



SOMERLEY CAPITAL LIMITED

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29 November 2024

To: *the Independent Board Committee and the Independent Shareholders*

Dear Sirs,

CONTINUING CONNECTED TRANSACTIONS IN RELATION TO THE RENEWED MERCHANDISE SUPPLY FRAMEWORK AGREEMENT

We refer to our appointment to advise the Independent Board Committee and the Independent Shareholders in relation to the purchase of merchandise (including apparel and toys) by the Group from ENS Toys for the year ending 31 December 2025 under the Renewed Merchandise Supply Framework Agreement (the "**Continuing Connected Transactions**") and the proposed annual cap (the "**Annual Cap**"), details of which are contained in the circular to the Shareholders published by the Company dated 29 November 2024 (the "**Circular**"), of which this letter forms a part. Unless the context otherwise requires, terms used in this letter shall have the same meanings as defined in the Circular.

ENS Toys is ultimately wholly-owned by Mr. Hui, the executive Director, chairman of the Board, chief executive officer and one of the controlling shareholders of the Company. Therefore, ENS Toys is considered as an associate of Mr. Hui and a connected person of the Company under Chapter 14A of the Listing Rules, and the entering into of the Renewed Merchandise Supply Framework Agreement and the transactions contemplated thereunder constitute continuing connected transactions of the Company under Chapter 14A of the Listing Rules.

As one or more applicable percentage ratios as defined under Rule 14.07 of the Listing Rules for the Annual Cap exceed 5%, the transactions contemplated under the Renewed Merchandise Supply Framework Agreement and the Annual Cap are subject to the reporting, announcement, Independent Shareholders' approval and annual review requirements under Chapter 14A of the Listing Rules.



The Company will seek approval from the Independent Shareholders of the Renewed Merchandise Supply Framework Agreement and the transactions contemplated thereunder in accordance with the requirements of the Listing Rules. In view of Mr. Hui's material interests in the Renewed Merchandise Supply Framework Agreement as the ultimate shareholder of ENS Toys, Mr. Hui and his associates will be required to abstain from voting for the ordinary resolution approving the Renewed Merchandise Supply Framework Agreement and the transactions contemplated thereunder at the EGM.

The Independent Board Committee comprising all the independent non-executive Directors, namely Ms. Leung Ping Fun Anita, Mr. Sung Chi Keung and Dr. Chan Kai Yue Jason, *MH, JP*, has been established to advise the Independent Shareholders on the Renewed Merchandise Supply Framework Agreement and the transactions contemplated thereunder. We, Somerley Capital, have been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in this regard.

During the past two years, there was no engagement between the Company and Somerley Capital. As at the Latest Practicable Date, there were no relationships or interests between (a) Somerley Capital; and (b) the Group, ENS Toys and their respective subsidiaries and associates that could reasonably be regarded as a hindrance to our independence as defined under Rule 13.84 of the Listing Rules to act as the Independent Financial Adviser.

In formulating our opinion and recommendation, we have relied on the information and facts supplied, and the opinions expressed, by the Directors and management of the Group and have assumed that such information, facts and opinions were true, accurate and complete in all material aspects and will remain so up to the time of the EGM. We have reviewed, among others, the relevant information contained in (i) the Renewed Merchandise Supply Framework Agreement, (ii) the annual report of the Company for the years ended 31 December 2022 and 2023, (iii) the interim report of the Company for the six months ended 30 June 2024, and (iv) relevant information as contained in the Circular. We have also sought and received confirmation from the Directors that all material relevant information has been supplied to us and that no material facts have been omitted from the information supplied and opinions expressed to us. We have no reason to believe that any material information has been omitted or withheld from us, or to doubt the truth, accuracy or completeness of the information provided. We have relied on such information and consider that the information we have received is sufficient for us to reach an informed view. We have, however, not conducted any independent investigation into the business and affairs of the Group, ENS Toys or their respective subsidiaries or associates, nor have we carried out any independent verification of the information supplied.



PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion and recommendation on the Renewed Merchandise Supply Framework and the transactions contemplated thereunder (including the Annual Cap), we have taken into account the following principal factors and reasons:

1. Information on the Group and ENS Toys

The Group

The Group is principally engaged in (i) character licensing business and (ii) e-commerce and other business. The Character licensing business involves the creation, design, licensing, brand management and marketing of self-created B.Duck Family Characters across multi-channels. The Group licenses the B.Duck Family Characters and brands to its licensees, provides them with product design application services and allows them to use the same in their products and services offering. The Group's e-commerce and other business mainly involves the design, development, procurement and retail sale of licensed brand products (mainly the B.Duck Family Characters-featured products) through multi-channels. Shares have been listed on the Stock Exchange since January 2022 and the Company had a market capitalisation of approximately HK\$1.1 billion as at the Latest Practicable Date.

In 2023, the Group recorded revenue of approximately HK\$129.5 million, representing a decrease of approximately 32.7% as compared to 2022. Such decrease was mainly due to the reduction in revenue contribution from both character licensing business and e-commerce and other business, as the Group and its licensees utilised the accumulated inventory from the prior year which was suffered from the weakened consumer sentiment as a result of the COVID-19 pandemic. In the first half of 2024, the Group resumed growth, with revenue increased by approximately 4.9% year-on-year to approximately HK\$59.9 million. The improvement was mainly due to its 21.3% revenue growth in e-commerce and other business, mainly as a result of the Group's continuous promotion and expansion efforts in various e-commerce platforms in the PRC and Southeast Asia.

ENS Toys

ENS Toys is a limited liability company established in the PRC and its entire equity interests is ultimately wholly-owned by Mr. Hui. ENS Toys is principally engaging in manufacturing business and holding manufacturing facilities located in the PRC. Its business scope includes, among others, production of electronic products, apparel and accessories, plastic toys, crafts, toys, cloth-made office supplies and daily necessities.



2. Background to and reasons for entering into the Renewed Merchandise Supply Framework Agreement

As stated in the Company's listing document, leveraging the synergies generated from its character licensing business, the Group started to design and sell its self-created B.Duck Family Characters-featured products to its customers through third parties' e-commerce platforms in the PRC since 2015, including Tmall and JD.com. Such business has subsequently been expanded to other e-commerce platforms in both PRC and overseas markets.

Based on our discussion with the management of the Group, ENS Toys has been one of the main original equipment manufacturing ("OEM") suppliers of the Group's products for its e-commerce business, and the Group has been purchasing merchandise from ENS Toys during its ordinary and usual course of business for over ten years. Given the long history of cooperation between two groups, ENS Toys is familiar with the Group's business needs, and ENS Toys has been providing the Group with final production samples and high-quality merchandise in a timely manner, with terms (including pricing) offered that were comparable to or better than terms offered by other independent third-party OEM suppliers in the PRC.

Currently, the transactions between the Group and ENS Toys are governed by the 2024 Merchandise Supply Framework Agreement III, which was approved by the then independent shareholders of the Company at a shareholder's meeting held on 27 May 2024. The 2024 Merchandise Supply Framework Agreement III will expire on 31 December 2024. In view of the upcoming expiry, the Renewed Merchandise Supply Framework Agreement has been entered into on 22 November 2024, to enable the Group to continue purchasing merchandise from ENS Toys for a term of one year commencing on 1 January 2025 and ending on 31 December 2025.

Shareholders should note that the Renewed Merchandise Supply Framework Agreement is on a non-exclusive basis, the Group is free to purchase merchandise from other Independent Third Parties to cater for the Group's business needs. We concur with the Directors' view that the entering into of the Renewed Merchandise Supply Framework Agreement affords the Group with the flexibility and the option to continue purchasing the merchandise from ENS Toys, which forms part of the ordinary and usual course of business of the Group.



3. Principal terms of the Renewed Merchandise Supply Framework Agreement

Set out below are the principal terms of the Renewed Merchandise Supply Framework Agreement. Further details are disclosed in the section headed “Renewed Merchandise Supply Framework Agreement” in the letter from the Board.

Subject matter

Pursuant to the Renewed Merchandise Supply Framework Agreement, the Company has agreed to, and would procure other members of the Group to, purchase merchandise (including but not limited to apparel and toys) from ENS Toys. There is no minimum purchase amount stipulated in the Renewed Merchandise Supply Framework Agreement, nor is the Group bound to purchase merchandise from ENS Toys. The types and quantities of merchandise to be purchased, purchase prices and delivery terms shall be specified in individual purchase order to be placed by the Group.

Term

The Renewed Merchandise Supply Framework Agreement has a term of one year from 1 January 2025 to 31 December 2025, subject to the Independent Shareholders’ approval at the EGM.

Pricing basis

Pursuant to the Renewed Merchandise Supply Framework Agreement, the products will be priced on normal commercial terms and in the ordinary course of the Group’s business with reference to the market price of merchandise with the same or comparable product type and purchase quantity provided by Independent Third Parties. Before entering into any transactions with ENS Toys, the Group will obtain quotes from at least two Independent Third Parties for comparison, details of which are set out in the section below headed “5. Internal Control Measures”.

Payment terms

Upon due delivery of merchandise, ENS Toys shall issue an invoice to the Company and/or relevant members of the Group for such merchandise; and payment shall be due within 60 days after placement of the individual purchase order, unless otherwise agreed between the parties in writing.



Comparison of terms with other independent third parties

We have discussed with the management of the Group the key terms of the Renewed Merchandise Supply Framework Agreement, which are broadly consistent with the 2024 Merchandise Supply Framework Agreement III. We were advised that in choosing the OEM supplier, the Company would also look into, among others, the pricing and credit terms, the OEM suppliers' merchandise quality, their ability to supply the merchandise in sufficient quantities and on a timely basis, and their past experience in manufacturing merchandise with the same or comparable product type.

We have also obtained and reviewed the lists of transactions with ENS Toys during the period from 1 January 2024 to 30 September 2024, for which the management of the Group confirmed to us that they have provided to us an exhaustive list of transactions for the above time frame, and randomly selected five samples for the purchases of merchandise by the Group from ENS Toys from such lists. In view of the sample transactions covering different types of merchandise, including apparel and toys which are the major merchandise under the 2024 Merchandise Supply Framework Agreements, we consider the sample transactions selected to be fair and representative. We have compared the selected samples with quotes obtained from independent third party suppliers for merchandise with the same or comparable product type and purchase quantity, and we concur with the Company's view that the overall terms of the transactions with ENS Toys, including the quoted prices and credit terms, were on terms no less favourable to the Group than those obtained by the Group from independent third party suppliers.

4. The Annual Cap

Review of historical transactions

Set out below are the historical transaction amounts with ENS Toys for the years ended 31 December 2021, 2022 and 2023, and for the nine months ended 30 September 2024, as well as the respective annual caps, under the existing and previous merchandise supply framework agreements:

(HK\$'000)	For the year ended 31 December			For the nine months ended
	2021	2022	2023	30 September 2024
Purchase from ENS Toys	34,789	19,202	20,306	16,819
Relevant annual caps	40,000	45,000	52,000	27,861
Utilisation rates	87.0%	42.7%	39.1%	80.5%
				(Note)

Note: Utilisation rate for the nine months ended 30 September 2024 is calculated based on the relevant nine-month transaction amounts and pro rata annual cap amount.



As set out in the table above, the total amount of merchandise purchases from ENS Toys decreased substantially by approximately 44.8% in 2022 to approximately HK\$19.2 million, but stabilised in 2023 at approximately HK\$20.3 million. As advised by the management of the Group, the decrease in 2022 was mainly attributable to the slowdown in sales of the Group's B.Duck Family Characters-featured products through e-commerce platforms, due to the lingering impacts brought by the COVID-19 pandemic on the PRC economy, leading to a generally more cautious approach to spending. Although Mainland China has lifted most of the COVID-19 related restrictions since late 2022, the amount of merchandise purchases from ENS Toys had not recovered to the level in 2021, mainly due to the fact that the Group utilised its accumulated merchandise inventory from the prior year for its e-commerce business as explained earlier, in turn leading to a lower level of purchases by the Group from its suppliers, including ENS Toys, in 2023.

For the nine months ended 30 September 2024, the total amount of merchandise purchases from ENS Toys increased year-on-year to approximately HK\$16.8 million, representing approximately 82.8% of the full year transaction amount in 2023. The higher level of purchases was mainly driven by the growing sales of the Group's merchandise through e-commerce platforms in both PRC and Southeast Asian markets. The relevant annual cap in 2024 had been fairly utilised, being approximately 80.5%.

Assessment of the Annual Cap

The Annual Cap under the Renewed Merchandise Supply Framework Agreement for the year ending 31 December 2025 is proposed to be HK\$36,000,000.

In order to assess the reasonableness of the Annual Cap, we have discussed with management of the Group the bases and assumptions underlying the projections for the purchase of the merchandise from ENS Toys. In determining the Annual Cap, the Company has taken into account (i) the historical transaction amounts with ENS Toys in the past three financial years, together with the annual cap utilisation rate of about 80% for the nine months ended 30 September 2024, as discussed in the sub-section above, and (ii) the expected demand for the Group's merchandise through e-commerce platforms in both PRC and overseas markets for the year 2025.

We note that the Annual Cap amount in 2025 represents a significant increase of approximately 29.2% as compared to the relevant annual cap in 2024. We understand from the management of the Group that the Group has been actively pursuing business development in both PRC and overseas markets. Apart from the ongoing devotion of resources on e-commerce platforms in the PRC, the Group has established a joint venture company in Thailand in 2023 to operate e-commerce and licensing businesses, and initiated operations on various e-commerce platforms targeting customers and fans in other Southeast Asian countries, including Indonesia and Vietnam. Further expansion will also be explored in other countries



and regions in the coming years. All these initiatives have become and will continue to be the growth engine for the Group's e-commerce business in the near future. Based on our discussion with the management of the Group, the Group's overseas e-commerce business is still in the growth stage, with promising opportunities and growth potential. This is evidenced by the Group's revenue growth from its e-commerce and other business in the first half of 2024, increasing by approximately 21.3% year-on-year to HK\$33.6 million. Out of its total revenue, the Group's revenue from Southeast Asia and Taiwan increased by over 3 times in the first half of 2024, as compared to 2023. The growth in actual purchases from ENS Toys for the first nine months in 2024, together with the abovementioned initiatives being taken by the Group in Thailand and other Southeast Asian countries and the resulting substantial growth in revenue from such geographical locations, further support the substantial increase in expected transaction amount with ENS Toys in 2025.

To substantiate the above, we have further researched the e-commerce market in both PRC and Southeast Asian markets. For the PRC market, according to the National Bureau of Statistics of China, (i) in 2023, the retail sales nationwide grew by approximately 11.0% to approximately RMB15,426.4 billion, of which the online retail sales of physical goods grew by approximately 8.4% to approximately RMB13,017.4 billion (as retrieved from its website at https://www.stats.gov.cn/english/PressRelease/202402/t20240201_1947119.html on the Latest Practicable Date), making the PRC the world's largest e-commerce retail market for 11 consecutive years; and (ii) in the first nine months of 2024, the retail sales nationwide further grew by approximately 8.6% year-on-year to approximately RMB10,892.8 billion, while the online retail sales of physical goods grew by approximately 7.9% to RMB9,072.1 billion (as retrieved from its website at https://www.stats.gov.cn/english/PressRelease/202410/t20241025_1957147.html on the Latest Practicable Date).

For the Southeast Asian market, according to The International Trade Administration, an agency in the United States Department of Commerce, the e-commerce market spendings in Southeast Asia is expected to grow from approximately US\$137 billion in 2023 to approximately US\$186 billion by 2025, representing a compound annual growth rate of approximately 16.5% (as retrieved from its website at <https://www.trade.gov/southeast-asia-region-forecast> on the Latest Practicable Date). The above statistics indicate the continuous and potential growth of the e-commerce market in both PRC and Southeast Asian markets in 2025, and such rapid e-commerce market development may potentially contribute to the Group's future e-commerce business growth, which in turn drive the Group's demand of merchandise from its suppliers including ENS Toys.



In our opinion, it is in the interests of the Company and the Shareholders to determine the Annual Cap in a way that can accommodate the potential growth of the Group's e-commerce business and corresponding merchandise purchase needs. It should be noted that the Group's e-commerce business is highly dependent on a number of factors, including the consumer's sentiment and preferences, which are beyond its control. It follows that it would be difficult for the management of the Group to estimate the future merchandise purchases from suppliers, including ENS Toys, with a high level of certainty. Having considered that (i) the historical transaction amount between the Group and ENS Toys, including the fair utilisation of the annual cap in 2024 under the 2024 Merchandise Supply Framework Agreement III, being approximately 80.5%, and (ii) the Group's continuous expansion strategies, as discussed in the sub-section above, which in turn drive the demand for the Group's merchandise and corresponding demand from the Group's suppliers including ENS Toys, we consider it reasonable for the Group to use the above factors in determining the Annual Cap.

5. Internal Control Measures

In addition to the annual review as required under the Listing Rules as explained in below section headed "6. Reporting requirements and conditions of the Continuing Connected Transactions", the Group has adopted and will continue to implement the following internal control measures, in order to ensure that the terms (including pricing basis) of the Renewed Merchandise Supply Framework Agreement and the Annual Cap are complied with:

- 1) before entering into any transactions with ENS Toys, the purchasing department of the Group will obtain quotes from at least two Independent Third Parties which provide merchandise of the same or comparable product type and purchase quantity. A summary report comparing the quotes obtained from two Independent Third Parties and ENS Toys will be submitted to the product planning department of the Group for approval;
- 2) the product planning department of the Group will review and compare the quotes from the Independent Third Parties with the quotes from ENS Toys when determining the supplier so as to ensure that the prices of the products provided by ENS Toys to the Group are fair and reasonable and are determined on normal commercial terms or on terms no less favourable to the Group than the terms available from the Independent Third Parties; and
- 3) the finance department of the Group will monitor the actual transaction amounts under the Continuing Connected Transactions and compare them against the relevant annual cap on a monthly basis. If the finance department of the Group finds that the actual transaction amounts under the Continuing Connected Transactions reach 70% of the relevant annual cap, it will confer with the relevant departments to assess the subsequent business needs so as to determine whether to revise the amount of the relevant annual cap.

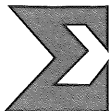


As confirmed by the management of the Group, there is a proper and complete separation of duties, and no common staff, senior management or director of the Group or ENS Toys will be involved in the internal control measures. The Directors considers that the above internal control measures are sufficient to ensure that the relevant Continuing Connected Transaction will be conducted on normal commercial terms and not prejudicial to the interests of the Company and the Shareholders as a whole. In our opinion, the above internal control measures are important for the conduct of the relevant Continuing Connected Transactions, since exact terms and details will only be agreed and specified in individual purchase order. In these circumstances, we consider that the solicitation of quotes from Independent Third Parties, and a comparison with those offered by ENS Toys, will assist the Group in ensuring that the Continuing Connected Transactions are on terms no less favourable to the Group.

6. Reporting requirements and conditions of the Continuing Connected Transactions

Pursuant to Rules 14A.55 to 14A.59 of the Listing Rules, the Continuing Connected Transactions are subject to the following annual review requirements:

- (a) the independent non-executive Directors must review the Continuing Connected Transactions every year and confirm in the Company's annual report that the transactions have been entered into:
 - (i) in the ordinary and usual course of business of the Group;
 - (ii) on normal commercial terms or better; and
 - (iii) according to the agreement governing them on terms that are fair and reasonable and in the interests of the Shareholders as a whole;
- (b) the Company must engage its auditors to report on the Continuing Connected Transactions every year. The Company's auditors must provide a letter to the Board confirming whether anything has come to their attention that causes them to believe that the Continuing Connected Transactions:
 - (i) have not been approved by the Board;
 - (ii) were not, in all material respects, in accordance with the pricing policies of the Group if the Continuing Connected Transactions involve the provision of goods or services by the Group;
 - (iii) were not entered into, in all material respects, in accordance with the relevant agreement governing the Continuing Connected Transactions; and
 - (iv) have exceeded the Annual Cap;



- (c) the Company must allow, and ensure that the counterparties of the Continuing Connected Transactions allow, the Company's auditors sufficient access to their records for the purpose of the reporting on the Continuing Connected Transactions as set out in paragraph (b); and
- (d) the Company must promptly notify the Stock Exchange and publish an announcement if the independent non-executive Directors and/or auditors of the Company cannot confirm the matters as required.

In light of the reporting requirements attached to the Continuing Connected Transactions, in particular, (i) the restriction of the value of the Continuing Connected Transactions by way of the Annual Cap; and (ii) the ongoing review by the independent non-executive Directors and auditors of the Company of the terms of the Renewed Merchandise Supply Framework Agreement not being exceeded, we are of the view that appropriate measures will be in place to monitor the conduct of the Continuing Connected Transactions and assist to safeguard the interests of the Independent Shareholders.

OPINION AND RECOMMENDATION

Having taken into account the above principal factors and reasons, we consider that the Renewed Merchandise Supply Framework Agreement and the transactions contemplated thereunder (including the Annual Cap) are on normal commercial terms and fair and reasonable so far as the Independent Shareholders are concerned. We also consider that the entering into of the Renewed Merchandise Supply Framework Agreement and the transactions contemplated thereunder are in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole.

Accordingly, we advise the Independent Board Committee to recommend, and we ourselves recommend, the Independent Shareholders to vote in favour of the ordinary resolution to be proposed at the EGM to approve the Renewed Merchandise Supply Framework Agreement and the transactions contemplated thereunder.

Yours faithfully,
for and on behalf of
SOMERLEY CAPITAL LIMITED



John Wong
Director

Mr. John Wong is a licensed person registered with the Securities and Futures Commission of Hong Kong and a responsible officer of Somerley Capital, which is licensed to carry on Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities under the SFO. He has over fifteen years of experience in the corporate finance industry.