



16 February 2009

To *the Independent Board Committee and
the Independent Shareholders*

Dear Sirs,

**PROPOSED OPEN OFFER
CONNECTED TRANSACTION: LOAN CAPITALISATION AND APPLICATION
FOR WHITEWASH WAIVER**

INTRODUCTION

We refer to our appointment as the joint independent financial advisers to advise the Independent Board Committee and the Independent Shareholders in respect of the terms of the Open Offer, the Loan Capitalisation and the Whitewash Waiver, details of which are contained in the Letter from the Board (the "Letter") in the circular dated 16 February 2009 (the "Circular"), of which this letter forms part. Terms used in this letter shall have the same respective meanings as defined in the Circular unless the context requires otherwise.

On 19 November 2008, the Board announced that it was proposing to raise not less than approximately HK\$27.7 million before expenses by issuing not less than 345,968,750 Offer Shares and not more than 415,040,428 Offer Shares at the Subscription Price of HK\$0.08 per Offer Share on the basis of one Offer Share for every two Shares held on the Record Date. The minimum number of Offer Shares to be issued pursuant to the terms of the Open Offer represents 50% of the Company's existing issued share capital and approximately 33.3% of the Company's issued share capital as enlarged by the issue of the Offer Shares.

As set out in the Letter, as at the Latest Practicable Date, save for the Shares Options, the BOC Convertible Bonds and the CW Convertible Bonds, there are no outstanding warrants or share options or securities or derivatives that are convertible or exchangeable into Shares or confer any right to subscribe for Shares. The CW Convertible Bonds in the aggregate principal amount of HK\$180,050,000 with maturity date in 2017 and the rights to convert into 1,200,333,333 Shares at an initial conversion price of HK\$0.15 were issued by the Company to Good Outlook



Investments Limited, a wholly owned subsidiary of China Water. Pursuant to an agreement dated 22 September 2008, Good Outlook Investments Limited has agreed to sell and Global Business Investment Enterprises Limited, a wholly owned subsidiary of Prime, has agreed to acquire the CW Convertible Bonds in principal amount of HK\$25,000,000 at a consideration of HK\$30,000,000. For further details of the CW Convertible Bonds, please refer to the announcement and circular of the Company dated 12 July 2007 and 24 September 2007 respectively and the announcement of Prime dated 22 September 2008. China Water has undertaken that it will procure that the CW Convertible Bonds will not be converted into Shares prior to the completion of the Open Offer.

Pursuant to the Underwriting Agreement, China Water, being the Underwriter, and the Company have agreed that the aggregate Subscription Price required to be paid by China Water and its concert parties on (i) China Water's irrevocable undertakings (the "Irrevocable Undertakings") to accept or procure acceptance of their entitlements under the Open Offer; and (ii) China Water's underwriting obligation under the Underwriting Agreement, will be deemed to be paid by way of the full or partial capitalisation of the Loan of up to HK\$27,677,500 in first place and the remaining balance of the Subscription Price (if any) will be settled in cash. The exact amount of the Loan to be capitalised for such aggregate Subscription Price depends on the number of Offer Shares to be taken up by the Qualifying Shareholders. As the Underwriter is a substantial Shareholder, the Loan Capitalisation constitutes a connected transaction pursuant to Chapter 14A of the Listing Rules.

As set out in the Letter, in the event that no Qualifying Shareholders take up their respective entitlements under the Open Offer and China Water, as the underwriter of the Open Offer, pursuant to the Underwriting Agreement will be required to take up all the Offer Shares that are not taken up by the Qualifying Shareholders under the Open Offer, which in aggregate with the subscription of Offer Shares under the Irrevocable Undertakings will result China Water and its concert parties holding approximately 46.15% (or approximately 44.01% in the event all Share Options and all BOC Convertible Bonds have been converted in full) of the entire issued share capital of the Company upon completion of the Open Offer in the event that none of the Share Options and BOC Convertible Bonds have been converted. In such case, an obligation on the part of China Water and its concert parties to make a mandatory general offer under Rule 26 of the Takeovers Code for all the Shares not already owned by or agreed to be acquired by it and its concert parties will arise. An application has been made by China Water to the Executive for the Whitewash Waiver pursuant to Note 1 on dispensations from Rule 26 of the Takeovers Code. The Whitewash Waiver, if granted by the Executive, would be



subject to, among other things, the approval of the Independent Shareholders at the EGM by way of poll.

Pursuant to the Listing Rules, the Loan Capitalisation is conditional on, among other things, the approval by the Independent Shareholders. As China Water is deemed to have a material interest in the Open Offer and the Loan Capitalisation, China Water and its concert parties and those who are involved in or interested in the Open Offer, the Whitewash Waiver and the Loan Capitalisation will abstain from voting on the respective resolutions at the EGM for approving the Whitewash Waiver and the Loan Capitalisation. The voting at the EGM will be taken by way of poll.

We have been retained by the Company to advise the Independent Board Committee and the Independent Shareholders as to (i) whether the Open Offer, the Loan Capitalisation and the Whitewash Waiver are in the interests of the Company and the Shareholders as a whole; (ii) whether the terms of the Open Offer, the Loan Capitalisation and the Whitewash Waiver are arm's length, on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned; and (iii) how the Independent Shareholders should vote in respect of the relevant resolutions to approve the Loan Capitalisation, and the Whitewash Waiver at the EGM.

The Independent Board Committee comprising all non-executive Directors and independent non-executive Directors in respect of the Open Offer and the Whitewash Waiver and comprising all independent non-executive Directors in respect of the Loan Capitalisation has been established for the purpose of advising the Independent Shareholders on the terms of the Open Offer, the Loan Capitalisation and the Whitewash Waiver.

BASIS OF OPINION

In formulating our advice and recommendation to the Independent Board Committee and the Independent Shareholders, we have relied on the statements, information, opinions and representations contained or referred to in the Circular and the information and representations as provided to us by the Directors and senior management of the Company. We have assumed that all information and representations that have been provided by the Directors and senior management of the Company, for which they are solely and wholly responsible, are true, complete and accurate in all material respects at the time when they were made and continue to be so as at the date of the despatch of the Circular. We have also assumed that all



statements of belief, opinion, expectation and intention made by the Directors in the Circular were reasonably made after due enquiries and careful considerations.

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 advisers and/or Directors, which have been provided to us. We consider that we have taken sufficient and necessary steps on which to form a reasonable basis and an informed view for our recommendation in compliance with Rule 13.80 of the Listing Rules and Note 2 to Rule 2 of the Takeovers Code.

The Directors and the Underwriter have jointly and severally accepted full responsibility for the accuracy of the information contained in the Circular and have confirmed, having made all reasonable enquires, which to the best of their knowledge and belief, there are no other facts the omission of which would make any statement in the Circular misleading. We consider that we have been provided sufficient information to reach an informed view and to provide a reasonable basis for our recommendation. We have not, however, conducted any independent in-depth investigation into the business and affairs of the Company, or their respective subsidiaries or associates, nor have we considered the taxation implication on the Group or the Shareholders as a result of the Open Offer, the Loan Capitalisation and the Whitewash Waiver.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In formulating our opinion and recommendation to the Independent Board Committee and the Independent Shareholders, we have taken into consideration, inter alia, the following principal factors and reasons. Our conclusions are based on the results of all analyses taken as a whole.

1. Background and Reasons for the Open Offer

The Group is principally engaged in the production and distribution of snack food and convenience frozen food products and in cultivation of seabuckthorn seedlings, manufacture, sales, research and development of seabuckthorn-related health products.

As advised by the Company, China Water has made a loan of approximately HK\$13 million on 11 November 2008 to the Company. Pursuant to an



announcement of the Company dated 23 January 2009, the Board announced that due to an inadvertent clerical error of the Company, the undated cheque of HK\$12,677,500 issued by China Water, being part of the Loan, was not collected by the Company until 23 January 2009 and was deposited into the accounts of the Company on 11 February 2009. As advised by the Company, the purposes of the above two loans were to strengthen the capital base of the Company, smoothen the financial flexibility on its operation and working capital and made partial repayment on its bank borrowings to release the pressure placed by the bank creditors at that time. As further advised by the Company, the above two loans together with the HK\$2 million current account balance with China Water made up the Loan of approximately HK\$27,677,500 as at the Latest Practicable Date.

We were advised by the management of the Company that they have considered alternative methods to raise funds including open offer, rights issue and placement of new shares at that time, however, given the recent financial crisis has resulted in a difficult situation for the Group to secure financing facilities from financial institutions and/or raised funds from the market by means of placement of new securities and the limited time to make partial bank borrowings repayment as demanded by bank creditors, the Company considered financial assistance from China Water is possibly the only alternative under such relevant period. Having taken into account the difficulty in conducting equity fund raising as a result of global financial crisis at that time and the stressful situation of the Company on repayment on its bank borrowings, we concur with the Company that the financial assistance from China Water at that time is fair and reasonable and is in the interest of the Company and the Shareholders as a whole.

As it was the consensus of the Company and China Water that the Company will repay the Loan within a short period of time, after considering the outstanding bank borrowings amounted to approximately HK\$122 million and the cash and bank balance of approximately HK\$45.89 million as at 30 November 2008, the Company proposed to raise fund by the Open Offer for financing its operations and activities for expanding its businesses. Nevertheless, given the recent market sentiment, the Company was unable to procure any potential underwriters. Eventually, after arm's length negotiation between the Company and China Water, China Water agreed to be the Underwriter for the Open Offer and settle the Loan by way of Loan Capitalisation.

As set out in the Letter, the Directors have considered other alternative fund raising methods such as issue of new shares and bank borrowings and consider that the Open Offer has the benefits of allowing the Qualifying Shareholders to maintain



their respective pro rata shareholdings if they take up their entitled Offer Shares and participate in the future growth of the Group. The Directors believe that the Open Offer is fair and reasonable and in the interests of the Company and the Shareholders as a whole. Our analyses on other alternatives to the Open Offer has been set out under the section headed “4. Alternatives to the Open Offer” below.

As advised by the Company, the Loan owed by the Company to China Water amounted to approximately HK\$27.68 million as at the Latest Practicable Date. Also advised by the Company, the maximum gross proceeds arising from the Open Offer will be approximately HK\$27.68 million in the event that none of the Share Options and the BOC Convertible Bonds have been exercised before the Record Date and approximately HK\$33.20 million in the event that all Share Options and the BOC Convertible Bonds have been exercised in full before the Record Date.

We were advised by the Company that the proceeds raised from the Open Offer will be used as follows:

In the event none of the Share Options and the BOC Convertible Bonds have been exercised before the Record Date:

	All Qualifying Shareholders have taken up their respective entitlements under the Open Offer	No Qualifying Shareholders has taken up their respective entitlements under the Open Offer
	<i>HK\$ '000,000</i>	<i>HK\$ '000,000</i>
Gross proceeds	27.68	27.68
Net proceeds	26.48	26.48
Less: Loan Capitalisation	5.32	27.68
Remaining proceeds	21.16	0

In the event all Share Options and the BOC Convertible Bonds have been exercised in full before the Record Date:

All Qualifying Shareholders have	No Qualifying Shareholders has taken up their
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6



	taken up their respective entitlements under the Open Offer	respective entitlements under the Open Offer
	<i>HK\$ '000,000</i>	<i>HK\$ '000,000</i>
Gross proceeds	33.20	33.20
Net proceeds	32.0	32.0
Less: Loan Capitalisation	5.32	27.68
Remaining proceeds	26.68	4.32

As set out in the Letter, the Group needs additional funds to finance its operations and activities for expanding its businesses. While the Group intends to continue to pursue its principal business, the Directors intend to apply the net proceeds of the Open Offer, if any, towards general working capital of the Group.

The following is a summary of the financial results extracted from the interim report 2008 (the "IR 2008") and the annual report 2007 (the "AR 2007") of the Company.

	For the six months ended 30 June 2008	For the year ended 31 December 2007
	<i>HK\$ '000</i> <i>(Unaudited)</i>	<i>HK\$ '000</i> <i>(Audited)</i>
Turnover	128,136	281,054
Gross profit	39,174	85,537
Gain from changes in fair value of biological assets less estimated point-of-sales costs	60,211	72,927
Finance cost	20,186	16,234
Profit/ (loss) before tax	47,788	105,468
Profit/(loss) after tax	43,816	97,237
	As at 30 June 2008	As at 31 December 2007
Net asset value	468,227	413,220
Bank balances and cash	103,891	134,649

7



As set out in the above table, the gain from changes in fair value of biological assets less estimated point-of-sales costs, which generated no cashflow to the Group, represented approximately 69.15% and approximately 126.00% of the Group's profit before tax for the year ended 31 December 2007 and the six months ended 30 June 2008 respectively.

We noted from the Company's announcement dated 24 October 2007 in respect of the BOC Convertible Bonds that each holder of BOC Convertible Bonds (the "BOC CB Holders") will have the right to require the Company to redeem in whole or in part of the BOC Convertible Bonds after the second anniversary of the date of issue of the BOC Convertible Bonds, which is 28 November 2009. Given (i) significant portion of the profits which resulted from the revaluation gain of fair value adjustment of biological assets of the Group contributing no cash inflow to the Group; and (ii) the Group had cash and bank balance of approximately HK\$32 million as at 31 December 2008 whereas the Group also had an outstanding bank borrowings amounted to approximately HK\$116 million as at 31 December 2008, based on the existing situation, we consider the Company may have a potential financial stress on its liquidity position in 2009 if the BOC CB Holders exercise the above-mentioned early redemption option to fully redeem the BOC Convertible Bonds with aggregate principal amount of HK\$122 million immediate after 28 November 2009 or any other creditors who decide to demand for repayment of their facilities maintained with the Group at a short notice.

In view that the Open Offer which may provide funds for the working capital of the Company and the Loan Capitalisation which will reduce cash outflow and gearing simultaneously for the Group (further analyses on the Loan Capitalisation has been set out under the section headed "9. Loan Capitalisation" below), we believe that the Open Offer and Loan Capitalisation are in the interest of the Company. However, given the financial uncertainty of the Company, one of which being the potential redemption of BOC Convertible Bonds, Independent Shareholders should aware the risk associated with their further investment in the Company by means of subscribing to the Open Offer.

2. Principal terms of the Open Offer

Basis

The Open Offer is on the basis of provisional allotment of one Offer Shares for



every two existing Shares held by the Qualifying Shareholders on the Record Date at the Subscription Price. The Offer Shares (when allotted, fully paid and issued) will rank pari passu with the Shares in issue in all respects. Holders of the Offer Shares will be entitled to receive full future dividends and distributions which are declared, made or paid on or after the date of allotment and issue of the Offer Shares.

Subscription Price

As stated in the Letter, HK\$0.08 per Offer Share shall be payable in full when a Qualifying Shareholder accepts the relevant provisional allotment of Offer Shares or applies for excess Offer Shares.

The Subscription Price represents:

- (i) a discount of approximately 15.79% to the closing price of HK\$0.095 per Share as quoted on the Stock Exchange on the Last Trading Date;
- (ii) a discount of approximately 20.32% to the average closing price of HK\$0.1004 per Share as quoted on the Stock Exchange for the 5 consecutive trading days up to and including the Last Trading Date;
- (iii) a discount of approximately 11.11% to the theoretical price of HK\$0.09 per Share based on the closing price of HK\$0.095 as quoted on the Stock Exchange on the Last Trading Date; and
- (iv) a discount of approximately 84.90% to the net asset value per Share of approximately HK\$0.53 based on the unaudited consolidated net asset value of the Group as at 30 June 2008 as shown in the IR 2008 and the number of Shares in issue immediately before completion of the Open Offer and assuming there will neither be any exercise of the Share Options nor conversion of the BOC Convertible Bonds and/or the CW Convertible Bonds.

As stated in the Letter, the Subscription Price was arrived at after arm's length negotiation between the Company and the Underwriter with reference to, among other things, the generally decreasing trend of the price of the Shares. The Group needs additional funds to finance its operations and business activities. In view of the recent financial conditions of the Group and taking into consideration of the theoretical price per Share, in order to increase the attractiveness of the Open Offer and to encourage the existing Shareholders to participate in the Open Offer, the Directors consider that



the proposed discount of the Subscription Price is appropriate.

Given each Qualifying Shareholder is entitled to subscribe for the Offer Shares at the same price in proportion to his/her/its existing shareholding in the Company and also entitled to excess application, the Directors consider the Subscription Price is fair and reasonable and in the interests of the Company and the Shareholders as a whole.

To enhance the attractiveness of an open offer exercise and to encourage the existing shareholders to participate in an open offer, the subscription price of an open offer is normally set at a discount to the prevailing market prices of the relevant share. Hence, the fact that the Subscription Price is at a discount of the market prices of the Shares is in line with the general market practice with the reasons stated above and is acceptable.

Share price performance

The average daily closing prices, the monthly highest recorded closing price and the monthly lowest recorded closing price of the Shares traded on the Stock Exchange in each of the twelve calendar months commencing from 1 December 2007 up to and including the Latest Practicable Date (the "Review Period") are shown below:

Period	The Subscription Price of HK\$0.08 per Offer Share being			
	Average daily closing price per Share in the Review Period (approx. HK\$)	discount to the average daily closing price per Share in the Review Period (%)	Highest closing price per Share in the Review Period (HK\$)	Lowest closing price per Share in the Review Period (HK\$)
<u>2007</u>				
December	1.215	93.42	1.34	1.10
<u>2008</u>				
January	1.319	93.94	1.42	1.24
February	1.108	92.78	1.30	1.00
March	0.772	89.63	1.12	0.465
April	0.532	84.97	0.61	0.50
May	0.529	84.87	0.57	0.495
June	0.441	81.84	0.50	0.40
July	0.370	78.40	0.405	0.34



August	0.336	76.21	0.375	0.305
September	0.245	67.36	0.30	0.15
October	0.185	56.67	0.249	0.10
November	0.095	15.67	0.12	0.077
December	0.097	17.53	0.11	0.079
<i>2009</i>				
January	0.114	29.82	0.123	0.101
February (up to and including the Latest Practicable Date)	0.117	31.62	0.123	0.110

Source: The Stock Exchange of Hong Kong Limited

As shown in the table above, the average daily closing price of the Shares has experienced a gradual downward trend since January 2008. The price per Share recorded a high of HK\$1.42 on 14 January 2008 and reached its low of HK\$0.077 on 25 November and 28 November 2008 during the Review Period. The closing price of the Share on the Last Trading Date was quoted at HK\$0.095.

In view that (i) the closing prices of HK\$0.095 per Share on the Last Trading Date and the average closing price of HK\$0.1004 per Share for the 5 consecutive trading days up to and including the Last Trading Date represented discounts of approximately 93.31% and approximately 92.93% respectively to the highest recorded closing price of HK\$1.42 on 14 January 2008 during the Review Period; and (ii) during the Review Period, the Subscription Price represented a maximum discount of 93.94% to the average daily closing price per Share in January 2008 and discounts of more than 76% to the average daily closing price per Share before the market tumbled significantly since mid-September as a result of the global financial crisis, we consider a slight discount to the market prices around the date of the Underwriting Agreement is sufficient to encourage the Qualifying Shareholders to participate in the Open Offer.

To conclude, given (i) it is in line with market practice to set the Subscription Price at a discount to the market price; (ii) the discount is sufficient to encourage the Qualifying Shareholders to participate in the Open Offer; and (iii) all Qualifying Shareholders are offered an equal opportunities to subscribe the Offer Shares and to apply for excess application at the Subscription Price, we consider the Subscription Price and the terms of the Open Offer are fair and reasonable and in the interest of the



Company and its Shareholders as whole.,

3. Underwriting arrangements

We have reviewed the Underwriting Agreement and set out below are the major terms thereof.

Underwriting Commission

Pursuant to the Underwriting Agreement, no underwriting commission will be paid to China Water for its underwriting commitment. As such, we consider the underwriting commission is fair and reasonable so far as the Independent Shareholders are concerned.

Application for excess Offer Shares

Any Qualifying Shareholders who choose not to take up in full their provisional allotments under the Open Offer will have their shareholdings in the Company diluted by up to 33.33%. On the other hand, those Qualifying Shareholders who wish to increase their shareholdings in the Company through the Open Offer may acquire additional Offer Shares in the market and/or apply for excess Offer Shares through the excess application arrangement. Given the fact that there will be sufficient arrangements for the Shareholders to apply for excess Offer Shares through the excess application, we are of the opinion that such arrangements are fair and reasonable.

Termination

Subject to the fulfillment of the conditions contained in the Underwriting Agreement, it should also be noted that the Open Offer would not be proceeded if the Underwriter exercise their termination rights under the Underwriting Agreement, details of the provisions granting the Underwriter such termination rights are included in the section headed “**Termination of the Underwriting Agreement**” in the Letter. In the view that it is common to have termination clause incorporated in underwriting agreements, we consider such provisions are normal commercial terms and in line with the normal market practice.

After reviewing the Underwriting Agreement and having consider the above, we are of the view that the terms of the Underwriting Agreement are fair and reasonable and in the interest of the Company and Shareholders as a whole.



4. Alternatives to the Open Offer

The Directors advised that they have considered other methods of funds raising such as rights issue, placement of new Shares and bank borrowing. Taking into account that (i) rights issue has a higher cost and take a longer time to complete as compared to open offer; (ii) debt financing and bank borrowing will increase the gearing and incur further interest burden to the Company; (iii) any placing of new Shares without first offering the existing Shareholders the opportunity to participate in the Company's equity raising exercise would result in dilution of shareholding of and per Share value to the existing Shareholders; and (iv) the Open Offer will enable the Shareholders to maintain their proportionate interests in the Company should they so wish, we concur with the Directors' view that fund raising by way of the Open Offer is fair and reasonable and in the interest of the Company and the Shareholders as a whole.

5. Risks associated with the Open Offer

Shareholders should note that, as stated in the Letter, the Open Offer is conditional upon, among other things, the Underwriting Agreement having become unconditional and the Underwriter not having terminated the Underwriting Agreement in accordance with the terms thereof (a summary of which is set out in the sub-paragraph headed "**Termination of the Underwriting Agreement**" in the Letter). As such, the Open Offer may or may not proceed. The Shareholders and potential investors should exercise caution when dealing in the Shares, and if they are in any doubt about their position, they should consult their professional advisers.

6. Potential dilution effect of the Open Offer on shareholding interests

As the Open Offer is offered to all Qualifying Shareholders on the same basis, the Qualifying Shareholders will be able to maintain their proportional interests in the Company if they take up their allotments under the Open Offer in full. In addition, for those Qualifying Shareholders who apply for excess Offer Shares through the excess application arrangement, they may increase their shareholdings in the Company through the Open Offer if there are any provisionally allotments under the Open Offer not taken up by other Qualifying Shareholders upon the time for acceptance of and payment for the Offer Shares is closed. Any Qualifying Shareholders who choose not to take up in full their assured entitlements under the Open Offer will have their shareholdings in the Company diluted by up to a maximum of approximately 33.33%



from their shareholding interest of approximately 45.33% to approximately 30.22% in the event no Share Options and BOC Convertible Bonds have been exercised and approximately 45.53% to approximately 30.35% in the event all Share Options and BOC Convertible Bonds have been exercised in full.

In all cases of rights issues and open offers, the dilution on the shareholding of those Qualifying Shareholders who do not take up in full their assured entitlements under the Open Offer is inevitable. In fact, the dilution magnitude of any rights issues or open offers depends mainly on the extent of the basis of entitlement under such exercises since the higher offering ration of new shares to existing shares is the greater the dilution on the shareholding would be.

Taking into account (i) the inherent dilutive nature of open offer in general; and (ii) the Open Offer enables the Qualifying Shareholders to maintain their proportionate interests in the Company should they wish to at a lower price as compared to the historical and prevailing market price of the Shares, we are of the view that such potential dilution of the Open Offer on the shareholding of the Shareholders is acceptable.

7. Financial effects of the Open Offer

Net asset value

Based on the statement of unaudited pro forma financial information set out in Appendix II of the Circular, the unaudited pro forma adjusted consolidated net tangible assets of the Group amounts to approximately HK\$190,017 million upon completion of the Open Offer, representing an increase of HK\$21,157 million as compared to the audited consolidated net tangible asset value of the Group of approximately HK\$168,860 million as at 31 December 2007.

Gearing Ratio

On the basis that the unaudited total liabilities of the Group and the unaudited total asset of the Group as at 30 June 2008 were approximately HK\$478.41 million and HK\$946.64 million respectively, the gearing ratio, which is calculated by dividing the total liabilities by the total assets of the Group, was about 0.51 as at 30 June 2008. Immediately following the Open Offer, the total asset of the Group will be increased by the net proceeds of the Open Offer while the total liabilities will be reduced by the full or partial Loan Capitalisation and accordingly, the gearing ratio of the Group will



be improved as a result of the Open Offer.

Given the above analyses on the Open Offer, we consider the terms of the Open Offer are fair and reasonable and in the interest of the Company. However, as mentioned earlier, Independent Shareholders should aware the risk associated with their further investment in the Company by means of subscribing to the Open Offer given the financial uncertainty as a result of the potential redemption of BOC Convertible Bonds.

8. Whitewash Waiver

In the event that China Water is required to perform its underwriting commitment under the Underwriting Agreement in full, the aggregate shareholding of China Water and its concert parties will increase from approximately 19.22% to approximately 46.15% in the event no Share Options and BOC Convertible Bonds have been exercised and from approximately 16.02% to approximately 44.01% in the event all Share Options and BOC Convertible Bonds have been exercised in full. Accordingly, China Water will be obliged under Rule 26.1 of the Takeovers Code to make a mandatory general offer for all of the Shares which are not owned by or agreed to be acquired by it and its concert parties. The Underwriter has applied to the Executive for the Whitewash Waiver under Note 1 on dispensations from Rule 26 of the Takeovers Code. The Whitewash Waiver, if granted by the Executive, would be subject to, among other things, the approval of the Independent Shareholders at the EGM by way of poll.

As stated in the Letter, the Open Offer is conditional upon, among other things, the Executive granting the Whitewash Waiver to China Water and its concert parties. Based on our analysis of the terms of the Open Offer as set out above, we consider that the terms of the Open Offer are fair and reasonable and the Open Offer which will reduce the liquidity pressure of the Company on its working capital and Loan repayment is in the interests of the Company and the Shareholders as a whole. If the Whitewash Waiver is not granted by the Executive or not approved by the Independent Shareholders, the Open Offer will not proceed. Given (i) the abovementioned positive impacts on the Group as a result of the Open Offer; (ii) all Qualifying Shareholders will be provided with an equal opportunity to take up their Offer Shares in accordance with their provisional entitlements under the Open Offer and their respective interests in the Company will not be diluted if they elect to take up in full their provisional allotments under the Open Offer; and (iii) Qualifying Shareholders who wish to increase their shareholdings in the Company through the



Open Offer may apply for excess Offer Shares through the excess application arrangement, we are of the opinion that, for the purposes of implementing the Open Offer as discussed above, the application of the Whitewash Waiver is fair and reasonable and in the interests of the Company and the Shareholders as a whole.

9. Loan Capitalisation

As mentioned in the section headed “1. Background and Reasons for the Open Offer”, China Water made a loan of approximately HK\$13 million on 11 November 2008 to the Company. Pursuant to an announcement of the Company dated 23 January 2009, the Board announced that due to an inadvertent clerical error of the Company, the undated cheque of HK\$12,677,500 issued by China Water, being part of the Loan, was not collected by the Company until 23 January 2009 and was deposited into the accounts of the Company on 11 February 2009. As advised by the Company, the purposes of the above two loans were to strengthen the capital base of the Company, smoothen the financial flexibility on its operation and working capital and made partial repayment on its bank borrowings to release the pressure placed by the bank creditors at that time. As further advised by the Company, the above two advances together with the HK\$2 million current account balance with China Water made up the Loan of approximately HK\$27,677,500 as at the Latest Practicable Date.

We were advised by the management of the Company that they have considered alternative methods to raise funds including open offer, rights issue and placement of new shares at that time, however, given the recent financial crisis has resulted in a difficult situation for the Group to secure financing facilities from financial institutions and/or raised funds from the market by means of placement of new securities and the limited time to make partial bank borrowings repayment as demanded by bank creditors, the Company considered financial assistance from China Water is possibly the only alternative under such relevant period.

It was also the consensus of the Company and China Water that the Company will repay the Loan within a short period of time. As a result of the recent market sentiment, the Company attempted but failed to procure any underwriters for the proposed Open Offer. Eventually, after arm's length negotiation between the Company and China Water, China Water agreed to be the Underwriter for the Open Offer and settle the Loan by way of Loan Capitalisation.

Pursuant to the Underwriting Agreement, China Water and the Company have agreed that the aggregate Subscription Price required to be paid by China Water and



its associates under its underwriting obligation of the Underwriting Agreement and the Open Offer will be deemed to be paid by way of the full or partial capitalisation of the Loan of up to HK\$27,677,500 in first place and the remaining balance of the Subscription Price (if any) will be settled in cash. The exact amount of the Loan to be capitalized for such aggregate Subscription Price depends on the number of Offer Shares to be taken up by the Qualifying Shareholders.

The Directors consider that the Loan Capitalisation will enable the Group to repay part or whole of the liabilities of the Company without cash outflow and will allow the Group to reduce its gearing level, the Directors accordingly consider that the Loan Capitalisation as opposed to cash payment is in the interests of the Company and the Shareholders as a whole.

As advised by the Company, the intercompany balance due by the Company to China Water in aggregate amounted to approximately HK\$27.8 million, comprising the Loan and accrued interest of approximately HK\$130,000, as at the Latest Practicable Date. The Loan carries an interest of 1% per annum over the Hong Kong dollar prime rate and is repayable on demand.

Taking into account that (i) the liquidity position, with cash and bank balance of approximately HK\$32 million and total bank borrowings of approximately HK\$116 million as at 31 December 2008, of the Company is severely tight; (ii) the Company has resorted to China Water for the Loan in a difficult situation and timing where alternative financing is impossible; (iii) the Company has agreed with China Water to repay the Loan in a short period of time; (iv) the Company had been unable to procure any potential underwriters for the Open Offer; (v) the Loan Capitalisation enables the Group to repay its liabilities without cash outflow and to lower its gearing level; and (vi) fair and equal subscription and excess application rights have been incorporated in the terms of the Open Offer, which means that rights of minority shareholders would not be prejudiced even if the Loan Capitalisation is in place, we consider the Loan Capitalisation is fair and reasonable and are in the interest of the Company and the Shareholders as a whole.

10. Financial effects of both the Open Offer and the Loan Capitalisation

Net assets and gearing

As set out in AR 2007 and IR 2008, the Group had an audited consolidated net assets of approximately HK\$413.22 million as at 31 December 2007 and an unaudited



consolidated net assets of approximately HK\$468.23 million as at 30 June 2008 respectively.

As advised by the Company, upon completion of the Open Offer and the Loan Capitalisation, the consolidated total liabilities of the Group will be reduced as a result of the Loan Capitalisation and the consolidated net assets of Group will be improved by the net proceeds from the Open Offer. On such basis, the consolidated net assets of the Group is expected to increase and the gearing ratio (defined as total liabilities over total assets) of the Group is expected to reduce immediately upon completion of the Open Offer and the Loan Capitalisation.

Liquidity

As discussed with the Company, the Loan Capitalisation will relieve the Group from the burden of repayment of the Loan in cash. As such, the Loan Capitalisation is expected to have a positive effect on the liquidity position of the Group.



御泰融資(香港)有限公司
REXCAPITAL (Hong Kong) Limited

AsiaVest Partners
AsiaVest Partners Limited

RECOMMENDATION

Having considered the above principal factors and reasons, we consider that the terms of the Open Offer and the Loan Capitalisation are fair and reasonable and the overall impact on the Company arising from the Open Offer, the Loan Capitalisation and the Whitewash Waiver are in the interests of the Company and the Shareholders as a whole and we advise the Independent Board Committee to recommend to the Independent Shareholders to vote in favor of the ordinary resolutions approving the Loan Capitalisation and the Whitewash Waiver at the EGM. However, given the financial uncertainty of the Company, one of which being the potential redemption of BOC Convertible Bonds, Independent Shareholders should aware the risk associated with their further investment in the Company by means of subscribing to the Open Offer.

Yours faithfully,

For and on behalf of
REXCAPITAL (Hong Kong) Limited

Gregory Ho
Head of Corporate Finance

For and on behalf of
AsiaVest Partners Limited

Raymond Lo CF
Managing Partner