

# *Hercules*

Hercules Capital Limited  
凱利融資有限公司

2 October 2009

*To the Independent Board Committee  
and Independent Shareholders*

Dear Sirs,

**MANDATORY UNCONDITIONAL CASH OFFER BY  
TAIFOOK SECURITIES COMPANY LIMITED ON BEHALF OF  
RIGHT PERFECT LIMITED TO ACQUIRE ALL THE SHARES  
IN SEWCO INTERNATIONAL HOLDINGS LIMITED  
(OTHER THAN THOSE ALREADY OWNED OR AGREED  
TO BE ACQUIRED BY RIGHT PERFECT LIMITED AND  
PARTIES ACTING IN CONCERT WITH IT)**

## **INTRODUCTION**

We refer to our engagement as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders with respect to the terms of the Offer, details of which are set out in the letter from the Board contained in the circular of the Company dated 2 October 2009 to the Shareholders (the "Offeree Board Circular"), of which this letter forms part, and the letter from Taifook Securities contained in the Offer Document. Terms used in this letter have the same meanings as defined elsewhere in the Offeree Board Circular unless the context requires otherwise.

On 13 August 2009, the Offeror, Great Victory and Mr. Cheung Po Lun (the "Warrantor") entered into the sale and purchase agreement (the "Agreement"), pursuant to which Great Victory agreed to sell, and the Offeror agreed to acquire, the Sale Shares, being 300,000,000 Shares in aggregate, at a cash consideration of HK\$120.0 million (i.e. HK\$0.4 per Sale Share).

Following the completion of the sale and purchase of the Sale Shares which took place on 26 August 2009, the Offeror and parties acting in concert with it became interested in a total of 300,000,000 Shares, representing approximately 67.35% of the issued share capital of the Company as at the Completion Date. The Offeror is therefore obliged under Rule 26.1 of the Takeovers Code to make a mandatory unconditional general offer in cash for all the issued Shares other than those already owned or agreed to be acquired by the Offeror and parties acting in concert with it.

The Independent Board Committee, comprising all independent non-executive Directors, namely Ms. Cynthia Law, Mr. Lam Chin Fung and Mr. Tse Wei Kin, has been constituted to make recommendations to the Independent Shareholders as to whether the Offer is fair and reasonable and as to acceptance. We, Hercules Capital Limited, have been appointed, with the approval of the Independent Board Committee, to give an independent opinion to the Independent Board Committee and the Independent Shareholders as to whether the terms of the Offer are fair and reasonable so far as the Independent Shareholders are concerned and whether the Independent Shareholders should accept the Offer.

We are not associated with the Offeror, the Company, their respective substantial shareholders or parties acting in concert with any of them. Apart from normal professional fees payable to us in connection with this appointment, no arrangement exists whereby we will receive any fee or benefit from the Offeror or the Company or their respective substantial shareholders or any party acting in concert with any of them.

#### **BASIS OF OUR OPINION**

In formulating our opinion and recommendations, we have relied on the information and representations supplied, and the opinion expressed, by the Directors and/or management of the Company and have assumed that such information and statements, and representations made to us or referred to in the Offeree Board Circular and/or the Offer Document are true, accurate and complete in all material respects as of the date hereof and will continue as such during the period the Offer remains open for acceptance. The Directors have jointly and severally accepted full responsibility for the accuracy of the information contained in the Offeree Board Circular and confirmed that, having made all reasonable enquiries and to the best of their knowledge and belief, opinions expressed in the Offeree Board Circular have been arrived at after due and careful consideration and there are no material facts not contained in the Offeree Board Circular the omission of which would make any statement in the Offeree Board Circular misleading. The sole director of the Offeror has also accepted full responsibility for the accuracy of the information contained in the Offer Document and confirmed that, having made all reasonable enquiries and to the best of his knowledge and belief, opinions expressed in the Offer Document have been arrived at after due and careful consideration and there are no material facts not contained in the Offer Document the omission of which would make any statement in the Offer Document misleading. We have no reasons to suspect that any material information has been withheld by the Directors, management of the Company or the Offeror, or is misleading, untrue or inaccurate, and consider that they may be relied upon in formulating our opinion.

We consider that we have reviewed sufficient information to reach an informed view, to justify reliance on the accuracy of the information contained in the Offeree Board Circular and/or the Offer Document and to provide a reasonable basis for our recommendation. We have not, however, for the purpose of this exercise, conducted any independent investigation or audit into the businesses or affairs or future prospects of the Group. Our opinion is necessarily based on financial, economic, market and other conditions in effect and the information made available to us as at the Latest Practicable Date.

We have not considered the tax implications on the Independent Shareholders arising from acceptances or non-acceptances of the Offer as these depend on their individual circumstances. It is emphasized that we will not accept responsibility for any tax effect on or liability of any person resulting from his or her acceptance or non-acceptance of the Offer. In particular, the Independent Shareholders who are overseas residents or are subject to overseas taxation or Hong Kong taxation on securities dealings should consider their own tax positions, and if in any doubt, should consult their own professional advisers.

## **PRINCIPAL FACTORS AND REASONS CONSIDERED**

In arriving at our opinion regarding the terms of the Offer, we have considered the following principal factors and reasons:

### **1. Background to and terms of the Offer**

On 13 August 2009, the Offeror entered into the Agreement with Great Victory and the Warrantor to acquire 300,000,000 Shares at a total consideration of HK\$120.0 million (i.e. HK\$0.4 per Sale Share). Following the completion of sale and purchase of the Sale Shares on 26 August 2009, the Offeror and parties acting in concert with it became interested in a total of 300,000,000 Shares, representing approximately 67.35% of the issued share capital of the Company as at the Completion Date. Under Rule 26.1 of the Takeovers Code, the Offeror is obliged to make the Offer to acquire all the issued Shares, other than those Shares already owned or agreed to be acquired by the Offeror and parties acting in concert with it. Accordingly, Taifook Securities is making the Offer, which is unconditional in all respects, on behalf of the Offeror for all of the issued Shares not already owned or agreed to be acquired by the Offeror and parties acting in concert with it on the following basis:

For every Offer Share ..... HK\$0.4 in cash

The Offer Shares to be acquired under the Offer must be fully paid and free from all liens, charges, encumbrances, right of pre-emption and any other third party right of any nature and together with all rights attaching to them on or after the Completion Date, including the rights to receive in full all dividends and distributions, if any, declared, made or paid on or after the Completion Date.

Further details of the terms and conditions of the Offer, including the procedures for acceptance, are set out in the letter from Taifook Securities and Appendix I to the Offer Document.

## 2. Historical performance of the Group

The Company is an investment holding company and its subsidiaries are principally engaged in the manufacturing and trading of toys. The financial information of the Group for the six months ended 30 June 2009 and 30 June 2008 and two years ended 31 December 2008, which is extracted from Appendix I to this Offeree Board Circular, is summarized as follows:

*Table I – Consolidated financial information of the Group for the six months ended 30 June 2009 and 30 June 2008 and two years ended 31 December 2008*

	For the six months ended 30 June		For the year ended 31 December	
	2009 (unaudited) HK\$'000	2008 (unaudited) HK\$'000	2008 (audited) HK\$'000	2007 (audited) HK\$'000
Revenue	146,141	400,694	873,677	774,362
Gross profit	21,489	19,552	35,057	40,408
Profit/(loss) before tax	1,046	(31,047)	(80,838)	(54,647)
Profit/(loss) attributable to ordinary equity holders of the Company	818	(31,016)	(84,274)	(55,773)
			As at 30 June 2009 (unaudited) HK\$'000	As at 31 December 2008 (audited) HK\$'000
Non-current assets			177,095	181,724
Current assets			154,979	202,249
Current liabilities			162,083	214,883
Net current liabilities			7,104	12,634
Non-current liabilities			1,843	1,819
Net assets attributable to ordinary equity holders of the Company			168,148	167,271

For the two years ended 31 December 2008, over 99% of the Group's revenue was generated from its toy business. The revenue of the Group for the year ended 31 December 2008 was approximately HK\$873.7 million, representing an increase of approximately 12.8% as compared to the previous year, and approximately 78.2% of which was attributable to its customers in the United States of America ("USA") and Canada. However, owing to the increases in raw material costs and labour costs resulted from the implementation of new PRC labour laws in January 2008 and the shortage of

labour in the Guangdong Province as well as the appreciation of Renminbi during the period under review, the gross profit of the Group reduced by approximately 13.2% to approximately HK\$35.1 million for the year ended 31 December 2008. The outbreak of the global financial crisis in late 2008 worsened the worldwide business climate swiftly and the performance of the Group has also been adversely affected. Impairment losses of approximately HK\$19.9 million were recognized for the goodwill and trade receivables of the associates of the Company during the year and the loss attributable to the ordinary equity holders of the Company for the year ended 31 December 2008 amounted to approximately HK\$84.3 million, representing a significant increment of approximately 51.1% as compared to the previous year.

As at 31 December 2008, net current liabilities of the Group was approximately HK\$12.6 million and net assets attributable to equity holders of the Company was approximately HK\$167.3 million. The auditors of the Company did not qualify their opinion on the Group's financial statements for the year ended 31 December 2008, however, expressed that the Group's loss for the year ended 31 December 2008 and net current liabilities as at 31 December 2008 indicated the existence of a material uncertainty in relation to the going concern of the Group and the Company.

The revenue of the Group for the six months ended 30 June 2009 decreased significantly to approximately HK\$146.1 million, representing a dramatic drop of approximately 63.5% as compared to the previous corresponding period. The Group's revenue for the period was solely generated from its toy business and approximately 69.0% of which was attributable to its customers in the USA and Canada. The decrease in turnover was mainly attributable to the cessation of business with customers with low profit margin and lowered sales volume resulted from adverse effect of the global financial crisis. Nevertheless, as a result of the success of the group restructuring in late 2008, the Group has effectively reduced its production and administrative costs and improved the overall management of its manufacturing operations. For the period under review, the selling and distribution costs and administrative expenses of the Group decreased sharply by approximately 55.2% as compared to the last corresponding period. Together with the decline in raw material prices and the rise in the PRC export tax refund rate from 11% to 14% since November 2008, the gross profit of the Group increased by approximately 9.9% to approximately HK\$21.5 million for the six months ended 30 June 2009. As a result, profit attributable to ordinary equity holders of the Company of approximately HK\$0.8 million was recorded for the six months ended 30 June 2009, whereas loss attributable to ordinary equity holders of the Company of approximately HK\$31.0 million was recorded for the six months ended 30 June 2008.

As at 30 June 2009, the non-current assets of the Group amounted to approximately HK\$177.1 million, of which approximately HK\$164.3 million were property, plant and equipment and approximately HK\$9.7 million were prepaid land premiums, while the current assets of the Group amounted to approximately HK\$155.0 million, which mainly comprised inventories of approximately HK\$80.1 million, trade and other receivables, prepayments and deposits of approximately HK\$42.1 million and cash and cash

equivalents of approximately HK\$32.3 million. The current liabilities of the Group amounted to approximately HK\$162.1 million, which mainly consisted of trade and other payables and accruals of approximately HK\$79.4 million and interest-bearing bank loans of approximately HK\$81.8 million. Despite a drop of approximately 24.6% in current liabilities as compared to the year-end balance as at 31 December 2008, the Group still recorded net current liabilities of approximately HK\$7.1 million as at 30 June 2009. The non-current liabilities of the Group, which comprised solely the deferred tax liabilities, remained stable at approximately HK\$1.8 million. As at 30 June 2009, net assets attributable to ordinary equity holders of the Company amounted to approximately HK\$168.1 million, representing a slight increase of approximately 0.5% as compared to the figure as at 31 December 2008.

Subsequent to the interim period of 30 June 2009, the Group entered into the CB Placing Agreement and the Subscription Agreement on 20 August 2009. Pursuant to the CB Placing Agreement, the placing agent agreed to procure, on a best efforts basis, independent placees to subscribe for convertible bonds (the "Placing Bonds") of an aggregate principal amount of up to HK\$130 million (the "CB Placing"). Pursuant to the Subscription Agreement, the Offeror agreed to subscribe for convertible bonds of an aggregate principal amount of up to HK\$120 million (the "Subscription Bonds"), on the basis of HK\$24 million of Subscription Bonds for every HK\$26 million of Placing Bonds placed by the placing agent (the "Subscription"). According to the Announcement, the maximum net proceeds of the CB Placing and the Subscription is expected to amount to approximately HK\$245.4 million, of which approximately HK\$120.0 million will be applied for the construction of a new plant at a location where the Group can operate at a lower cost, approximately HK\$80.0 million will be used for the repayment of bank borrowings and approximately HK\$45.4 million will be used as working capital of the Group to fund its sales programs and general asset replenishment in 2009 and 2010. As at the Latest Practicable Date, the CB Placing Agreement and the Subscription Agreement remained conditional upon the fulfillment of conditions precedent as set out in the Announcement including, among other things, Shareholders' approval at a special general meeting to be held.

On 1 September 2009, the Company and a placing agent entered into the Share Placing Agreement, pursuant to which the placing agent agreed to procure, on a best efforts basis, independent placees to subscribe for a maximum of 89,084,000 new Shares at HK\$0.49 each (the "Share Placing"). The Share Placing was completed on 11 September 2009 and the Company raised approximately HK\$42.6 million for use in general working capital and potential investments if suitable opportunities arise.

With the completion of the Share Placing, the Company's current assets increased by approximately HK\$42.6 million. The increase in current assets enables the Group to resume its current ratio from 0.96 as at 30 June 2009 to above 1.

### 3. Future prospect of the Group

According to the 2009 interim report of the Company, approximately 69.0% of the Group's customers are located in the USA and Canada, approximately 30.1% are located in Japan and other countries and the remaining are located in Hong Kong and the PRC.

The "Toy Markets in the World 2009" published by The NPD Group, a global consumer and retail market research information provider, in June 2009 revealed that the global toy market worth approximately US\$78.1 billion in 2008, representing a slightly drop of 0.8% as compared to 2007. In 2008, the northern American countries accounted for 30.0% of the total market size while the Asian countries accounted for 27.0% of the total market size. The USA has continued to account for the largest portion of the total market size with sales amount of approximately US\$21.7 billion in 2008, followed by Japan and the PRC with sales amount of approximately US\$5.8 billion and US\$4.5 billion respectively. These top-three countries accounted for, in aggregate, approximately 41.0% of the total market size of the international toy industry in 2008. Owing to the global financial crisis, it is expected that the worldwide toy market will further decrease to approximately US\$75.0 billion in 2009. However, as the Asian countries are impacted by the global financial crisis in a lesser extent, it is anticipated that the Asian markets will continue to grow in 2009 and its market share is expected to reach 29.0% while the market share of northern American markets will remain stable at 30.0%. According to a press release published on 29 July 2009 by The NPD Group, it is expected that the worldwide toy sales shall reach US\$80.3 billion in 2012 if the current development pace is kept.

The Organization for Economic Cooperation and Development reported in the OECD Economic Outlook No. 85 issued in June 2009 that the economy of the USA was going through a severe and protracted recession and it was predicted to bottom out later this year as the fiscal and monetary support took hold and the housing cycle bottomed out. It is also anticipated that the real gross domestic products ("GDP") of the USA will contract by 2.8% in 2009 and the economy is projected to start recovering by the mid of 2010 with a real GDP growth of 0.9% in 2010. The report also set out that the contraction in world trade led to a sharp plunge in the exports and business investment of Japan, while the falling employment and wages also reduced private consumption. It is predicted that the real GDP of Japan will contract by 6.8% in 2009 and the fiscal stimulus is expected to lift output growth into positive territory from the second half of 2009 and at a growth rate of 0.7% in 2010. On the contrary, the report stated that the economy of the PRC was rebounding strongly from the slowdown in the autumn of 2008 as a result of the sizeable monetary and fiscal stimuli. The real GDP is projected to grow at a rate of 7.7% and 9.3% in 2009 and 2010 respectively.

Given that the global economic environment, especially the USA market, is yet to be stabilized and there is an increasing number of confirmed cases of swine flu, the outbreak of which may retard corporate activities and business transactions in the region again, we maintain a prudent view on the future prospect of the Group and consider that it is uncertain as to whether the Group will be able to achieve any significant improvement in its profitability in the near future. As such, Independent Shareholders who are not optimistic about the future business prospects of the Group should consider accepting the Offer so as to dispose of their investments in the Company at the Offer Price. On the other hand, Independent Shareholders who are optimistic about the future business prospects of the Group should consider keeping the Shares so as to enjoy the future growth of the Group.

#### **4. Offer Price**

The Offer Price of HK\$0.4 is equal to the price per Share paid by the Offeror to Great Victory under the Agreement and represents:

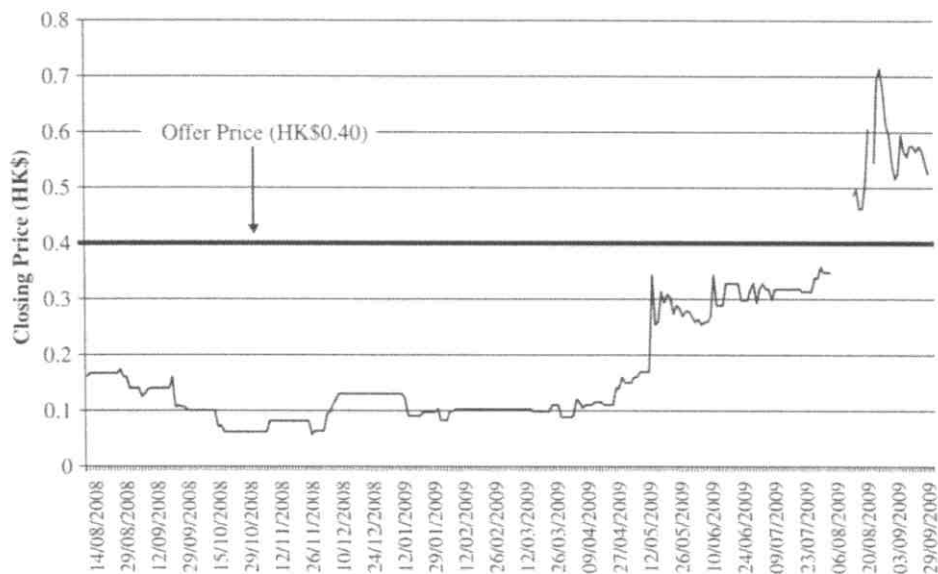
- (i) a premium of approximately 14.29% over the closing price of HK\$0.350 per Share as quoted on the Stock Exchange on the Last Trading Day;
- (ii) a premium of approximately 14.29% over the average closing price of approximately HK\$0.350 per Share as quoted on the Stock Exchange during the five trading days up to and including the Last Trading Day;
- (iii) a premium of approximately 19.40% over the average closing price of approximately HK\$0.335 per Share as quoted on the Stock Exchange during the ten trading days up to and including the Last Trading Day;
- (iv) a discount of approximately 24.53% to the closing price of HK\$0.530 per Share as quoted on the Stock Exchange as at the Latest Practicable Date; and
- (v) a premium of approximately 5.26% over the audited consolidated total equity attributable to Shareholders of approximately HK\$0.380 per Share as at 31 December 2008.



a. *Historical share price of the Shares*

In order to assess the fairness and reasonableness of the Offer Price, we have reviewed the movements in trading price of the Shares during the period from 14 August 2008, being twelve months immediately preceding the Last Trading Day, to the Latest Practicable Date (the "Review Period"). The closing prices of the Shares during the Review Period are depicted in Chart 1 below:

**Chart 1 – Closing prices of the Shares during the Review Period**



Source: the website of the Stock Exchange

As illustrated in Chart 1, the closing price of the Shares fluctuated in a range from HK\$0.124 to HK\$0.174 during the period from 14 August 2008 to 25 September 2008. Subsequent to the publication of the Group's interim results for the six months ended 30 June 2008 after the close of trading time on 25 September 2008, which showed increases of approximately 32.2% in turnover and 47.3% in net loss attributable to equity holders of the Company as compared to the last corresponding period, the closing price of the Shares plunged to HK\$0.106 on 26 September 2008. Since then, the trading price of the Shares dropped gradually to HK\$0.061 on 22 October 2008 and remained stable at similar level until 11 November 2008. On 12 November 2008, the closing price of the Shares suddenly increased to HK\$0.081 and stayed flat until 1 December 2008, when the Company published an announcement after the close of trading time regarding the change of Directors and chief executive officer of the Company. On 2 December 2008, the closing price of the Shares decreased to its lowest level in the Review Period of HK\$0.056 and rebounded to HK\$0.13 on 15 December 2008 and lasted until 16 January 2009 before the occurrence of another drop in the closing price of the Shares to HK\$0.09 on 20 January 2009. After that, the closing price of the Shares fluctuated in the range

of HK\$0.082 to HK\$0.120 during the period from 21 January 2009 to 4 May 2009 and increased steadily to HK\$0.17 on 15 May 2009. On 21 May 2009, the closing price of the Shares skyrocketed by over 100% to HK\$0.345 and the Company published an announcement on the same day to clarify that the Board was not aware of any reason for such increase in share price. Since then, the closing price of the Shares fluctuated in the range of HK\$0.255 to HK\$0.360 and dropped slightly to HK\$0.35 on the Last Trading Day.

The trading of Shares was suspended during the period from 14 August 2009 to 24 August 2009 pending the release of the Announcement regarding, among others, the change in controlling shareholder and the possible conditional mandatory general offer. On 25 August 2009, being the day following the publication of the Announcement, the closing price of the Shares surged to HK\$0.49 and increased steadily to HK\$0.61 on 1 September 2009. The trading of Shares was suspended on 2 September 2009 pending the release of the announcement for the Share Placing and the closing price of Shares was HK\$0.55 on 3 September 2009 after the publication of the announcement. The increasing trend in the price of the Shares continued and reached HK\$0.72 on 7 September 2009, the highest level during the Review Period. The trading of Shares closed at HK\$0.53 on the Latest Practicable Date.

The Independent Shareholders should note that the trading prices of the Shares were below the Offer Price for most of the time during the Review Period and rose to above the Offer Price only after the publication of the Announcement. The management of the Company confirmed that it was not aware of any event that was price sensitive in nature after the release of the Announcement save for the Announcement and the announcement regarding the Share Placing published on 2 September 2009. Therefore, we believe that the surge in the trading price of the Shares upon the publication of the Announcement, to a large extent, may likely due to the market speculation on the change in control of the Company as a result of the Agreement. However, there are no guarantees whether the trading price of the Shares will sustain at a level higher than the Offer Price during and after the Offer Period.

b. *Historical trading volume of the Shares*

We have also reviewed the historical trading volume of the Shares during the Review Period. The average daily trading volume of the Shares, the percentages of average daily trading volume of the Shares as compared to the total number of issued Shares and the Shares held by the public during the Review Period are shown in Table 2 below:

**Table 2 – Historical average daily trading volume of the Shares**

<b>Month</b>	<b>Average daily trading volume</b>	<b>% of average daily trading volume to the total number of issued Shares <sup>(Note 1)</sup></b>	<b>% of average daily trading volume to the total number of Shares in public hands <sup>(Note 2)</sup></b>
<b>2008</b>			
August <sup>(Note 3)</sup>	40,364	0.0076%	0.0172%
September	84,381	0.0158%	0.0360%
October	211,048	0.0395%	0.0900%
November	–	–	–
December	153,714	0.0288%	0.0655%
<b>2009</b>			
January	30,444	0.0057%	0.0130%
February	49,650	0.0093%	0.0212%
March	13,636	0.0026%	0.0058%
April	35,400	0.0066%	0.0151%
May	674,316	0.1262%	0.2875%
June	291,091	0.0545%	0.1241%
July	115,455	0.0216%	0.0492%
August <sup>(Note 4)</sup>	6,131,238	1.1471%	2.6144%
September <sup>(Note 5)</sup>	8,830,476	1.6521%	3.7654%

Source: the website of the Stock Exchange

Notes:

1. Calculated based on 534,514,000 Shares in issue as at the Latest Practicable Date.
2. Calculated based on 234,514,000 Shares held in public hands as at the Latest Practicable Date.
3. Represents trading volume for the period from 14 August 2008 to 31 August 2008.
4. Trading of Shares was suspended from 14 August 2009 to 24 August 2009.
5. Represents trading volume for the period from 1 September 2009 to the Latest Practicable Date and the trading of Shares was suspended on 2 September 2009.

Table 2 demonstrates that during the Review Period, the average daily trading volume of the Shares was in the range of nil to approximately 1.6521% as to the total number of issued Shares as at the Latest Practicable Date and nil to approximately 3.7654% as to the total number of the Shares held in public hands as at the Latest Practicable Date. The above statistics showed that the liquidity of the Shares was relatively low during the Review Period.

In view of the low trading volume of Shares in the Review Period, we anticipate that the Shareholders may have difficulties in selling a significant number of Shares in the open market within a short period of time if the same trading pattern of the Shares persists after the Offer Period. We therefore consider that the Shareholders should accept the Offer if they wish to realize their investments in the Company within a short period of time.

*c. Comparison with market comparables*

In forming our opinion on the Offer Price, we have also considered the commonly adopted comparable approaches in evaluation of a company, namely price-to-earnings approach, dividends approach and net assets approach. However, given that the Group recorded net loss for the year ended 31 December 2008 and the Company had not declared any dividend to the Shareholders during the year ended 31 December 2008, we consider that the price-to-earnings approach and the dividends approach are not applicable for assessing the value of the Group.

Based on the adjusted net asset value of approximately HK\$210.7 million, being the unaudited net asset value attributable to the equity holders of the Company of approximately HK\$168.1 million as at 30 June 2009 adjusted by the net proceed from the Share Placing amounted to approximately HK\$42.6 million and 534,514,000 Shares in issue on the Latest Practicable Date, the adjusted net asset value per Share amounted to approximately HK\$0.394. The price-to-book ratio (PBR) of the Group implied by the Offer Price of HK\$0.4 is thus approximately 1.02 times.

In assessing the fairness and reasonableness of the Offer Price, we have compared the PBR of the Group implied by the Offer Price with those of other comparables which are in similar size and business. Based on the closing price of HK\$0.53 per Share on the Latest Practicable Date and 534,514,000 Shares in issue on the Latest Practicable Date, the market capitalization of the Company amounted to approximately HK\$283.3 million. For comparison purposes, we have considered all the companies which (a) are currently listed on the Main Board of the Stock Exchange; (b) are principally engaged in manufacturing and/or trading of toys; and (c) had a market capitalization in the range of approximately 100% above and below the market capitalization of the Company (i.e. between Nil and HK\$570 million) as at the Latest Practicable Date. Such range of market capitalization was selected so as to ensure the sample pool contains sufficient data samples for analysis purposes

and we consider the selected range of market capitalization is fair and representative. We have identified 7 comparable companies (the "Industry Comparables"), being all the companies which meet all the above-mentioned criteria. Given the Industry Comparables are chosen to have similar principal businesses and market features (i.e. listing on the Main Board of the Stock Exchange and with market capitalization of not exceeding HK\$570 million as at the Latest Practicable Date), we consider the Industry Comparables are fair and representative samples. Set out in Table 3 below is a comparison of the valuation statistics of the Company implied by the Offer Price with the market valuations at which the Industry Comparables are currently trading.

**Table 3: Trading multiples of the Industry Comparables and the Company**

<b>Company Name (Stock code)</b>	<b>Principal Business Activities</b>	<b>Market capitalization as at the Latest Practicable Date HK\$' million</b>	<b>PBR times</b>
21 Holdings Limited (1003)	Trading of toy, gift and premium products, securities trading and investments, provision of property agency and related services	124.0	N/A (Note)
Dream International Limited (1126)	Design, development, manufacturing and sales of plush stuffed toys, steel and plastics toys	290.8	0.71
Herald Holdings Limited (114)	Manufacture, sale and distribution of toy, gift products, housewares, clocks, watches and electronic products, manufacture and sale of computer heads and leasing of properties	512.1	0.68
Kader Holdings Company Limited (180)	Manufacture and sale of plastic, electronic and stuffed toys and model trains, property investment, investment holding and trading	246.2	0.32

<b>Company Name (Stock code)</b>	<b>Principal Business Activities</b>	<b>Market capitalization as at the Latest Practicable Date HK\$' million</b>	<b>PBR times</b>
Lerado Group (Holdings) Company Limited (1225)	Manufacture and distribution of strollers, beds and playards, infant soft goods and battery-operated ride-on cars	530.7	0.60
Playmates Holdings Limited (635)	Design, development, marketing and distribution of toys and family entertainment activity products, property investment and management and restaurant operation	505.9	0.27
Playmates Toys Limited (869)	Design, development, marketing and distribution of toys and family entertainment activity products	108.9	1.16
<b>Minimum</b>			<b>0.27</b>
<b>Maximum</b>			<b>1.16</b>
<b>Average</b>			<b>0.63</b>
<b>The Company (209)</b>	<b>OEM toys manufacturing and private label consumer products trading</b>	<b>283.3</b>	<b>1.02</b>

*Source: the website of the Stock Exchange*

*Note:* According to the interim results announcement of 21 Holdings Limited published on 21 September 2009, 21 Holdings Limited had unaudited net liabilities of approximately HK\$33.0 million as at 30 June 2009.

As shown in Table 3, the PBR of the Industry Comparables ranged from 0.27 times to 1.16 times, with an average of approximately 0.63 times. The PBR implied by the Offer Price is 1.02 times, which falls within the range of the PBR of the Industry Comparables and is higher than the average of Industry Comparables of 0.63 times.

As each of the Industry Comparables may not be entirely comparable to the Group in terms of the scale of operations, market capitalization, financial position and performance, future prospect as well as other relevant criteria, and all of these factors may affect the valuation of a company as illustrated by the various results in our comparison, the above comparison is for illustrative purpose only.

Based on the above analysis and taking into consideration that (i) the Offer Price is the same as the consideration paid by the Offeror under the Agreement; (ii) the Offer Price represents a premium over the closing price of the Share for most of the time during the Review Period; (iii) although the Offer Price is lower than the closing price of the Shares as quoted on the Stock Exchange after the publication of the Announcement, it is uncertain whether the trading price of the Shares could be sustained at a level higher than the Offer Price during and after the Offer Period; (iv) the liquidity of the Shares during the Review Period was thin and it is uncertain whether the liquidity of the Shares could be improved to allow the Independent Shareholders to dispose of their holding in the Shares in the market at the Offer Price; and (v) the PBR implied by the Offer Price falls within the range of those of the Industry Comparables and is higher than the average of the Industry Comparables, we consider that the Offer Price is fair and reasonable to the Company and the Independent Shareholders as a whole.

## **5. Information of the Offeror and its intention regarding the Group**

As stated in the Offer Document, the Offeror, an investment holding company incorporated in the BVI with limited liability, is beneficially and wholly-owned by Smart Legend, which is beneficially and wholly-owned by Mr. Suen, the sole director of the Offeror and Smart Legend. As at the Latest Practicable Date, the Offeror and Smart Legend owned 300,000,000 Shares and did not have any principal asset or business operation other than the entering into of the Agreement and the Subscription Agreement.

The Offer Document stated that Mr. Suen, aged 48, holds a Master of Business Administration degree from the University of South Australia and is a merchant. Mr. Suen is an executive director and the chairman of China Yunnan Tin Minerals Group Company Limited (stock code: 263), Poly Development Holdings Limited (stock code: 1141) and BEP International Holdings Limited (stock code: 2326), all being listed companies in Hong Kong.

It is stated in the Offer Document that save for the acquisition of the Sale Shares pursuant to the Agreement and the proposed Subscription for 3% convertible bonds in an aggregate principal amount of up to HK\$120,000,000 proposed to be issued by the Company pursuant to the Subscription Agreement, none of the Offeror nor parties acting

in concert with any of them has dealt in any Share or any option, warrant, derivative or security convertible into Shares during the Relevant Period. The Offeror, Mr. Suen and parties acting in concert with any one of them have not entered into any contract in relation to the outstanding derivatives in respect of securities in the Company nor borrowed or lent any relevant security (as defined in Note 4 of Rule 22 of the Takeovers Code) in the Company.

According to the Offer Document, it is the intention of the Offeror to maintain the listing of the Shares on the Stock Exchange and to continue the existing principal activities of the Group after the close of the Offer. The Offeror does not intend to introduce any major change to the existing operations and business of the Group or to redeploy any asset of the Group other than in its ordinary course of business immediately after the Offer. Meanwhile, a detailed review on the operations of the Group will be conducted by the Offeror for the purpose of formulating suitable business strategies for the Group's future development. The Offeror will also consider other suitable investments or business opportunities to enhance the growth of the Group should they arise. The Offeror stated in the Offer Document that it had no intention or plans for any acquisition or disposal of assets and/or business by the Group. However, the Company is considering the disposal of, and has therefore put on market for offers through estate agents, the Group's office premises in Hong Kong which are not material to the principal business activities of the Group. As at the Latest Practicable Date, no agreement has yet been reached or entered into in respect of the disposal and the disposal under discussion may or may not proceed.

The Board currently comprises seven Directors, including four executive Directors, namely Ms. Cheung Yan, Priscilla, Ms. Cheung Man, Catherine, Mr. Hui Kwok Chu and Mr. Sham Lok Shing, Edward and three independent non-executive Directors, namely Ms. Cynthia Law, Mr. Lam Chin Fung and Mr. Tse Wei Kin. The Offeror stated in the Offer Document that it intended to nominate Mr. Lo Ming Chi, Charles, Mr. Sue Ka Lok and Ms. Chan Yuk Yee as executive Directors and Mr. Kwok Ming Fai as an independent non-executive Director with effect from the calendar day immediately after the despatch of the Offeree Board Circular. The biographical details of the proposed new Directors are set out in the letter from Taifook Securities contained in the Offer Document.

## **RECOMMENDATION**

Having considered the principal factors and reasons stated above, in particular (i) the future prospects of the Group remain uncertain due to unstable market conditions; (ii) the Offer Price is the same as the consideration paid by the Offeror under the Agreement; (iii) the Offer Price represents a premium over the closing price of the Share for most of the time during the Review Period; (iv) although the Offer Price is lower than the closing price of the Shares as quoted on the Stock Exchange as at the Latest Practicable Date, it is uncertain whether the trading price of the Shares could be sustained at a level higher than the Offer Price during and after the Offer Period; (v) the liquidity of the Shares during the Review Period was thin and it is uncertain whether the liquidity of the Shares could be improved to allow the Independent

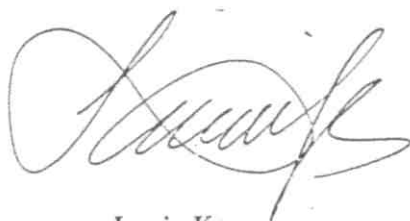


Shareholders to dispose of their holding in the Shares in the market without exerting downward pressure on the price of the Shares; and (vi) the PBR implied by the Offer Price falls within the range of those of the Industry Comparables and is higher than the average of the Industry Comparables, we are of the view that the terms of the Offer are fair and reasonable so far as the Independent Shareholders are concerned. As such, we recommend the Independent Board Committee to advise the Independent Shareholders, and recommend the Independent Shareholders, to accept the Offer. However, Independent Shareholders are strongly advised that the decision to realize or hold their investments in the Shares is subject to individual circumstances and investment objectives.

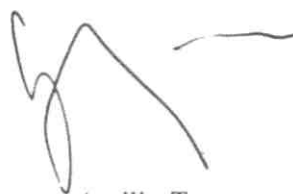
Independent Shareholders should also note that although the Offer Price represents a premium over the historical closing price of the Shares for most of the time during the Review Period, the Shares have been trading above the Offer Price after the Announcement was made. Therefore, opportunities may exist for Independent Shareholders to sell their Shares in the open market above the Offer Price and thus the Independent Shareholders are reminded that they should carefully and closely monitor the market price and the liquidity of the Shares before the end of the Offer Period and consider selling their Shares in the open market rather than accepting the Offer if the net proceeds from the market sale of their Shares after deducting all transaction costs are more than the net amount to be received under the Offer.

The procedures for acceptance of the Offer are set out in Appendix I to the Offer Document and the accompanying Form of Acceptance despatched to the Shareholders on 14 September 2009. The latest time for acceptance of the Offer (unless extended by the Offeror) is 4:00 p.m. on Friday, 16 October 2009. Independent Shareholders are urged to act according to the timetable if they wish to accept the Offer.

Yours faithfully,  
For and on behalf of  
**Hercules Capital Limited**



**Louis Koo**  
*Managing Director*



**Amilia Tsang**  
*Director*