红日资本有限公司
RED SUN CAPITAL LIMITED

22 May 2023

To: The Independent Board Committee and the Independent Shareholders of Top Form International Limited

Dear Sirs or Madams,

RENEWAL OF CONTINUING CONNECTED TRANSACTIONS

I. INTRODUCTION

We refer to our engagement as the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders in respect of the 6th Renewal Agreement and the transactions contemplated thereunder (the "**Continuing Connected Transactions**") as well as the proposed annual caps of the underlying transactions under the 6th Renewal Agreement for the three years commencing from 1 July 2023 and ending on 30 June 2026 (the "**Proposed Annual Caps**"), details of which are set out in the letter from the Board (the "**Letter from the Board**") contained in the circular of the Company dated 22 May 2023 (the "**Circular**") of which this letter forms part. This letter contains our advice to the Independent Board Committee and the Independent Shareholders in respect of the 6th Renewal Agreement and the Proposed Annual Caps. Capitalised terms used in this letter shall have the same meanings as those defined in the Circular unless the context otherwise requires.

As set out in the Letter from the Board, in the past, the Company entered into the Master Agreement and renewed such agreement five (5) times with VDV with regard to the sale of ladies' intimate apparel by the Group to VDV. Given that the 5th Renewal Agreement will expire on 30 June 2023 and the Group expects that the continuing connected transactions will continue on a recurring basis, the Company entered into the 6th Renewal Agreement with VDV to renew the terms of the Master Agreement for a further three years commencing from 1 July 2023 and ending on 30 June 2026 to continue the sale of ladies' intimate apparel by the Group to VDV.

香港中环德辅道中141号中保集团大厦3楼310室
Room 310, 3/F., China Insurance Group Building, 141 Des Voeux Road Central, Hong Kong
Tel电话 : (852) 2857 9208 Fax传真 : (852) 2857 9100
E-mail电邮 : info@redsunhk.com

It is also noted that as (i) Mr. Herman Van de Velde, a non-executive Director of the Company, is the chairman of VDV and Ms. Lien Van de Velde, a non-executive Director of the Company, is an associate of Mr. Herman Van de Velde under Chapter 14A of the Listing Rules; (ii) Mr. Lucas A.M. Laureys, a former non-executive Director of the Company in the last 12 months, is the non-executive director of VDV; (iii) Mr. Herman Van de Velde and the two daughters of Mr. Lucas A.M. Laureys (associates of Mr. Lucas A.M. Laureys under Chapter 14A of the Listing Rules) hold an indirect equity interest of 56.26% in VDV via a jointly controlled corporation; and (iv) VDV, a substantial shareholder of the Company, is beneficially and directly interested in approximately 25.66% of the entire issued share capital of the Company, the transactions between the Group and VDV contemplated under the 6th Renewal Agreement therefore constitute continuing connected transactions for the Company under Rule 14A.31 of the Listing Rules.

As one or more of the applicable percentage ratios in respect of the annual cap for each of the three financial years ending 30 June 2024, 2025 and 2026 exceeds 5%, the Continuing Connected Transactions are subject to the reporting, announcement, and Independent Shareholders' approval requirements, and annual review by the independent non-executive Directors and the auditors of the Company under Chapter 14A of the Listing Rules.

As at the Latest Practicable Date, each of Mr. Herman Van de Velde, Ms. Lien Van de Velde, Mr. Lucas A.M. Laureys, VDV and their respective associates who is deemed to be interested in 77,258,590 Shares, representing approximately 25.66% of the entire issued share capital of the Company, will abstain from voting on the resolution in relation to the 6th Renewal Agreement and the relevant annual caps of the underlying transactions to be passed at the SGM.

Save as aforesaid mentioned, based on the Letter from the Board, none of the Directors has material interests in the 6th Renewal Agreement and are required to abstain from voting on the relevant resolution at the SGM.

II. THE INDEPENDENT BOARD COMMITTEE

The Independent Board Committee, comprising all the independent non-executive Directors, namely Ms. Leung Churk Yin, Jeanny, Mr. Leung Ying Wah, Lambert and Mr. Lin Sun Mo, Willy, has been formed in accordance with Chapter 14A of the Listing Rules to advise the Independent Shareholders on, among other things, whether the 6th Renewal Agreement (together with the Proposed Annual Caps) are fair and reasonable and in the interests of the Company and the Independent Shareholders as a whole.

Our appointment has been approved by the Independent Board Committee. Our role as the Independent Financial Adviser is to give our recommendation to the Independent Board Committee and the Independent Shareholders as to (i) whether the 6th Renewal Agreement (together with the Proposed Annual Caps) are conducted in the ordinary and usual course of business, on normal commercial terms, fair and reasonable so far as the Independent Shareholders are concerned and are in the interests of the Company and the Shareholders as a whole; and (ii) how the Independent Shareholders should vote in respect of the relevant resolution to approve the 6th Renewal Agreement and transactions to be contemplated thereunder, including the Proposed Annual Caps, at the SGM.

III. OUR INDEPENDENCE

As at the Latest Practicable Date, we did not have any relationship with or interest in the Company or any other parties that could reasonably be regarded as relevant in assessing our independence. In the previous two years from the date of the Circular, Red Sun Capital Limited has not acted as an independent financial adviser to the Independent Board Committee and the Independent Shareholders of the Company for any transaction. Apart from normal professional fees paid or payable to us in connection with this appointment and the engagement as stated above as the Independent Financial Adviser, no arrangements exist whereby we had received or will receive any fees or benefits from the Company or any other parties that could reasonably be regarded as relevant in assessing our independence. Accordingly, we consider that we are independent pursuant to Rule 13.84 of the Listing Rules.

IV. BASIS OF OUR ADVICE

In formulating our opinion to the Independent Board Committee and the Independent Shareholders, we have relied on the statements, information, opinions and representations contained in the Circular and the information and representations provided to us by the Company, the Directors and the management of the Company (the "**Management**"). We have assumed that all statements, information, opinions and representations contained or referred to in the Circular, which have been provided by the Company, the Directors and the Management (for which they are solely and wholly responsible), were true and accurate at the time they were made and continue to be so as at the Latest Practicable Date.

The Directors jointly and severally accept full responsibility for the accuracy of the statements, information and representations contained in the Circular and confirm, having made all reasonable enquiries, that to the best of their knowledge, opinions expressed in the Circular have been reasonably arrived at after due and careful consideration and there are no other material facts not contained in the Circular the omission of which would make any statement in the Circular misleading. We consider that we have been provided with sufficient information in order to form a reasonable basis for our opinion. We have no reason to suspect that any relevant information has been withheld, nor are we aware of any facts or circumstances which would render the information provided and representations made to us untrue, inaccurate or misleading. We consider that we have performed all necessary steps to enable us to reach an informed view and to justify our reliance on the information provided so as to provide a reasonable basis for our opinion.

We have not, however, for the purpose of this exercise, conducted any independent verification, investigation or audit into the information provided by the Directors and the Management, business or affairs or future prospects of the Company, VDV and their respective shareholder(s) and subsidiaries or affiliates, and their respective history, experience and track records, or the prospects of the markets in which they respectively operate.

This letter is issued for the Independent Board Committee and the Independent Shareholders solely in connection with their consideration of the Continuing Connected Transactions (together with the Proposed Annual Caps) and, except for its inclusion in the Circular, is not to be quoted or referred to, in whole or in part, nor shall this letter be used for any other purposes, without our prior written consent.

V. PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion to the Independent Board Committee and the Independent Shareholders in respect of the Continuing Connected Transactions and Proposed Annual Caps, we have taken into consideration the following principal factors and reasons:

1. Information of the Group

1.1. Background information of the Group

The Company is an investment holding company. Its principal subsidiaries are engaged in the design, manufacture and distribution of ladies' intimate apparel, principally brassieres.

1.2. Historical financial performance of the Group

With a view to provide background information on the historical financial performance of the Group, we set out the following financial information of the Group as extracted and summarised from the Group's published annual report for the year ended 30 June 2022 (the "**2022 Annual Report**") and the Group's published interim report for the six months ended 31 December 2022 (the "**2023 Interim Report**").

Summary of the Group's revenue by operating segment:

	For the six months ended 31 December		**For the year ended 30 June**	
	2022	**2021**	**2022**	**2021**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
	(unaudited)	*(unaudited)*	*(audited)*	*(audited)*
Revenue	471,912	713,652	1,481,592	1,428,532
Profit for the period/year attributable to the Shareholders	(23,847)	450	3,550	2,797

*For the six months ended 31 December 2022 ("**1H2023**") and 31 December 2021 ("**1H2022**")*

As set out in the 2023 Interim Report, the Group's total revenue amounted to approximately HK$471.9 million for 1H2023, representing a decrease of approximately 33.9% compared to approximately HK$713.7 million for 1H2022. Such decrease was primarily attributable to the decline in sales from the Group's customers in the United States of America (the "**U.S.**"). In response, the Management has implemented stringent cost controls to reduce expenses. Unfortunately, these were not enough to offset the entire negative impact of the decrease in sales.

In terms of revenue generated by geographical segment for 1H2023, the largest geographical segment of the of the Group was the U.S., which accounted for approximately 54% of the Group's sales, followed by the European countries of approximately 25%, with the remaining revenue being generated from sales to the rest of the world.

For 1H2022 and 1H2023, the sales by the Group to VDV amounted to approximately HK$57.2 million and HK$67.7 million, representing approximately 8.0% and 14.3% of the Group's total revenue, respectively.

The Group recorded a loss for the 1H2023 attributable to its Shareholders of approximately HK$23.8 million compared to a profit for the 1H2022 attributable its Shareholders of approximately HK$0.5 million. As set out in the 2023 Interim Report, this was attributable to a combination of factors, including inventory gluts in the major customers of the Group which was a result of over purchase coupled with significant delay due to global supply chain disruptions during the COVID period, persistently high inflation in the U.S. and Europe which dampened consumer confidence and eroded disposable income, and multiple rate hikes by the U.S. Federal Reserve which not only increased the financing cost but also reduced company spending and investment.

*For the year ended 30 June 2022 ("**FY2022**") and 30 June 2021 ("**FY2021**")*

The Group's total revenue amounted to approximately HK$1,481.6 million for FY2022, representing a slight increase of approximately 3.7% compared to approximately HK$1,428.5 million for FY2021.

In terms of revenue generated by geographical segment for FY2021 and FY2022, the largest geographical segment of the of the Group was the U.S.. In this connection, the Group generated approximately HK$1,072.6 million and HK$992.4 million of its sales revenue from the U.S., representing approximately 75.1% and 67.0% of the Group's total revenue for FY2021 and FY2022, respectively.

We also noted that the Group derived approximately HK$149.1 million and HK$210.2 million in revenue from the combined sales to Germany, Belgium and the Netherlands, for FY2021 and FY2022, respectively, representing an annual growth rate of approximately 41.0%. This accounted for approximately 10.4% and 14.2% of the Group's revenue for the respective financial years.

For FY2021 and FY2022, the sales by the Group to VDV amounted to approximately HK$97.1 million and HK$120.9 million, representing approximately 6.8% and 8.2% of the Group's total revenue, respectively.

The Group recorded a profit attributable to the shareholders of the Company of approximately HK$3.6 million for FY2022, representing an increase of approximately 28.6% as compared to approximately HK$2.8 million for FY2021 attributable to, among others, cost management exercises and improvement in operation efficiencies.

1.3. Information on the VDV

According to the latest published annual report of VDV[1] for the year ended 31 December 2022 (the "**2022 VDV Annual Report**"), VDV, together with its subsidiaries, designs, develops, manufactures and markets fashionable luxury lingerie. VDV works closely with about 4,000 independent lingerie boutiques around the globe, as well as having their own retail network and brands. Their primary focus is on the European and North American market.

Set out below is a summary of the VDV's operating results for the financial years ended 31 December 2021 and 2022, extracted from the 2022 VDV Annual Report:

	For the year ended 31 December	
	2022	**2021**
	EUR'000	*EUR'000*
Turnover *(Note 1)*	211,745	195,251
– Eurozone *(Note 2)*	151,333	140,588
– Others *(Note 3)*	60,412	54,663

Notes:

(1) For illustration purposes only, EUR is converted into HK$ at the rate of EUR1: HK$8.55. On this basis, turnover of VDV group is equivalent to approximately HK$1.7 billion and HK$1.8 billion for the year ended 31 December 2021 and 2022, respectively.

(2) Eurozone markets for VDV mainly comprised of Germany, Belgium and the Netherlands.

(3) Other market for VDV mainly comprised of United States of America, United Kingdom and Switzerland.

[1] *VDV 2022 Annual Report (source: https://assets.ctfassets.net/3zzevkhc8io9/gl3AjG5hs6CGKC4Q0yLst/e88f7b9fe379be33b4d9a82bbafda6b9/GB_-_280152_Jaarverslag_2022_UK_interact.pdf)*

As illustrated above, VDV recorded a turnover of approximately EUR211.7 million for the year ended 31 December 2022, representing an increase of approximately 8.4% compared with its revenue of approximately EUR195.3 million for the year ended 31 December 2021. Based on the 2022 VDV Annual Report, both of VDV's business-to-business and direct to customers segments recorded growth, which were attributable to the return of customers to physical stores during the first half of the year, recovery of swimwear sales after two years of travel restrictions and the turnover in the second half of the year was largely in line with the corresponding period last year. It is also noted from the 2022 VDV Annual Report that VDV's strategic plan in 2023 involve (i) investing in three lingerie brands; (ii) focusing on consumers and creating a community for each brand; and (iii) strengthening its optichannel strategy.

1.4. Reasons for and benefits of the 6th Renewal Agreement

It was noted that from the Letter from the Board, the Group has been supplying ladies' intimate apparel to VDV for the past 41 years and it is anticipated that the Group will continue to carry out such transactions on a recurring basis. On this basis and given the expiration of the 5th Renewal Agreement on 30 June 2023, the Company entered into the 6th Renewal Agreement with VDV to renew the terms of the Master Agreement for a further three years ending on 30 June 2026 with a view to continue the sales of ladies' intimate apparel to VDV.

It is noted that the transactions contemplated under the 6th Renewal Agreement are expected to continue on a recurring basis in the ordinary and usual course of business, on normal commercial terms agreed after arm's length negotiations between the Group and VDV. The Directors are of the view that the terms of the 6th Renewal Agreement and the Proposed Annual Caps of the transactions contemplated thereunder are fair and reasonable and are in the interests of the Company and the Shareholders as a whole.

Given that (i) the Group principally engages in the design, manufacture and distribution of ladies' intimate apparel; (ii) Europe and the U.S. are significant markets to the Group's business; (iii) the Company has been supplying quality ladies' intimate apparel to VDV for the past 41 years as part of the Group's ongoing business; (iv) the Continuing Connected Transactions are a furtherance of the Group's core business; (v) the Continuing Connected Transactions (together with the Proposed Annual Caps), if approved, would facilitate the Continuing Connected Transactions for the three years ending 30 June 2024, 2025 and 2026; and (vi) the Group has the right but not the obligation to confirm sales orders from VDV at terms determined in accordance with the relevant pricing policies, we concur with the Directors' view that the Continuing Connected Transactions are in the interests of the Company and the Shareholders as a whole.

2. Terms of the 6th Renewal Agreement

On 17 April 2023, the Company entered into the 6th Renewal Agreement to renew the terms of the Master Agreement for a further three years commencing from 1 July 2023 to 30 June 2026 and facilitates the continuing sales of ladies' intimate apparel to VDV and its subsidiaries by the Group.

Pursuant to the pricing policy set out under the 6th Renewal Agreement, the actual pricing and the terms and conditions of payment shall be determined between the parties on each purchase order basis. Such is attributable to the fact that the ladies' intimate apparel manufactured by the Group varies in design, features, complexity and manufacturing time. Hence, the selling price of each product is determined by reference to the total costs per product, plus a certain range of markup rate of no less than 5%. The markup rate is determined by reference to different product category and will be varied from different value-added procedures and manufacturing time of each product in different product category. In this connection, sales made to VDV will be satisfied in cash within a period of 7 days or 10 days (applicable as the case may be). During the year ended 30 June 2022 and for the six months ended 31 December 2022, the number of purchase orders from VDV placed with the Group were not less than 800 purchase orders and 400 purchase orders, respectively.

In order to assess the reasonableness of the terms under 6th Renewal Agreement, we have obtained and reviewed (i) a total of 12 samples of sales record of ladies' intimate apparel between the Group and its customers, of which six of the samples reviewed by us were sales transactions to VDV during the months falling in the most recent financial year (i.e. the year ending 30 June 2023), selected on a random basis from the sales record obtained from the Company which covered a range of sales transaction size, the amount of which ranged from approximately US$1,200 to not less than US$8,500, and the pieces in relation to these sales transactions ranged from not less than 400 pieces to more than 3,000 pieces, with a view to ensure the samples covered different sales transaction sizes over a period of time, and six of the samples were sales transactions to its independent third-party customers, during the year of 2022 and 2023 (for the comparable product type and quantity at the relevant time), which is considered to be sufficient for the purpose of our analysis as we have reviewed and assessed the effectiveness of the relevant internal control procedures and assessed whether under such internal control procedures, the sampled transactions adhered to the pricing policies as a result. Based on our work performed, it is noted that the internal control procedures are carried out on each of the sampled transactions and that the sampled transactions adhered to the relevant pricing policies; and (ii) a list of its customers that contain information in respect of the contribution margins received by the Group (for the comparable product type and quantity at the relevant time) from all of its major customers for the two financial years ended 30 June 2022 and the six months ended 31 December 2022.

The VDV sample selection covered a range of product designs with various complexity, and we have also requested the Company to provide comparable products supplied to independent third-party customers which are comparable to the products supplied to VDV under the six sampled transactions selected on a random basis, for comparison purposes. Given the Group manufactures a wide range of ladies' intimate apparel, which varies in design, features, complexity and manufacturing time, such factors would in turn affect the profit margin of a particular type of product. Taking into considering the above factors, the Management divided its ladies' intimate apparel into different product categories. The Management advised that the markup rate is determined by reference to different product category and varied for different product category and value-added procedures carried out by the Group for the subject product in different product categories. Through our discussion with the Management and documents obtained by us, the Company would, when providing price quotations to customers, consider certain factors such as estimate material usage, time costs for manufacturing processes involved, the design, features and complexity of the different products. Such information is prepared by the sales department and is authorised prior to responding to the subject customer's request for quotation.

In addition, for the purpose of our analysis, we have also reviewed sales transactions with independent third-party customers of the similar product category as the sampled VDV sales transactions. We note that the profit margin of the sampled sales to VDV was no less favourable than the profit margin recorded from the comparable sampled sales to independent third-party customers, respectively.

Furthermore, we note that the credit period offered to VDV, as stipulated in the 6th Renewal Agreement, is 7 days or 10 days (applicable as the case may be), which is not less favourable than that offered to independent third-party customers that the average credit period on purchases of goods of the Group ranged from 30 to 60 days as set out in the 2022 Annual Report.

As set out in the Letter from the Board, all the quotations to VDV would be prepared by the sales teams of the Group and subject to the review and pre-approval of an executive Director (who does not have any material interests in the transactions). The executive Director will compare the gross profit margin of sales to VDV to those of sales to other independent third-party customers of the same product category with similar features, complexity and manufacturing time. If the terms of the orders offered by VDV after the price negotiations are below the lower limit of the markup rate, the Group may choose not to accept the orders placed by VDV. By doing so, the Directors consider that the sales transactions under the 6th Renewal Agreement will continue to be conducted on normal commercial terms and on terms no more favourable than those charged by the Group to other independent third-party customers and not prejudicial to the interests of the Company and its Shareholders as a whole. We have obtained and discussed with the Management regarding the quotations to VDV prepared by the sales team of the Group and noted that the sampled transactions were approved by an executive Director.

As set out in the Letter from the Board, we noted that the Continuing Connected Transactions will be conducted in the ordinary and usual course of business of the Group and on normal commercial terms that are no more favourable than those offered to independent third-party customers, the 6th Renewal Agreement facilitates the Company to transact with VDV (subject to acceptable terms). Based on our analysis and work performed as detailed in this section above, including but not limited to, our review and work performed in relation to the sampled transactions and internal control procedures carried out by the Company, we concur with the view of the Directors that the 6th Renewal Agreement is in the interests of the Company and the Independent Shareholders as a whole and its terms are fair and reasonable so far as the Independent Shareholders are concerned.

3. Basis for determining the Proposed Annual Caps

The table below sets forth the annual caps for the continuing connected transactions contemplated under the 5th Renewal Agreement for each of the FY2021, FY2022 and FY2023 (defined hereafter), the actual transaction amounts under the 5th Renewal Agreement for each of the FY2021, FY2022 and 1H2023, and the relevant utilisation rate of the existing annual caps:

	Actual sales of ladies' intimate apparel by the Group to VDV *(HK$ million)*	Sales to overall revenue for the respective year/period *(%)*	Annual caps *(HK$ million)*	Respective annual/ period cap utilisation rate *(%)*
For the year ended:				
30 June 2021	97.1	6.8	160	60.7
30 June 2022	120.9	8.2	170	71.1
For the six months ended:				
31 December 2021 *(unaudited)*	57.2	8.0	170	33.6 *(annualised: 67.3) (Note)*
31 December 2022 *(unaudited)*	67.7	14.3	180	37.6 *(annualised: 75.2) (Note)*

Note: Utilisation rate based on unaudited information for 1H2022 and 1H2023 provided by the Management of the Group, respectively. For illustration purposes only, annualised utilisation rates are calculated based on sales to VDV for the respective six months period.

As set out in the above table, for each of the FY2021, FY2022 and 1H2023, the aggregate value of sales of ladies' intimate apparel to VDV amounted to approximately HK$97.1 million, HK$120.9 million and HK$67.7 million, respectively, representing approximately 6.8%, 8.2% and 14.3% of the Group's revenue of the respective financial year/period. The respective utilisation rate for the annual caps for the two financial years ended 30 June 2022 and the six months period ended 31 December 2022 are approximately 60.7%, 71.1% and 37.6%, respectively. For illustration purposes only, the annualised utilisation rate calculated based on the six months ended 31 December 2022 compared to the annual cap for the year ending 30 June 2023 ("**FY2023**") is approximately 75.2%. As advised by the Management, the aforesaid relatively modest utilisation rate of the annual cap for the financial year ended 30 June 2021 was primarily attributable to the then challenging business environment during the COVID period and the utilisation rate of the annual cap has gradually increased since the re-opening of Europe.

The following sets forth the Proposed Annual Caps under the 6th Renewal Agreement for the three years ending 30 June 2024, 2025 and 2026:

	For the year ending		
	30 June 2024	**30 June 2025**	**30 June 2026**
	HK$ million	*HK$ million*	*HK$ million*
Proposed Annual Caps	130 (the "**2024 Annual Cap**")	140 (the "**2025 Annual Cap**")	150 (the "**2026 Annual Cap**")

According to the Letter from the Board, the Proposed Annual Caps under the 6th Renewal Agreement were determined after taking into account: (i) the historical sales of ladies' intimate apparel by the Group to VDV for FY2021, FY2022 and 1H2023; (ii) the estimation made by the Management that the sales to VDV for the FY2023 will be less than HK$130 million; (iii) the discussions between the Management and VDV in arriving at the annual caps and the revenue forecast for the three financial years ending 30 June 2026, including, among others, the moderate year-on-year growth in expected future demand; (iv) provision of more value added production procedures and technology, such as, the processing of fabrics in the Group's factory in China and relocation of sourcing services from Europe to Asia; and (v) the prevailing and the expected market conditions, which the Management expects to be a conducive macro environment for steady demand growth over the next few years. The Directors are of the view that the proposed annual caps are fair and reasonable, on normal commercial terms and in the interest of the Company and Shareholders as a whole.

For the avoidance of doubt, the Proposed Annual Caps represent the maximum value of sales by the Group to VDV in each year and there is no minimum or implied value of sales in each of these years.

In order to assess the fairness and reasonableness of the Proposed Annual Caps, we have reviewed and discussed the information provided by the Management, namely the estimated average sales price, the estimated sales volume and a buffer for each of the three years ending 30 June 2026.

Although the overall revenue of the Group for 1H2023 decreased by over 30% period-on-period, as analysed under section headed "1.2. Historical financial performance of the Group" above, it is also noted that the aggregate value of sales of ladies' intimate apparel to VDV with respect to the Group's total revenue for FY2021 increased from approximately 6.8% to approximately 8.2% for FY2022. In addition, the aggregate sales value of ladies' intimate apparel to VDV with respect to the Group's total revenue for 1H2023 was approximately 14.3%, compared to approximately 8.0% for 1H2022.

We also noted that the historical sales of ladies' intimate apparel by the Group to VDV represented a year-on-year increase and a period-on-period increase from FY2021 to FY2022 and from 1H2022 to 1H2023, respectively. Such increase represented a year-on-year growth rate and a period-on-period growth rate of approximately 24.5% and 18.3%, respectively (the "**Historical Growth Rate**"). In comparison, the 2025 Annual Cap represents an increase of approximately 7.7% to the 2024 Annual Cap, and the 2026 Annual Cap represents an increase of approximately 7.1% to the 2025 Annual Cap, both of the aforesaid rate of increase in the respective proposed annual caps are below the Historical Growth Rate. Nonetheless, it is noted that VDV has previously communicated to the Management regarding information on their inventory level at the material time. Having considered the abovementioned factors as well as the factors considered for the determination of the Proposed Annual Caps as set out in the Letter from the Board, the Management has adjusted the 2024 Annual Cap, 2025 Annual Cap and 2026 Annual Cap accordingly.

Furthermore, we also noted that the utilisation rate for the annual caps for FY2021 and FY2022 amounted to approximately 60.7% and 71.1%, respectively. For illustration purposes only, if we annualised the actual sales to VDV for the six months ended 31 December 2022 (the "**2022/23 Annualised Amount**") and compared such calculated amount to existing annual cap of HK$180 million, the calculated utilisation rate based on the annualised sales amount would be approximately 75.2%. In addition, the 2022/23 Annualised Amount would be slightly higher but broadly in line with the 2024 Annual Cap, which was determined by the Management after discussions with VDV regarding their potential demand in the forthcoming year as it is expected that the demand would be at a similar level to that of the year ending 30 June 2023. Based on the forgoing, the Management considered that it is prudent and reasonable to lower the 2024 Annual Cap to HK$130 million from the existing annual cap of HK$180 million for the year ending 30 June 2023, and given the reasons set out in the preceding paragraph, the respective growth rate applied to determine the 2025 Annual Cap and 2026 Annual Cap are also considered to be reasonable.

According to the pricing policy of the 6th Renewal Agreement, the selling price of each product is determined by reference to the total costs per product plus a certain range of markup rate and the selling price together with the mark up rate of different product category will be varied from different value-added procedures and manufacturing time of each product in different product category. We have discussed the basis and assumptions with the Management that the additional costs for the value-added production procedures may further increase the costs of production and the selling price. On the aforementioned basis, we consider that it is reasonable for the Directors to make reference to the aforesaid factors as the basis to determine the Proposed Annual Caps of HK$130 million, HK$140 million and HK$150 million for each of the three financial years ending 30 June 2024, 2025 and 2026, respectively.

Having considered the aforesaid factors, in particular (i) the historical transaction amounts with VDV compared to the Proposed Annual Caps; (ii) the well-developed distribution channel of VDV within the lingerie market in Europe and the U.S., both being important markets of the Group in the past; (iii) the Group's recent financial performance; (iv) the historical utilisation rate of the existing annual caps as well as our analysis on the 2022/23 Annualised Amount; (v) the information and indications from VDV communicated to the Management regarding their inventory level and demand in the next few years; (vi) the sales to VDV shall be conducted on terms no less favourable to the Company than comparable sales to independent third-party customers; (vii) the Proposed Annual Caps, if approved, would facilitate the Continuing Connected Transactions to be conducted in an effective and efficient manner without the need for the Company to seek Shareholders' approval on a transaction-by-transaction basis; and (viii) the Continuing Connected Transactions are a furtherance of the Group's core business, we consider that the Proposed Annual Caps of HK$130 million, HK$140 million and HK$150 million for each of the three financial years ending 30 June 2024, 2025 and 2026 to be fair and reasonable so far as the Independent Shareholders are concerned.

VI. RECOMMENDATION

Having taken into account of the above factors and reasons as set out above, we are of the view that the 6th Renewal Agreement (including the Proposed Annual Caps) is in the ordinary and usual course of business of the Group and on normal commercial terms and in the interests of the Company and the Independent Shareholders as a whole, and the terms of the 6th Renewal Agreement and the Proposed Annual Caps are fair and reasonable so far as the Independent Shareholders are concerned. Accordingly, we would advise the Independent Board Committee to recommend, and we ourselves recommend, the Independent Shareholders to vote in favour of the ordinary resolution to approve the 6th Renewal Agreement and the Proposed Annual Caps at the SGM.

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

Lewis Lai
Managing Director

Mr. Lewis Lai is a licensed person registered with the SFC and a responsible officer of Red Sun Capital Limited to carry out type 1 (dealing in securities) and type 6 (advising on corporate finance) regulated activities under the SFO and has over 15 years of experience in the corporate finance industry.