



红日资本有限公司

RED SUN CAPITAL LIMITED

22 December 2021

To: *The Independent Board Committee and the Independent Shareholders of  
Jiahua Stores Holdings Limited*

**DISCLOSEABLE AND CONNECTED TRANSACTION IN RELATION  
TO THE LONG-TERM LEASE AGREEMENT**

**I. INTRODUCTION**

We refer to our appointment as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in connection with the Long-Term Lease Agreement, details of which are set out in the letter from the Board (the "Letter from the Board") of the circular to the Independent Shareholders dated 22 December 2021 (the "Circular"), of which this letter forms part. Capitalised terms used in this letter shall have the same meanings as those defined in the Circular unless the context otherwise requires.

On 15 November 2021 (after trading hours), the Tenant entered into the Long-Term Lease Agreement with the Landlord with a term commencing from 16 November 2021 to 15 October 2031 (both days inclusive) to renew the Existing Lease Agreement which has been expired by 15 November 2021 for the operation of the Group's retail store.

Pursuant to HKFRS 16, the entering into the Long-Term Lease Agreement as a lessee will require the Group to recognise the right to use the Premises as the right-of-use asset of an estimated aggregate value of approximately RMB24.3 million. Thus, the entering into the Long-Term Lease Agreement and the transactions contemplated thereunder will be regarded as acquisition of asset by the Group. As all applicable percentages taking into account the right to use the Premises as acquisition of the right-of-use assets is below 25%, the Long-Term Lease Agreement and the transactions contemplated thereunder constitute a discloseable transaction for the Company under Chapter 14 of the Listing Rules and are subject to reporting and announcement requirements under Chapter 14 of the Listing Rules. In addition, as at the Latest Practicable Date, to the best of the Directors' knowledge, information and belief and having made all reasonable enquiries, Mr. Zhuang, the controlling Shareholder, executive Director and Chairman of the Company is interested in 535,485,000 Shares representing approximately 51.61% of the total issued Shares and is a connected person of the Company. As the Landlord is a company

beneficially owned by Mr. Zhuang and Mrs. Zhuang, his spouse, the Landlord is therefore also a connected person of the Company under the Listing Rules. Accordingly, the entering into the Long-Term Lease Agreement constitutes a connected transaction of the Company. As the total lease payment in respect of the Long-Term Lease Agreement is more than HK\$10 million, the entering into the Long-Term Lease Agreement is subject to the reporting, announcement, circular and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

In view of the interest of Mr. Zhuang and Mrs. Zhuang in the Landlord, Mr. Zhuang, Mrs. Zhuang and their respective associates (including Mr. Zhuang Xiao Xiong, son of Mr. Zhuang and Mrs. Zhuang, Ms. Chen Li Jun, daughter-in-law of Mr. Zhuang and Mrs. Zhuang, and Ms. Zhuang Xiao Yun, daughter of Mr. Zhuang and Mrs. Zhuang) will abstain from voting in relation to the resolution(s) to approve the Long-Term Lease Agreement at the EGM.

## II. THE INDEPENDENT BOARD COMMITTEE

The Board consists of six Directors, namely Mr. Zhuang Lu Kun (Chairman), Mr. Zhuang Pei Zhong (Chief Financial Officer) and Mr. Zhuang Xiao Xiong as executive Directors, Mr. Chin Kam Cheung, Mr. Sun Ju Yi and Mr. Ai Ji as independent non-executive Directors.

The Independent Board Committee comprising all of the independent non-executive Directors, namely Mr. Chin Kam Cheung, Mr. Sun Ju Yi and Mr. Ai Ji, has been established to advise the Independent Shareholders as to whether the terms of the Long-Term Lease Agreement are on normal commercial terms and in the ordinary and usual course of business of the Group, and are fair and reasonable, and in the interests of the Company and the Independent Shareholders as a whole.

We have been appointed to advise the Independent Board Committee and the Independent Shareholders in these respects and to give our opinion in relation to the Long-Term Lease Agreement, for the Independent Board Committee's consideration when making their recommendation to the Independent Shareholders.

## III. OUR INDEPENDENCE

As at the Latest Practicable Date, we were independent from and not connected with the Company and their respective shareholders, directors or chief executives, or any of their respective associates and accordingly, are qualified to give independent advice to the Independent Board Committee and the Independent Shareholders regarding the Long-Term Lease Agreement. In the previous two years we have not acted as a financial adviser to the Company, the Independent Board Committee and the Independent Shareholders of the Company on any transaction.

Apart from the normal advisory fee paid or payable to us in connection with our appointment as the Independent Financial Adviser, no arrangement exists whereby we have received or will receive any fees or benefits from the Company that could reasonably be regarded as relevant in assessing our independence. Accordingly, we consider that we are independent pursuant to Rule 13.84 of the Listing Rules.

#### IV. BASIS AND ASSUMPTIONS OF THE ADVICE

In formulating our advice to the Independent Board Committee and Independent Shareholders, we have relied solely on the statements, information, opinions, beliefs and representations for matters relating to the Group and management contained in the Circular and the information and representations provided to us by the Group and/or its senior management (the “**Management**”) and/or the Directors. We have assumed that all such statements, information, opinions, beliefs and representations contained or referred to in the Circular (including this letter) or otherwise provided or made or given by the Group and/or the Management and/or the Directors and for which it is/they are solely responsible were true and accurate, and valid and complete in all material respects at the time they were made and given and continue to be true and accurate, and valid and complete in all material respects as at the date of the Circular. We have assumed that all the opinions, beliefs and representations for matters relating to the Group made or provided by the Management and/or the Directors contained in the Circular have been reasonably made after due and careful enquiry. We have also sought and obtained confirmation from the Company and/or the Management and/or the Directors that no material facts have been omitted from the information provided and referred to in the Circular.

We consider that we have been provided with sufficient information and documents to enable us to reach an informed view and the Management has assured us no material information has been withheld from us to allow us to reasonably rely on the information provided so as to provide a reasonable basis for our advice. We have no reason to doubt the truth, accuracy and completeness of the statements, information, opinions, beliefs and representations provided to us by the Group and/or the Management and/or the Directors and their respective advisers or to believe that material information has been withheld or omitted from the information provided to us or referred to in the aforesaid documents. We have not, however, carried out any independent verification of the information provided, nor have we conducted any independent investigation into the business and affairs of the Company and their respective shareholder(s) and subsidiaries or affiliates, and their respective histories, experience and track records, or the prospects of the markets in which they respectively operate.

## V. PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion and recommendations to the Independent Board Committee and the Independent Shareholders, we have taken into consideration the following principal factors and reasons:

### 1. Background information of the Group

As disclosed in the Letter from the Board, the Group is principally engaged in property investment and operation and management of retail stores in the PRC.

Set out below is the summary of the Group's (i) audited consolidated statements of profit or loss and comprehensive income and consolidated statements of financial position for the years ended 31 December 2019 and 2020 as set out in the annual report of the Group for the year ended 31 December 2020 (the "2020 Annual Report"); and (ii) unaudited consolidated financial results of the Group for the six months ended 30 June 2020 and 2021 as set out in the interim report of the Group for the six months ended 30 June 2021 (the "2021 Interim Report"):

#### *Summary of consolidated statements of profit or loss and comprehensive income*

	For the year ended 31 December		For the six months ended 30 June	
	2019	2020	2020	2021
	RMB'000	RMB'000	RMB'000	RMB'000
	(Audited)	(Audited)	(Unaudited)	(Unaudited)
<b>Revenue</b>				
– Operation and management of retail stores and other related businesses	638,441	422,052	221,600	243,715
– Provision of financing services	6,888	6,005	3,032	3,283
<b>Total Revenue</b>	<b>645,329</b>	<b>428,057</b>	<b>224,632</b>	<b>246,998</b>
Loss before tax	(49,771)	(193,527)	(50,233)	(29,253)
<b>Loss attributable to owners of the Company</b>	<b>(52,342)</b>	<b>(194,461)</b>	<b>(51,371)</b>	<b>(30,364)</b>

*For the six months ended 30 June 2021 compared to the six months ended 30 June 2020*

For the six months ended 30 June 2021, the revenue increased by approximately RMB22.4 million or approximately 10.0%, from approximately RMB224.6 million for the six months ended 30 June 2020 to approximately RMB247.0 million for the six months ended 30 June 2021.

As set out in the 2021 Interim Report, revenue from operation and management of retail stores and other related businesses increased to approximately RMB243.7 million for the six months ended 30 June 2021 from approximately RMB221.6 million for the corresponding period of 2020, representing a period-on-period increase of approximately 10.0%. The increase was mainly attributable to (i) increase in sales of goods by online and offline business and (ii) increase in rental income from investment properties. Besides, revenue from provision of financing services increased to approximately RMB3.3 million for the six months ended 30 June 2021 from approximately RMB3.0 million for the corresponding period of 2020, representing a period-on-period increase of approximately 10.0%. The increase was mainly attributable to the increase in business from a major customer.

It is noted that loss attributable to owners of the Company decreased by approximately RMB21.0 million or approximately 40.9%, from approximately RMB51.4 million for the six months ended 30 June 2020 to approximately RMB30.4 million for the six months ended 30 June 2021. Such decrease was mainly attributable to the decrease in other operating expenses in relation to the fixed asset write-off expenses and the fixed asset disposal loss incurred in the corresponding period of 2020 as set out in the 2021 Interim Report.

*For the year ended 31 December 2020 compared to the year ended 31 December 2019*

For the year ended 31 December 2020, the revenue of the Group decreased by approximately RMB217.2 million or approximately 33.7%, from approximately RMB645.3 million for the year ended 31 December 2019 to approximately RMB428.1 million for the year ended 31 December 2020.

As disclosed in the 2020 Annual Report, revenue from operation and management of retail stores and other related businesses decreased from approximately RMB638.4 million for the year ended 31 December 2019 to approximately RMB422.1 million for the year ended 31 December 2020. Such decrease was mainly attributable to (i) decrease in sales of goods due to reduced customer flow in stores based on the imposed measures in relation to the outbreak of COVID-19 pandemic and (ii) decrease in rental income from investment properties due to early termination of two tenancies. Besides, revenue from provision of financing services decreased to approximately RMB6.0 million for the year ended 31 December 2020 from approximately RMB6.9 million for the year ended 31 December 2019, representing a decrease of approximately 13.0%. The decrease was mainly attributable to the decrease in business of the major customer which has been affected by the COVID-19 pandemic.

It is noted that loss attributable to owners of the Company increased by approximately RMB142.2 million or approximately 271.9%, from approximately RMB52.3 million for year ended 31 December 2019 to approximately RMB194.5 million for year ended 31 December 2020. Such increase was mainly attributable to the provision of impairment loss on existing loss making stores or shopping malls, and the written off of assets upon closure of three stores during the year as set out in the 2020 Annual Report.

*Summary of consolidated statement of financial position*

	As at 31 December		As at 30 June
	2019	2020	2021
	RMB million	RMB million	RMB million
	(Audited)	(Audited)	(Unaudited)
<b>Total assets</b>	<b>1,505.6</b>	<b>1,192.1</b>	<b>1,127.3</b>
<b>Total liabilities</b>	<b>971.7</b>	<b>852.7</b>	<b>818.2</b>
<b>Net assets</b>	<b>533.9</b>	<b>339.4</b>	<b>309.1</b>

*Financial position of the Group as at 30 June 2021 compared to 31 December 2020*

The Group's total assets decreased by approximately RMB64.8 million or approximately 5.4% from approximately RMB1,192.1 million as at 31 December 2020 to approximately RMB1,127.3 million as at 30 June 2021. Such decrease was primarily attributable to the decrease in right-of-use assets from approximately RMB437.4 million as at 31 December 2020 to approximately RMB398.0 million as at 30 June 2021. As at 30 June 2021, assets of the Group mainly comprised of right-of-use assets of approximately RMB398.0 million, investment properties of approximately RMB284.6 million and property, plant and equipment of approximately RMB216.4 million, which accounted for approximately 35.3%, 25.2% and 19.2% of the total assets, respectively.

The Group's total liabilities decreased by approximately RMB34.5 million or approximately 4.0%, from approximately RMB852.7 million as at 31 December 2020 to approximately RMB818.2 million as at 30 June 2021. Such decrease was mainly attributable to the decrease in deposits received, other payables and accruals of approximately RMB31.1 million from approximately RMB119.6 million as at 31 December 2020 to approximately RMB88.5 million as at 30 June 2021. As at 30 June 2021, liabilities of the Group mainly comprised of lease liabilities of approximately RMB506.2 million, deposits received, other payables and accruals of approximately RMB88.5 million and trade payables of approximately RMB79.1 million, which accounted for approximately 61.9%, 10.8% and 9.7% of the total liabilities, respectively.

*Financial position of the Group as at 31 December 2020 compared to 31 December 2019*

The Group's total assets decreased by approximately RMB313.5 million or approximately 20.8% from approximately RMB1,505.6 million as at 31 December 2019 to approximately RMB1,192.1 million as at 31 December 2020. Such decrease was primarily attributable to the decrease in right-of-use assets from approximately RMB643.8 million as at 31 December 2019 to approximately RMB437.4 million as at 31 December 2020. As at 31 December 2020, assets of the Group mainly comprised of right-of-use assets of approximately RMB437.4 million, investment properties of approximately RMB284.6 million and property, plant and equipment of approximately RMB217.2 million, which accounted for approximately 36.7%, 23.9% and 18.2% of the total assets, respectively.

The Group's total liabilities decreased by approximately RMB119.0 million or approximately 12.2%, from approximately RMB971.7 million as at 31 December 2019 to approximately RMB852.7 million as at 31 December 2020. Such decrease was mainly attributable to the decrease in lease liabilities of approximately RMB143.0 million from approximately RMB681.8 million as at 31 December 2019 to approximately RMB538.8 million as at 31 December 2020. As at 31 December 2020, liabilities of the Group mainly comprised of lease liabilities of approximately RMB538.8 million, deposits received, other payables and accruals of approximately RMB119.6 million and trade payables of approximately RMB75.1 million, which accounted for approximately 63.2%, 14.0% and 8.8% of the total liabilities, respectively.

**2. Background information on the retail industry in the PRC**

As set out on the website of the National Bureau of Statistics of the PRC (<http://data.stats.gov.cn>), notwithstanding that the year-on-year growth in gross domestic product ("GDP") for the PRC in 2020 was approximately 2.3% which is substantially lower than that of 2019 at 6.0%, due to the adverse impacts under the COVID-19 pandemic, the PRC economy has been recovering at a high rate and recorded a period-on-period growth in GDP of approximately 9.8% for the nine months ended 30 September 2021 compared to the correspondence prior year period, based on preliminary data published by the National Bureau of Statistics of the PRC.

Moreover, pursuant to the Fourteenth Five Year Plan, the PRC government has announced the target urbanisation rate of the resident population\* (常住人口城鎮化) for the next five years from 2021 is approximately 65.0%. In this connection, the PRC government promoted urbanisation in the PRC through, among others, (i) accelerate the agricultural population urbanisation (加快農業轉移人口城鎮化) by implementing two main strategies, namely further reform of the household registration system\* (深化戶籍制度改革) and improvement on the system for promoting urbanisation of agricultural population\* (健全促進農業轉移人口城鎮化的機制); and (ii) improve urbanisation layout\* (完善城鎮化空間佈局) by implementing five strategies, namely promote integrated development of conurbations\* (推動城市群一體化發展), construct modernised metropolitan areas\* (建設現代化都市圈), optimise and enhance functions of central urban areas in mega-sized-cities\* (優化提升超大城市中心城區功能), improve habitability and employability in large and medium-sized cities\* (完善大中城市宜居宜業功能) and promote urbanisation construction with counties/cities as major carriers\* (推進以縣城為重要載體的城鎮化建設). The Premises is located in the outer skirt of central Shenzhen area. It has nevertheless shown a positive inflow of population from core districts in Shenzhen due to the commencement of operation of city train facilitating the citywide transportation.

Furthermore, according to a survey conducted by McKinsey & Company on Chinese consumer sentiment during the coronavirus in May 2021<sup>1</sup>, almost all consumers have already returned to normal out-of-home activities, 65% of respondents selected “go to a shopping mall” as their out-of-home activities done in the past 2 weeks, which is beneficial to the retail market. Further based on an industry research by the China Commerce Association for General Merchandise published in November 2021<sup>2</sup>, the total retail sales of consumer goods increased by 4.9% as compared with the corresponding period from previous year. The average growth rate of two-year retail sales of department stores speeds up by 0.3%, showing the consumer market continued to recover.

In light of the aforementioned, we concur with the Management that it is beneficial to the PRC property market as well as the retail market in PRC urban areas especially for the Premises which is located in the first tier city of Shenzhen. We concur with the Management that the emerging and growing of middle-income class consumers along with their spending power will be a substantial driving force on the development of the property market as well as the retail market in the PRC and the Premises and will provide reasonable income to the Group in the future.

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1. <https://www.mckinsey.com/business-functions/marketing-and-sales/our-insights/survey-chinese-consumer-sentiment-during-the-coronavirus-crisis>
  2. <http://www.ccagm.org.cn/bg-yj/6701.html>



### 3. Reasons for and benefits of entering into the Long-Term Lease Agreement

The Group is principally engaged in property investment and operation and management of retail stores in the PRC. The Group commenced tapping into the operation of shopping mall in 2017 by opening its first shopping mall in Shenzhen.

As stated in the Letter from the Board, the Group had been leasing the Premises for more than 15 years from the Landlord for the operation of the Group's Shiyan retail store. Given the Existing Lease Agreement entered into with the Landlord in relation to the Premises expired on 15 November 2021, the Group intended to continue to lease the Premises for the continuous operation of the Shiyan retail store in Shenzhen.

The terms of the Long-Term Lease Agreement (including the rent) were determined after arm's length negotiations between the parties, with reference to standard terms of the lease agreements adopted for lease of similar properties and taking into account the initial market rental of the Premises which was endorsed by a fair rent letter dated 15 November 2021 prepared by Valor Appraisal & Advisory Limited, an independent professional property valuer (the "Valuer") that such monthly rent as of the date of the valuation certificate is reasonable in the market and on normal commercial terms.

In view of such, the Directors (excluding the independent non-executive Directors) are of the view that the transactions contemplated under the Long-Term Lease Agreement were conducted (i) in the ordinary and usual course of business of the Group; (ii) on normal commercial terms; and that (iii) the terms contemplated under the Long-Term Lease Agreement are fair and reasonable and in the interests of the Company and the Independent Shareholders as a whole.

In order to assess the fairness and reasonableness of the Long-Term Lease Agreement, we have conducted relevant research in relation to the Baoan District in Shenzhen, where the Premises locates.

According to the Shenzhen Statistical Yearbook 2020 dated 31 December 2020 edited by Shenzhen Statistics Bureau and NBS Survey Office in Shenzhen, in 2019, Baoan District was the largest region in Shenzhen, with a total area of approximately 396.61 square kilometres, had population in 2019 of approximately 3.34 million, increased by approximately 2.5% as compared to approximately 3.26 million in 2018. Furthermore, the annual GDP of Baoan District was approximately RMB384.7 billion in 2020, slightly decreased by approximately 0.2% as compared with approximately RMB 385.3 billion in 2019 as the economy was temporarily and adversely affected by the outbreak of COVID-19 pandemic. However, the economy has since continued to recover and Baoan District recorded a period-on-period growth in GDP of approximately 20.7% for the six months ended 30 June 2021 compared to the correspondence prior year period, based on preliminary data published by the local Government of Baoan District on 13 August 2021.

In addition, according to a plan issued by the Baoan District Development and Reform Bureau\* (寶安區發展和改革局) in the first quarter of 2021, the “Baoan District Major Project Plan in 2021\*” (寶安區2021年重大專案計劃). As mentioned in the plan, there would be 153 major projects, with a total investment of approximately RMB306.7 billion and target to complete approximately RMB32.2 billion in 2021. In addition, 124 preliminary projects were announced, with a total investment of approximately RMB178.9 billion. As further mentioned in a notice by the Baoan Development and Reform Commission\* (寶安發改委), it is necessary to accelerate the realization of Baoan District to become the (i) new international modern city centre; and (ii) world-class electronic information industry cluster, thus further increase the number of companies and population.

In view of the large scale and long term project plan which is expected to bring advantage and drive the demand for department stores, we concur with the Management that the Group will benefit from the plan as mentioned above.

Having considered that (i) the emerging and growing middle-income class consumers with their growing spending power; (ii) the continue recovery of the retail and consumer market; (iii) project plan of Baoan District as mentioned above; (iv) with an increasing number of companies and population which drive the demand for department stores; and (v) the Long-Term Lease Agreement would maintain the revenue stream of the Company and may generate greater return potential to the Independent Shareholders, we concur with the Directors’ view that the Long-Term Lease Agreement is in the ordinary and usual course of business of the Group, beneficial to the Group’s long-term development in the Baoan District and in the interests of the Company and Independent Shareholders as a whole.

#### **4. Principal terms of the Long-Term Lease Agreement**

The following information has been extracted from the Letter from the Board:

Parties:	The Landlord as the landlord of the Premises The Tenant as the tenant of the Premises
Premises:	Level 1 of Commercial Podium, Jiahua Hao Yuan, Western Shiyan Avenue, Shiyan Street, Baoan District, Shenzhen, Guangdong Province, the PRC (深圳市寶安區石岩鎮石岩大道西側佳華豪苑大廈(工業區)1棟商場01層) with a total of area of 5,851.50 sq.m.
Term:	9 years and 11 months commencing from 16 November 2021 to 15 October 2031 (both days inclusive)

Rent:	An initial monthly rent of RMB296,861.50 per month (approximately RMB50.73 per sq.m. per month), with a 5% increment on the monthly rent for every 3 years.  Monthly rent is payable before the 10th of each month
Deposit:	A rental deposit of RMB593,723 payable by the Tenant to the Landlord 5 days after the execution of the Long-Term Lease Agreement.
Usage:	For commercial purposes
Sub-let:	The Landlord allows the Tenant to sub-lease part of the Premises to other parties provided that the term is within the lease term of the Long-Term Lease Agreement
Termination:	The Long-Term Lease Agreement may be terminated among other things, the mutual agreement between the Tenant and the Landlord.  Should the Long-Term Lease Agreement be terminated by the Tenant as a result of the compliance of the Listing Rules, the Tenant would not be responsible for any damages or payable to the Landlord
Condition precedent:	Effective of the Long-Term Lease Agreement is conditional upon the Company having fulfilled its obligations under the Listing Rules, including but not limited to obtaining approval from the Independent Shareholders

## 5. Our analysis on the Long-Term Lease Agreement

### 5.1 Basis of rent and terms

The monthly rent of the Long-Term Lease Agreement will be RMB296,861.50 (approximately RMB50.73 per square meter per month), with a 5% increment on the monthly rent for every 3 years. The monthly rent was determined after arm's length negotiations between the Landlord and the Tenant with reference to (i) standard terms of the lease agreements adopted for lease of similar properties; and (ii) the initial market rental of the Premises which was endorsed by a fair rent letter dated 15 November 2021 prepared by the Valuer, an independent professional property valuer that such monthly rent as of the date of the valuation certificate is reasonable in the market and on normal commercial terms.

Having reviewed (i) the fair rent letter as to the monthly rent in the Long-Term Lease Agreement prepared by the Valuer; and (ii) standard terms of the Long-Term Lease Agreement (as compared to the template 《深圳市房屋租賃合同》 issued by the Housing and Construction Bureau of Shenzhen\* (深圳市住房和建設局), we are given to understand (i) from the Management and the legal opinion the terms are commonly seen in a lease agreement in Shenzhen and (ii) from the Valuer that the monthly rent of the Long-Term Lease Agreement is more favourable comparing to similar properties in the area.

We have reviewed and enquired the Valuer's qualification and experience in relation to the valuation. The Valuer confirmed that it is an independent third party to the Company. We also obtained and reviewed the terms of the Valuer's engagement, in particular, their scope of work, and noted that it is appropriate to the opinion required to be given and there is no limitation on the scope of work which might adversely impact on the assessment given by them in the fair rent letter.

We have reviewed the fair rent letter issued by the Valuer dated 15 November 2021 and noted that the Valuer has adopted the direct comparison approach by making reference to comparable market rentals as available in the subject locality. This approach rests on the wide acceptance of the market rent as the best indicator and pre-supposes the evidence of relevant rentals in the market place can be extrapolated to similar properties, subject to allowances for variable factors and adjustments such as location, size, etc. In light of the above, we are of the view that the fair rent opinion has been reasonably prepared and is normal in nature without any unusual assumption, and the relevant basis is fair and reasonable.

Furthermore, we have obtained and reviewed one lease agreement for renting of properties for operation of department store between the Group and an independent third party (the "I3P Sample"). The limited sample size was due to the fact that the Group have limited operation of department stores in Shenzhen, other samples from districts outside Shenzhen are not considering to be comparative samples in our opinion since the price and terms could drastically differ from the market norm in the Baoan District comparing to other districts. We have further reviewed the legal opinion regarding (i) the compliance of relevant usage of Premises and (ii) the terms set out in the Long-Term Lease Agreement and are given to understand that the terms in the Long-Term Lease Agreement are normal and not uncommon in the market.

We note that a 5% increment on the monthly rent for every three years (equivalent to a compound annual growth rate of approximately 1.64%) for the subject property as stipulated in the Long-Term Lease Agreement has been taken into account by the Company. Further to our discussion with the Valuer and the Management, we concur with their view that the consumer price index ("CPI") released by the National Bureau of Statistics of China and the inflation rate of the PRC should be taken into reference in determining the reasonableness of the 5% increment on the monthly rent for every three years as stated in the terms in the Long-Term Lease Agreement. We therefore reviewed from publicly available information and noted that the CPI increased for approximately 2.1%, 2.9% and 2.5% for 2018, 2019 and 2020, respectively and the inflation rate of the PRC released by the World Bank and noted that the inflation rate of the PRC was approximately 2.1%, 2.9% and 2.4% for 2018, 2019 and 2020, respectively. In light of the above CPI growth rate and the inflation rate, we concur with the Management and the Valuer that the 5% increment for every 3 years is fair and reasonable.

We also discussed with the Management and are given to understand that the Company has a series of internal control procedures to review and approve for the pricing, terms and selection criteria before entering into the Long-Term Lease Agreement including e.g. market comparable research, appointing valuer for valuation, seek for professional advices on the terms i.e. legal opinion. Furthermore, we also obtained internal approval form for the Long-Term Lease Agreement and I3P Sample. We are of the view that the internal approval process adopted was reasonable and effectively implemented.

In light of the aforementioned, we are of the view that the rent and terms of the Long-Term Lease Agreement is on normal commercial terms, fair and reasonable so far as the Independent Shareholders are concerned and are in the interests of the Company and the Independent Shareholders as a whole.

## *5.2 Basis of determination of duration*

The Long-Term Lease Agreement will be from 16 November 2021 to 15 October 2031. The duration of the Long-Term Lease Agreement was determined after arm's length negotiations between the Tenant and Landlord. A rental deposit of RMB593,723 payable by the Tenant to the Landlord 5 days after the execution of the Long-Term Lease Agreement.

In assessing the reasonableness for the duration of the Long-Term Lease Agreement to be longer than three years, we have considered the following factors:

- (i) the Group had already made a substantial amount of capital investment on setting up the Shiyuan store, huge amount of relocation and other relevant costs would be incurred if need to be relocated;
- (ii) the term of more than nine years in the Long-Term Lease Agreement can prevent the recurrence of relocation costs and huge initial investment costs in setting up another Shiyuan store;
- (iii) the term of more than nine years in the Long-Term Lease Agreement will allow the Company to secure a favourable location which is currently operating the Shiyuan store;
- (iv) the long-term nature in the Long-Term Lease Agreement is in the interests of the Company given that a shorter duration term, the Company may face the risk of having to identify and locate another similar premises which may hamper the business operation and development of the Group in the future; and
- (v) having reviewed lease agreements entered into by the Group and independent third party for renting of a property for operation of department store, we noted that the leasing terms of the lease agreement are comparable to those of the Long-Term Lease Agreement.

In assessing the leasing term of period of the Long-Term Lease Agreement, except for the I3P Sample which has a leasing term of 10 years, we have carried out independent research and further identified and reviewed a list of 10 comparable transactions (the “**Comparable Transactions**”) involving the leasing of properties as retail stores/department stores which we consider to be exhaustive on our best effort basis. The Comparable Transactions were selected based on the criteria that (i) at least one of the transaction parties involved is listed on the Stock Exchange; (ii) the size transactions were at discloseable level or above; and (iii) the transactions are related to the leasing of retail stores/department stores in the PRC.

Company name (Stock code)	Date of the announcement	Date of the tenancy agreement	Lease period (Years)	Location
Parkson Retail Group Limited (3368)	12 July 2021	11 July 2021	20	PRC
Parkson Retail Group Limited (3368)	23 December 2020	23 December 2020	15	PRC
New World Department Store China Limited (825)	23 September 2020	(i) 3 September 2008	(i) 10	PRC
		(ii) 5 September 2008	(ii) 10	
Parkson Retail Group Limited (3368)	1 June 2020	1 June 2020	20	PRC
Shirble Department Store Holdings (China) Limited (312)	15 October 2019	15 October 2019	20	PRC
Parkson Retail Group Limited (3368)	14 June 2019	12 June 2019	12	PRC
Parkson Retail Group Limited (3368)	3 April 2019	26 February 2019	10	PRC
Yi Hua Holdings Limited (2213)	13 April 2015	13 April 2015	13	PRC
Yi Hua Holdings Limited (2213)	31 March 2014	31 March 2014	15	PRC
Lifestyle International Holdings Limited (1212)	22 September 2008	26 November 2004	20	PRC

As shown on the results from above, the terms of the Comparable Transactions range from 10 years to 20 years. Accordingly, the duration of the Long-Term Lease Agreement falls within the range of the lease period of the Comparable Transactions.

Having considered the principal factors as stated above, we concur with the Management and the Valuer that the lease term of period of the Long-Term Lease Agreement is normal and not uncommon in the market.

### 5.3 *The valuation report*

In order to evaluate the basis in determining the market value (value of the right-of-use asset) of the Long-Term Lease Agreement, we have reviewed the valuation report prepared by the Valuer, and have discussed with the Valuer and management of the Company. We noted that the Valuer has considered the market value through income capitalisation approach in valuing the Premises. They have also made reference to the yields achieved in the sales of similar properties in the market. To assess the market rent, the direct comparison method is adopted.

In conducting the valuation of the Premises, the Valuer has also adopted the following assumptions:

- (i) the Premises will be sold on the open market in their existing states without the benefit of a deferred term contracts, leasebacks, joint ventures, management agreements or any similar arrangements, which could serve to affect the values of the property interests;
- (ii) transferable land use rights in respect of the Premises for specific terms at nominal annual land use fees have been granted and that any premium payable has already been fully paid;
- (iii) owners of the Premises have enforceable titles to the Premises and have free and uninterrupted rights to use, occupy or assign the Premises for the whole of the respective unexpired terms as granted;
- (iv) the Premises are free from encumbrances, restrictions and outgoings of an onerous nature, which could affect the Premises' values; and
- (v) all information in relation to the Premises which provided to the Valuer are true and accurate.

In our discussion with the Valuer, we understand that the valuation was carried on a market basis. Market value is defined as "the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion".



We have discussed with the Valuer on the selection of valuation methodology. Considering the cost approach is used for valuing property with special nature, and rental comparable evidences are generally available, the Valuer therefore has not adopted the cost approach. Given that the property is a leasehold interest for a term of approximately 10 years, comparable sales transaction or information similar to such sales transaction is not available in Baoan District, with such constraint, the Valuer therefore has not adopted the direct comparison approach for the overall valuation.

In valuing the Premises, the Valuer has adopted income capitalisation approach by applying a yield (rate of return or discount rate) to market rent with reference to the yields achieved for similar properties in Shenzhen, the yield was arrived with reference to (i) the approximately 3.9% prime retail yield of properties in Shenzhen from the research report conducted in Q2 2021 by CBRE; and (ii) a 1% premium applied to the prime retail yield by the Valuer with their professional experience and judgement due to the fact that the Premises is located in a non-prime location in Shenzhen. After obtaining the valuation result of the Premises, the Valuer adopted direct comparison method to assess the market rent in order to opine the fairness of the rental fee of the Long-Term Lease Agreement. As discussed with the Valuer, the Directors and the Management, we are of the view that the adoption of such valuation methodology is reasonable.

Furthermore, we have obtained and reviewed the comparables adopted by the Valuer, we have further discussed with the Board, the Management and the Valuer to understand the selection criteria of comparables and given to understand that the market comparables were selected based on (i) the land use of the premises has to be commercial usage; and (ii) the premises must be located in the same town Shiyan\* (石岩). Given the geographical location of the Premises is considered a non-prime area in Baoan District, which is also a district located in the outer skirt of Shenzhen, we are of the view that the said selection criteria are reasonable.

In order to further verify the source of information considered in the valuation, we also conducted our own research on the referencing information to cross check the reasonableness of the parameters considered in the Valuation Report. Regarding the prime retail yield, we have conducted our own research on reports prepared and published by the top five property valuer in the global market from 2019 to 2021 but no relevant information can be identified. We therefore extended our selection criteria of the search scope to investment property yield in key cities in the PRC and their respective prime and non-prime locations and identified three results we consider to be of reasonable comparison on publicly available information. The three results comprised of (i) the yield of approximately 5.4% for retail property market in east China from a report by an internationally reputable property valuer about the Asia pacific real estate in June 2020; (ii) the yield of approximately 5.2% for the retail in Shenzhen from a report of an internationally reputable property valuer about investment property net yields in major cities in the PRC in 2018; and (iii) the yield of approximately 4.0% based on an acquisition of a retail property in Guangzhou completed by a company listed on the Main Board of the Stock Exchange in June 2021.

Considering the fact that the prime retail yield adopted in the Valuation Report falls within the range from approximately 4.0% to approximately 5.4% of the yield of the search results mentioned above, we are of the view that the adoption of such prime retail yield is reasonable.

We have further reviewed the valuation worksheet including referencing information considered and the calculation bases in the Valuation Report provided by the Valuer and compared that with the result of our own research based on similar selection criteria and are not aware of any material difference between the research result and the Valuation.

Accordingly, we are of the view that the referencing information considered in the Valuation Report is true and fair and the comparables selected by the Valuer are fair and reasonable so far as the Company and Independent Shareholders are concerned.

Besides, we have discussed with the Valuer in relation to their experiences and understood that Mr. Ian Ng, the Associate Director of the Valuer and the person in charge of this valuation, is a professional surveyor with over 10 years of experience in valuation of properties in Hong Kong, Macau and the PRC. Mr. Ng is a Professional Member of The Hong Kong Institute of Surveyors. Given Mr. Ng has plenty of practical experience in the valuation of properties in Hong Kong and the PRC, we are of the view that he is qualified to provide a reliable valuation for the valuation of the Premises. As discussed with the Valuer, they have no prior relationships with the Group or other parties and connected persons to the Long-Term Lease Agreement, and we are of the view that the independence and objectivity of the Valuer is fair and equitable in conducting such valuation. We also reviewed the terms of the engagement for the valuation of the Premises and the scope of work performed by the Valuer is consistent with the market practice and appropriate to give the opinion.

Given the income capitalisation valuation approach in the Valuation Report is commonly adopted and well recognised methodology for valuing properties, and the major assumptions made in connection with the valuation approach are reasonable, and having reviewed the basis of rent and the basis of determination of duration, we concur with the Management and the Valuer, and are of the view, that the basis in determining the market value (value of the right-of-use asset) is fair and reasonable so far as the Company and the Independent Shareholders as a whole are concerned.

## VI. RECOMMENDATION

Having considered the factors as set out in this letter above, in particular,

- (i) the reasons for and benefits of entering into the Long-Term Lease Agreement;
- (ii) the terms of the Long-Term Lease Agreement are fair and reasonable;
- (iii) the long-term duration of more than nine years of the Long-Term Lease Agreement is a normal business practice for the Group; and
- (iv) the basis in determining the estimated value of the right-of-use asset is fair and reasonable,

we are of the view that the entering of the Long-Term Lease Agreement is in the ordinary and usual course of business of the Group, on normal commercial terms, and the terms of the Long-Term Lease Agreement and the transactions contemplated thereunder are in the interests of the Company and its Shareholders as a whole and are fair and reasonable so far as the Independent Shareholders are concerned. Accordingly, we advise the Independent Board Committee to recommend, and we ourselves recommend, that the Independent Shareholders to vote in favour of the ordinary resolutions to approve the Long-Term Lease Agreement at the EGM.

Yours faithfully  
For and on behalf of  
**Red Sun Capital Limited**



Robert Siu  
*Managing Director*



Nicole Ying  
*Director*

*Mr. Robert Siu is a licensed person registered with the SFC and a responsible officer of Red Sun Capital Limited to carry out type 1 (dealing in securities) and type 6 (advising on corporate finance) regulated activities under the SFO and has over 20 years of experience in corporate finance industry.*

*Ms. Nicole Ying is a licensed person registered with the SFC and a responsible officer of Red Sun Capital Limited to carry out type 6 (advising on corporate finance) regulated activities under the SFO and has over 16 years of experience in corporate finance industry.*