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Ching Lee Holdings Limited

正利控股有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock code: 3728)

SUPPLEMENTAL ANNOUNCEMENT ON SUPPLEMENTAL AGREEMENT TO THE SHARE PURCHASE AGREEMENT

Reference is made to the announcement dated 29 September 2020 of Ching Lee Holdings Limited (the “**Company**”, together with its subsidiaries, the “**Group**”) in relation to a supplemental agreement to a share purchase agreement (the “**Announcement**”). Unless otherwise defined, capitalised terms used in this announcement shall have the same meanings as those defined in the Announcement.

The Company wishes to provide the following supplemental information on the Target Company and the Supplemental Agreement:

(1) Audited net profit of the Target Company

The audited net profit of the Target Company for the year ended 31 March 2020 was approximately HK\$6.2 million and is in line with the unaudited net profit of the Target Company disclosed in the Announcement.

(2) Original Profit Guarantee and Accumulated Profit Guarantee

The Share Purchase Agreement was entered into by the Group in April 2018. Under the Share Purchase Agreement, the Vendor had undertaken, among others, a profit guarantee for each of the three years ended 31 March 2020 (the “**Original Profit Guarantee**”) and a total accumulated profit guarantee for the three years ended 31 March 2020 (the “**Accumulated Profit Guarantee**”). For details of the said guarantees, please refer to the Company’s announcements dated 25 April 2018 and 10 May 2018, respectively.

In determining and agreeing on the Original Profit Guarantee and the Accumulated Profit Guarantee prior to the entering into of the Share Purchase Agreement in April 2018, the Board had considered (a) the then financial performance of the Target Company; (b) the customer-supplier relationship between the Target Company and the Group; and (c) the forecast of the Target Company’s growth based on the then market conditions.

The Board, having reviewed the financial performance of the Target Company and made all reasonable enquiries on its historical performance and projections prior to the entering into of the Share Purchase Agreement in April 2018, believed that the Target Company had demonstrated a solid financial performance and a year-on-year upward growth trend. The Board believed that the historical financial performance of the Target Company together with the projections provided by the Target Company was strong enough to justify the Group's investment. In order to safeguard the Group's investment with reasonable return, and having considered the financials and projections of the Target Company in light of the then market conditions and business environment of the construction industry, the Board agreed on the Original Profit Guarantee and the Accumulated Profit Guarantee.

(3) *Non-exercise of the Put Option*

The Group did not exercise the Put Option granted to it under the Share Purchase Agreement. In deciding the non-exercise of the Put Option in 2020, the Board first took into consideration the factors mentioned in paragraph (2) above, i.e. the factors considered by the Board in determining and agreeing on the Original Profit Guarantee and Accumulated Profit Guarantee.

Pursuant to the Put Option, the Group was granted the right to require the Vendor to purchase all the Sale Shares at a consideration equivalent to the sum of HK\$15.0 million and interest payment of 10% per annum accrued on HK\$15.0 million from the date of completion (i.e. 10 May 2018) until the date of full payment by the Vendor. Assuming that the date of full payment by the Vendor is 10 October 2020, the amount of consideration that the Company is entitled to receive if the Put Option was exercised in 2020 would be approximately HK\$18,615,000 (including interest of approximately HK\$3,615,000).

Due to the effect of some external factors, which were pervasive in the overall construction industry, including (i) the continuation of the Sino-US trade war which affected the global economic conditions; (ii) the persistently weak and competitive foundation market leading to lower contracted price; (iii) the increase in direct material costs and wages; and (iv) the delay in progress of some of the electrical and mechanical engineering projects resulting in decrease in progress billing (collectively, the "**External Factors**"), the Target Company's performance failed to meet the requirements of the Original Profit Guarantee. For further details, please refer to the Company's announcement dated 14 November 2019.

In light of the External Factors, the Board had considered the following additional matters when deciding the non-exercise of the Put Option in 2020:

- (a) The Target Company has been a reliable supplier of the Group since 2016. The Target Company could serve the strategic function of strengthening and expanding the Group's construction services in Hong Kong. As the epidemic would inevitably affect the business operation of the Group, securing a reliable supplier (which the Company is also one of its shareholders) could allow the Group to have more control over the supply chain and thereby could minimise disruption to the business of the Group, achieve cost control and at the same time remain confident in the quality of the goods and services supplied to the Group.

- (b) The Target Company's profit contribution of approximately HK\$2.7 million to the Group during the three years ended 31 March 2020.
- (c) The financial performance of the Target Company was affected by the External Factors and the social unrest in Hong Kong. In addition, the outbreak of COVID-19 has adversely affected the global economy and slowed down business activities around the world, including the business of the Target Company. In such difficult times, the Target Company was still able to contribute to the Group's profit of approximately HK\$1.8 million for the year ended 31 March 2020, which the Board considered satisfactory in the circumstances.
- (d) The Target Company has been able to secure contracts in relation to air-conditioning and electrical engineering installation and alteration works from time to time, which indicates that the Target Company has a solid business foundation and financial profile to withstand the economic turmoil. Based on the latest information provided, the Target Company has secured a total contract sum of approximately HK\$64.5 million for the year ending 31 March 2021.
- (e) The Target Company declared a dividend of HK\$6.0 million for the year ending 31 March 2021 on 30 June 2020, out of which the Group, being a shareholder holding 30.0% of its issued share capital, was entitled to HK\$1.8 million. The Group received such dividend payment of HK\$1.8 million in September 2020 which was accounted as an investing cash inflow to the Group with a dividend yield of 4.0% per annum (i.e. HK\$1.8 million of interim dividend income divided by the initial investment of HK\$15.0 million for three years) and was considered by the Board as a reasonable return to the Group that was higher than the average borrowing rate of the Company of approximately 3.6% and other investments such as Hong Kong 10 year bond yield of approximately 0.47% as at 29 September 2020, cash compensation, etc.. The management of the Target Company has informed its shareholders of their intention to declare and distribute dividends to its shareholders in future years if and when the performance of the Target Company meets the management's expectations which would be determined based on the Target Company's general business condition and strategies, cash flows, financial results, interests of shareholders and other factors that the management deems relevant.
- (f) The interim performance of the Target Company for the year ending 31 March 2021 based on its unaudited management accounts for the six months ended 30 September 2020 showed an unaudited net profit of approximately HK\$3.6 million.
- (g) Although the Target Company was unable to meet the Original Profit Guarantee, the Board considers that it would not be in the best interest of the Company to dispose of a business entity which has demonstrated a profit-making ability and an established relationship with the Company as explained above.

After considering the factors mentioned in paragraph (2) and the External Factors and the additional factors in paragraph (3) above, the Board decided not to exercise the Put Option in 2020.

(4) *Renewed Profit Guarantee and Renewed Put Option*

Before agreeing to the Renewed Profit Guarantee and the Renewed Put Option, the Board had considered the following major factors:

- (a) Under the current economic environment in Hong Kong which has been adversely affected by the social unrest and outbreak of COVID-19, the government's pace of awarding contracts has slowed down, which in turn disturbed the ongoing construction works in Hong Kong and hence caused negative impacts on the business operation and financial performance of the companies in the construction industry. A number of listed companies in the construction industry have recently issued profit warning announcements and private companies generally lack confidence in the short- and medium-term prospects of the construction industry. It is uncertain as to when the economic environment in Hong Kong would improve and business operation of companies in the construction industry could return to how it was prior to the social unrest and outbreak of COVID-19.
- (b) The Target Company has been a reliable supplier of the Group since 2016, providing air-conditioning and electrical engineering installation and alteration works of good quality to the Group. As the epidemic would inevitably affect the business operation of the Group, securing a reliable supplier (with the Company being one of its shareholders) could allow the Group to have more control over the supply chain and thereby could minimise disruption to the business of the Group, achieve cost control and at the same time remain confident in the quality of the goods and services supplied to the Group. The Board considered that the Target Company could serve the strategic function of strengthening and expanding the Group's construction services in Hong Kong, which also enhanced the synergy between the Target Company and the Company.
- (c) Pursuant to the Renewed Profit Guarantee, the Target Company has guaranteed to generate an accumulated audited net profits of not less than HK\$15.0 million for the three years ending 31 March 2023. As the Group holds 30.0% interests in the Target Company, the Renewed Profit Guarantee could provide a minimum return of HK\$4.5 million (HK\$15.0 million x 30.0%) for the three years ending 31 March 2023, representing approximately 30.0% of accumulated investment return based on investment amount, which is significantly higher than the interest rates of saving and bank borrowings.
- (d) The Renewed Put Option could provide an assurance to the Company that in the worst case scenario where the equity interest in the Target Company falls below the initial investment value, i.e. HK\$15.0 million, the Company would still be able to secure the principal amount by exercising the Put Option, which effectively serves the purpose of protecting the Company's assets and interests.

Having considered the above factors, the Board decided to agree to the Renewed Profit Guarantee and the Renewed Put Option. The Board is also of the view that the Renewed Profit Guarantee and the Renewed Put Option could serve the purpose of protecting the Company's assets and interests for the reasons stated in (b) to (d) above.

(5) *Supplemental Agreement*

The Board considered that the terms of the Supplemental Agreement which included the Renewed Profit Guarantee and the Renewed Put Option are in the best interests of the Company and its shareholders as a whole for the following reasons:

- (a) The investments brought purported benefits to the Group including (i) profit contribution to the Group; (ii) dividend contribution to the Group; (iii) established customer-supplier relationship; and (iv) the Target Company's ability to secure contracts.
- (b) According to the valuation of the Target Company performed by an independent valuer engaged by the Company for accounting reference for the years ended 31 March 2019 and 2020, the fair value of 30.0% equity interest of the Target Company was approximately HK\$15.0 million and HK\$17.4 million as at 31 March 2019 and 31 March 2020 respectively, with no impairment provided in the Group's financial statements. The valuer had adopted the income approach in the valuation of the Target Company which incorporated information about economic benefits contributed by the Target Company. Hence, the Board believed that the non-exercise of the Put Option would not have an adverse effect on the interests of the Company as long as the valuation of the entire Target Company did not fall below HK\$50.0 million. Based on the above valuation as well as the Board's view that (i) the returns from the Target Company under recent economic conditions in Hong Kong are reasonable; (ii) the valuation of the Target Company did not indicate any impairment; and (iii) the Group could still enjoy the flexibility of cost control while at the same time receiving high-quality goods and services from the Target Company, the Board decided not to exercise the Put Option in 2020.
- (c) The Board has also considered other possible investments if the Put Option was exercised. However, the Board is of the view that there are no profitable investment opportunities available at the moment. Without an alternative investment opportunity, the Company considers it inappropriate to rely on the redeemed amount to generate interests in the savings accounts with less than 1.0% per annum interest yield or repay the bank borrowing with an average interest rate of approximately 3.6%. These are lower than the average investment return of the Target Company which is approximately 6.0% (i.e. the Target Company's profit contribution to the Group of approximately HK\$2.7 million during the three years ended 31 March 2020 divided by the initial investment of HK\$15.0 million) or an average dividend yield of 4.0% per annum.
- (d) Although the Company would be entitled to a one-off compensation (i.e. the accrued interest at 10% per annum) in the amount of approximately HK\$3,615,000 should the Put Option be exercised in 2020, the Board has considered the strategic and operational benefits of retaining the Target Company in the Group and the proven profitability of the Target Company as shown by its profit and total comprehensive income of approximately HK\$2.7 million, HK\$2.9 million and HK\$6.2 million for the three years ended 31 March 2020, respectively. From a long-term perspective, the Board is of the view that the Target Company is capable of generating profits and would play a role in the business operation of the Group,

and the long-term benefits brought by the non-exercise of Put Option in 2020 and the entering into of the Supplemental Agreement would outweigh the one-off compensation upon the exercise of the Put Option in 2020.

- (e) Despite the Board's attempts to continue the previous arrangement with the Target Company under the Put Option, after arm's length negotiation between the parties, the Board agreed on the consideration of HK\$15.0 million without accrued interests for the Sale Shares under the Supplemental Agreement with reference to (i) the current market conditions affected by the Sino-US trade war and the outbreak of COVID-19; (ii) the lack of more profitable investment alternatives; and (iii) the long-term non-pecuniary benefits of retaining the Target Company in the Group as mentioned above which are not readily measurable in monetary terms.

The Board has considered different options to safeguard the Company's assets and interests including profit guarantee, put option and cash compensation. After discussions and negotiations with the Vendor, both parties reached a consensus and agreed to enter into the Supplemental Agreement, the terms of which (including the Renewed Profit Guarantee and Renewed Put Option) were accepted and agreed by both parties. Although the Board acknowledges that the terms of the Renewed Profit Guarantee and Renewed Put Option may, on the face of it, be less favourable to the Company as compared with the terms of the Original Profit Guarantee and the Put Option, the Board considered the Renewed Profit Guarantee and Renewed Put Option agreed by the Vendor could safeguard the Company's assets and interests as explained in details above.

By order of the Board
Ching Lee Holdings Limited
Mr. NG Choi Wah
Chairman

Hong Kong, 12 November 2020

As at the date of this announcement, the executive directors of the Company are Mr. Ng Choi Wah, Mr. Lui Yiu Wing and Mr. Lam Ka Fai, and the independent non-executive directors of the Company are Dr. Wai Wing Hong Onyx, Mr. Tong Hin Sum Paul and Mr. Chau Kam Wing Donald.