/2019	60.31%	12.22%	To fulfill regulatory requirements of the PRC authorities	The commercial and arm’s length negotiations between the parties, taking into consideration the potential financial impacts on both parties
Alpha Professional Holdings Limited (“Alpha”)	948	18/9/2019	13.93%	0	To unwind a previous acquisition transaction	The original issue price of consideration shares
Tern Properties Company Limited	277	16/5/2019	28.46%	Not disclosed	To restore the public float of the company	(i) The prevailing market conditions; (ii) the low liquidity of the shares; (iii) the current market prices of the shares; (iv) the net asset value per share; and (v) the opportunity to restore the public float of the company
New Silkroad Culturaltainment Limited (“New Silkroad”)	472	2/5/2019	188.89%	0	To unwind a previous acquisition transaction	The original issue price of consideration shares
The Sincere Company, Limited	244	22/3/2019	0	Not disclosed	To unwind the cross shareholdings between the company and its connected persons, simplify the group structure and improve the capital efficiency of the group	(i) The prevailing closing prices of the shares; and (ii) the capital required for carrying out the share buy-back and for the group’s daily operation

Company Name	Stock code	Date of announcement	Premium/ (discount) of the share buy-back price over/(to) the share price as at the respective last trading day	Premium/ (discount) of the share buy-back price over/(to) the respective original issue/ subscription share price	Reason(s) for the transaction	Basis of determination of the consideration
Dah Sing Financial Holdings Limited	440	23/1/2019	(1.50%)	76.06%	To enhance the company's earnings per share, rate of return on capital and net asset value per share	The prevailing market conditions
The Company	484	2020/11/12	201.6%	0	To unwind the Acquisition	The issue price of the Consideration Shares

Source: the website of the Stock Exchange

As shown in the above table, the premium represented by the share buy-back price over the share price as at the respective last trading day in all of the Comparable Transactions were both much lower than that represented by the Buy-back Price. While this observation may suggest that the Share Buy-back is not favourable to the Company, we are of the view that recent closing share prices are only for reference only and that they need not be the basis for determining the share buy-back prices in all occasions. In evaluating the fairness and reasonableness of the Share Buy-back and Buy-Back Price, one should also take into consideration the purpose of the Share Buy-back, which is to unwind the Acquisition.

In this regard, we are of the view that the Comparable Transactions which were conducted for the purpose of unwinding a previous acquisition transaction, namely those of Huan Yue, Alpha, and New Silkroad, are similar to the Share Buy-back of the Company and hence are more appropriate references for a comparative analysis, whereas the other Comparable Transactions, which were all stand-alone transactions, are rather different from the Company's Share Buy-back and hence are not considered by us to be proper references for a meaningful comparison. Accordingly, we have focused on reviewing the Comparable Transactions of Huan Yue, Alpha, and New Silkroad, and noted that their respective share buy-back price of the consideration shares were all determined with reference to the consideration shares' original issue prices. Except for the share buy-back price in the Comparable Transaction of Huan Yue, which was lower than the original issue price per consideration share, the buy-back prices in the two other Comparable Transactions of Alpha and New Silkroad were both equivalent to their respective original issue price per consideration share, as in the case of the Company's Share Buy-back.

Upon our further review, we noted that in the case of Huan Yue, the directors of Huan Yue were able to negotiate a discount to the original issue price of the consideration shares, making the buy-back price on terms more favourable to the

company. However, as discussed in the above section headed “Background of, reasons for and benefits of entering into the Transfer Agreement” in this letter, Shanghai Dacheng, the KongZhong Group and Beijing Xigua have been facing financial difficulties in raising capital to settle the Full Cash Compensation and the Outstanding Sum. Hence, it has been futile for the Directors to further negotiate a discount to the original issue price of the Consideration Shares, when the aforementioned three parties already fail to meet their existing repayment obligations. Nonetheless, given that the share buy-back prices in the Comparable Transactions of Huan Yue, Alpha, and New Silkroad were all determined with reference to the consideration shares’ original issue prices, we are of the view that such practice is common in unwinding a previous acquisition transaction and buying back previous consideration shares, and that the above analysis is a fair demonstration that the Company’s determination of the Buy-back Price is in line with market practice. Accordingly, we consider the Buy-Back Price to be fair and reasonable so far as the Independent Shareholders are concerned.

(c) Loan Assignment (which constitutes a special deal in accordance with Rule 25 of the Takeovers Code)

As set out in the section headed “Regulatory Implications” in the Board Letter, the amount of the Outstanding Sum is higher than the consideration for the Loan Assignment, and the relevant proposed settlement is not extended to all other Shareholders, the Loan Assignment constitutes a special deal under Rule 25 of the Takeovers Code, and will be conditional upon obtaining the prior consent of the Executive under Rule 25 of the Takeovers Code. An application has been to the Executive for consent under Rule 25 of the Takeovers Code for the Loan Assignment. Such consent, if granted, will be subject to (i) the Independent Financial Adviser publicly states that in its opinion the terms of the Loan Assignment are fair and reasonable; and (ii) the Loan Assignment is approved by the Independent Shareholders by way of poll at the EGM, in which the KongZhong Group, Shanghai Dacheng and parties acting in concert with any of them who are Shareholders, will be required to abstain from voting in the EGM. If the Executive does not consent to the Loan Assignment, and/or the approval of the Independent Shareholders is not obtained, the Loan Assignment will not proceed.

As discussed in the above section headed “Background of, reasons for and benefits of entering into the Transfer Agreement” in this letter, the Implied Transfer Consideration under the Transfer Agreement would not allow the Group to recover in full the Outstanding Sum of RMB30,599,878, given that the consideration for the Loan Assignment was only RMB5,519,280. In considering the fairness and reasonableness of the Loan Assignment, we have therefore also considered the fact that (i) Beijing Xigua has difficulties in raising capital to settle the Outstanding Sum, despite the Company’s repeated requests; (ii) the consideration for the Loan assignment is understood by the Company to be already the highest amount that can be offered by the KongZhong Group for it to ensure its fulfilment of such repayment obligation; (iii) the KongZhong Group and Beijing Xigua have been recording losses and in a net liability position and the existing operational performance of Beijing Xigua has been unsatisfactory; (iv) not only that the Group is not optimistic about the KongZhong Group’s ability of repaying the Outstanding Sum in instalments over a longer period, but that such arrangement had not been accepted by the KongZhong Group during its rounds of negotiations and discussions with the Group because of the KongZhong Group’s financial difficulties; (v) the KongZhong Group did not have sufficient assets other than the pledged 1,851,568 Shares to provide additional securities per the Company’s request with respect to its repayment of the Cash Compensation; (vi) if the Group commences legal proceedings against Shanghai Dacheng, the KongZhong Group and Beijing Xigua, the operation and financial position of the Group may be affected as a result of the unforeseeable time and cost implications and enforcement outcome; and (vii) given the time and resources already spent on revolving the issues arising from the Acquisition, the Board is of the view that it is more prudent for the parties to enter into a mutually agreeable and viable settlement promptly so that the Group can allocate its time and resources to other more fulfilling ventures. Accordingly, we are of the view that the consideration for the Loan Assignment, despite being lower than the Outstanding Sum, is a last resort of the Company that would help reduce a part of its asset losses and recoup part of its investment in Beijing Xigua, and hence we consider that the Loan Assignment is fair and reasonable so far as the Independent Shareholders are concerned.

(d) Section conclusion

Having considered our evaluation of the Equity Disposal, the Share Buy-back and the Loan Assignment as discussed above, we consider the entering into of the Transfer Agreement to be fair and reasonable and in the interests of the Company and the Independent Shareholders as a whole.

5. Effects on the shareholding structure of the Company

The following table illustrates the shareholding structure of the Company (i) as at the Latest Practicable Date; and (ii) immediately after the completion of the Share Buy-back, assuming there will be no other change in the issued share capital and the shareholding structure of the Company between the Latest Practicable Date and the date on which the Share Buy-back is completed.

Name of Shareholder	As at the Latest Practicable Date		Immediately after the completion of the Share Buy-back	
	Approximate		Approximate	
	% of total		% of total	
	No. of Shares	issued Shares	No. of Shares	issued Shares
Foga Group Ltd. (Note 1&7)	21,673,338	13.6	21,673,338	15.8
WANG Dongfeng (Note 2)	1,650,800	1.0	1,650,800	1.2
Foga Holdings Ltd. (Note 1)	7,763,997	4.9	7,763,997	5.7
Foga Internet Development Ltd. (Note 4)	7,785,700	4.9	7,785,700	5.7
YANG Tao (Note 5&7)	1,340,000	0.8	1,340,000	1.0
KongZhong (Note 3)	10,202,168	6.4	10,202,168	7.4
Shanghai Dacheng (Note 3)	22,268,908	14.0	—	—
China Create Capital Limited (Note 6)	9,584,000	6.0	9,584,000	7.0
ZHANG Qiang (Note 8)	93,333	0.1	93,333	0.1
Other Shareholders	77,016,994	48.3	77,016,994	56.2
Total	<u>159,379,238</u>	<u>100.0</u>	<u>137,110,330</u>	<u>100.0</u>

Note 1: Foga Group Ltd. is wholly-owned by Managecorp Limited as the trustee of Wang Trust. Wang Trust is a discretionary trust set up by Mr. WANG Dongfeng, who is its settlor and protector, with Managecorp Limited as trustee on 15 March 2013. The beneficiary objects of Wang Trust include Mr. WANG Dongfeng and certain of his family members. Mr. WANG Dongfeng and Managecorp Limited are taken to be interested in 21,673,338 Shares held by Foga Group Ltd.. In addition, Foga Holdings Ltd. is wholly-owned by Managecorp Limited as the trustee of Hao Dong Trust. Hao Dong Trust is a discretionary trust set up by Mr. LIAO Dong, who is its settlor and protector, with Managecorp Limited as trustee on 15 March 2013. The beneficiary object of Hao Dong Trust is Mr. LIAO Dong himself. Mr. LIAO Dong and Managecorp Limited are taken to be interested in 7,763,997 Shares held by Foga Holdings Ltd.

Note 2: Mr. WANG Dongfeng was granted 500,000 RSUs under the RSU Scheme in 2016, all of which vested during the period from 1 December 2016 to 1 June 2018. Mr. WANG Dongfeng bought an aggregate of 850,800 Shares during the period from 26 June to 13 July 2017. He was further granted 300,000 RSUs under the RSU Scheme in 2018, 50,000 of which vested on 1 December 2018 and 250,000 of which were cancelled on 30 June 2019. The Company further granted 250,000 RSUs to Mr. WANG Dongfeng under the RSU Scheme in 2019, 50,000 of which vested on 1 July 2019 and 50,000 vested on 1 January 2020. Mr. WANG Dongfeng resigned from executive Director with effect from 30 September 2019. Given that 1 RSU represents 1 Share upon vesting, the figure of 1,650,800 comprising 1,500,800 Shares and 150,000 uncancelled RSUs as well is considered as a prudent and complete disclosure by the Company of Mr. WANG Dongfeng's interests in the Company.

Note 3: Shanghai Dacheng is owned as to 98.54% by KongZhong China by way of certain contractual arrangements, which is in turn 100% owned by KongZhong. By virtue of the SFO, the KongZhong Group are taken to be interested in the 22,268,908 Shares held by Shanghai Dacheng.

Note 4: Foga Internet Development Ltd. is wholly-owned by Mr. YANG Tao. Mr. YANG Tao is taken to be interested in the 7,785,700 Shares held by Foga Internet Development Ltd.

Note 5: Mr. YANG Tao was granted 1,340,000 RSUs under the RSU Scheme in 2016, all of which vested during the period from 1 December 2016 to 1 June 2018.

Note 6: China Create Capital Limited is a company incorporated in the BVI and interested in 9,584,000 Shares in the capacity of a beneficial owner. To the best of the knowledge of the Company, none of the Directors is holding any shares in China Create Capital Limited and China Create Capital Limited is not related to other Shareholders.

Note 7: Mr. WANG Dongfeng, Mr. LIAO Dong and Mr. YANG Tao are co-founders of the Group. For further details of their relationship, please refer to the sections headed "Our History, Reorganization and Corporate Structure" and "Directors and Senior Management" of the prospectus of the Company dated 19 September 2013.

Note 8: As at the Latest Practicable Date, Mr. ZHANG Qiang, a non-executive Director, is holding 93,333 Shares in the capacity as a beneficial owner, representing approximately 0.06% of the issued share capital of the Company. Mr. ZHANG Qiang was granted 100,000 RSUs, all of which vested during the period from 1 December 2016 to 1 June 2018. He was further granted 50,000 RSUs, 8,333 of which vested on 1 December 2018 and 41,667 of which were cancelled on 30 June 2019. Mr. ZHANG Qiang sold 75,000 Shares on 17 January 2019. The Company further granted 60,000 RSUs to Mr. ZHANG Qiang, of which 12,000 vested on 1 July 2019, 12,000 vested on 1 January 2020 and 12,000 vested on 1 July 2020. Given that 1 RSU represents 1 Share upon vesting, the figure of 93,333 comprising 69,333 Shares and 24,000 uncanceled RSUs as well is considered as a prudent and complete disclosure by the Company of Mr. ZHANG Qiang's interests in the Company.

Assuming there will be no changes to the shareholding interest of the public Shareholders and the total number of issued Shares of the Company from the Latest Practicable Date to the date of Completion, upon Completion and cancellation of the Consideration Shares, the shareholding interest of the public Shareholders will increase from approximately 48.3% to approximately 56.2%. As such, the Completion, which will involve the cancellation of the Consideration Shares, would result in an increase in the public float of the Company.

6. Potential financial effects of the Transfer

Upon Completion, Beijing Xigua will cease to be a subsidiary of the Company and the accounts of the Beijing Xigua would be excluded from those of the Group.

As set out in the Board Letter, it is expected that the Transfer will have the below financial effects on the Group's earnings, working capital and net assets upon Completion. It should be noted that they are for illustrative purpose only.

(a) Earnings

Upon completion of the Equity Disposal, the Group expects to record a gain or loss on the Equity Disposal which will be reflected in the consolidated statement of profit or loss after taking into account the fair value of the Consideration Shares as at the date of the Completion less the net assets value of Beijing Xigua attributable to the Company as at the date of the Completion and the transaction costs to be incurred for the Equity Disposal.

Based on the net liabilities of Beijing Xigua attributable to the Company of approximately RMB89,522,000 as at 30 June 2020, the Company currently expects to recognise a gain of approximately RMB74,707,000. It is contemplated that the reserves of the Remaining Group will be increased upon the recognition of the disposal gain and the transaction costs in the consolidated statement of profit or loss.

It should be noted that the expected gain is only an estimate which assumes the completion of the Equity Disposal had taken place on 30 June 2020. The actual gain or loss of the Equity Disposal will depend on the fair value of the Consideration Shares and the net assets value of Beijing Xigua as at the completion date of the Equity Disposal.

(b) Working capital

According to the estimations of the Company, the working capital of the Remaining Group is expected to increase slightly by approximately RMB22,302,000 from approximately RMB512,478,000 to approximately RMB534,780,000, mainly due to the receipt of the Cash Consideration of RMB25,519,280 and the exclusion of the fair value of Profit Guarantee of RMB74,000,000 and the negative working capital of Beijing Xigua of approximately RMB70,783,000. Since there is no cash outflow required by the Company in order to effect the Share Buy-back, we agree with the Directors that the Share Buy-back will not have an adverse effect on the working capital sufficiency of the Company upon the completion of the Share Buy-back.

(c) Net assets

Assuming that the Loan Assignment had taken place on 30 June 2020, the Group would have incurred a loss in the amount of approximately RMB24,180,000 for the Loan Assignment due to the net effect of (a) approximately RMB28,078,000 being the outstanding principal under the Loan Agreement; (b) approximately RMB1,621,000 being the accumulated interest as at 30 June 2020; and (c) RMB5,519,000 being the consideration of the Loan Assignment received under the Transfer Agreement.

It is expected that the net asset value of the Remaining Group attributable to the owners of the Company will increase by approximately RMB11,342,000 from approximately RMB632,916,000 to RMB644,258,000, due to the net effect of (a) the exclusion of (i) the net liabilities of Beijing Xigua attributable to the Company of approximately RMB89,522,000 as at 30 June 2020; (ii) the outstanding principal of approximately RMB28,078,000 and the accumulated interest of approximately RMB1,621,000 under the Loan Agreement as at 30 June 2020; and (iii) the fair value of Profit Guarantee of RMB74,000,000; and (b) the receipt of the Cash Consideration of RMB25,519,280. Accordingly, the Group's net assets attributable to the owners of the Company per Share as at 30 June 2020 would increase from approximately RMB4.06 per Share to approximately RMB4.82 per Share.

In view of the above potential financial effects, considering (i) the Transfer would have a positive effect on the earnings, working capital and net asset value of the Group; (ii) the Share Buy-back will not incur any cash outflow and hence there will be no adverse effect on the operating cash flow but a positive effect on the working capital position of the Remaining Group; and (iii) the reasons for the entering into of the Transfer Agreement as set out in the above section headed “Background of, reasons for and benefits of entering into the Transfer Agreement” in this letter, we consider that the overall financial effects on the Group as a result of the Transfer are justifiable.

RECOMMENDATION

Having considered the principal factors and reasons referred to above, our views are summarised below:

- (i) Shanghai Dacheng, the KongZhong Group and Beijing Xigua have difficulties in raising capital to settle the Full Cash Compensation and the Outstanding Sum;
- (ii) the terms of the Transfer Agreement are generally in line with the original terms under the Investment Agreement;
- (iii) the Share Buy-back is expected to improve the net asset value per Share;
- (iv) it is a good opportunity for the Company to buy-back and cancel a significant block of Shares in a single transaction without significantly affecting the normal trading of the Shares in terms of price and volume as opposed to conducting a large number of daily on-market buy-back transactions under a general buy-back mandate over a period of time;
- (v) time to be spent by the management of the Group, as well as the cost implications and enforcement outcome in the event of litigation among the Company, the KongZhong Group, Shanghai Dacheng and Beijing Xigua, may have a negative impact on the operation and financial performance of the Group;
- (vi) the Company expects to recognise a disposal gain of approximately RMB74.7 million (before tax and transaction costs) upon Completion;
- (vii) the cessation of Beijing Xigua being a subsidiary of the Company upon Completion will not only improve the financial position of the Group, but will also remove the qualified opinion issued by the Auditor in relation to the financial information of Beijing Xigua in the future;
- (viii) it is common to unwind a previous acquisition transaction and buy back previous consideration shares in the original issue prices as indicated by the Comparable Transactions of Huan Yue, Alpha and New Silkroad; and
- (ix) the Loan Assignment, despite being lower than the Outstanding Sum, is a last resort of the Company that would help reduce a part of its asset losses and recoup part of its investment in Beijing Xigua, considering that:

- a. the consideration for the Loan assignment is understood by the Company to be already the highest amount that can be offered by the KongZhong Group for it to ensure its fulfilment of such repayment obligation;
 - b. the KongZhong Group and Beijing Xigua have been recording losses and in a net liability position and the existing operational performance of Beijing Xigua has been unsatisfactory;
 - c. not only that the Group is not optimistic about the KongZhong Group's ability of repaying the Outstanding Sum in instalments over a longer period, but that such arrangement had not been accepted by the KongZhong Group during its rounds of negotiations and discussions with the Group because of the KongZhong Group's financial difficulties; and
 - d. the KongZhong Group did not have sufficient assets other than the pledged 1,851,568 Shares to provide additional securities per the Company's request with respect to its repayment of the Cash Compensation; and
- (x) given the time and resources already spent on revolving the issues arising from the Acquisition, the Board is of the view that it is more prudent for the parties to enter into a mutually agreeable and viable settlement amicably and promptly so that the Group can allocate its time and resources to other more fulfilling ventures.

Having taken into consideration the factors and reasons as stated above, we are of the opinion that the terms of the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment, with the Loan Assignment constituting a special deal in accordance with Rule 25 of the Takeovers Code), although not conducted in the ordinary and usual course of business of the Group, are on normal commercial terms, fair and reasonable and in the interests of the Company and the Independent Shareholders as a whole. Accordingly, we advise the Independent Board Committee to recommend the Independent Shareholders to vote in favour of the resolution to be proposed at the EGM to approve the Transfer Agreement and the transactions contemplated thereunder (including but not limited to the Equity Disposal, the Share Buy-back and the Loan Assignment).

Yours faithfully,
For and on behalf of
Pelican Financial Limited



Charles Li*
Managing Director

* *Mr. Charles Li is a responsible person registered under the SFO to carry out Type 6 (advising on corporate finance) regulated activity for Pelican Financial Limited and has over 30 years of experience in the accounting and financial services industry.*