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MOG DIGITECH HOLDINGS LIMITED

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 1942)

SUPPLEMENTAL ANNOUNCEMENT IN RELATION TO THE DISCLOSEABLE TRANSACTION REGARDING THE ACQUISITION OF THE ENTIRE EQUITY INTEREST IN HOPE TALENT LIMITED

Reference is made to the announcement (the “**Announcement**”) of MOG Digitech Holdings Limited (the “**Company**”, together with its subsidiaries, the “**Group**”) dated 13 October 2023 in relation to, among other things, the acquisition of the entire equity interest in Hope Talent Limited. Unless otherwise defined, terms used in this announcement shall have the same meanings as those defined in the Announcement.

The Directors would like to provide the following supplemental information on how the Consideration was determined, including the key assumptions and inputs of the Valuation.

THE BASIS FOR DETERMINING THE CONSIDERATION

As disclosed in the Announcement, the Consideration was determined after arm’s length negotiations between the Purchaser and the Vendor on normal commercial terms and with reference to a preliminary valuation of 29% equity interest in Beijing Yuntu as estimated by the Valuer using the income approach and market approach.

After the Agreement was signed, the Company engaged the Valuer to conduct the Valuation. The Valuation Report was finalised on 8 June 2023. According to the Valuation Report, the appraised value of the 29% equity interest in Beijing Yuntu using the income approach and market approach were approximately RMB97.7 million and RMB102.7 million, respectively.

After internal discussions and consulting with the Valuer, the Company realised that using two valuation results to determine the Consideration may not accurately reflect the true value of the business or interest being valued. Therefore, to avoid any misleading information, the Company confirmed that the Consideration was derived based on a premium over the Valuation results using the income approach. It is important to note that the market approach was only used for cross-checking purposes.

The Company confirmed the Consideration based on the income approach after considering the following factors:

- (i) the Directors reviewed the comparable public companies that were selected by the Valuer (the “**Comparable Companies**”) for the purpose of adopting market approach. The Directors noticed that the business of the Comparable Companies was not directly related to that of Beijing Yuntu. This raised doubts about the representativeness, appropriateness and reasonableness of using Comparable Companies for the valuation process;
- (ii) the Directors reviewed the Projection (as defined below) of Beijing Yuntu, including the underlying assumptions, calculations, and supporting documents (including the contracts signed), and considered the Projection is reliable; and
- (iii) the Directors have thoroughly reviewed the Valuer’s calculations of the Valuation using the income approach, and have considered all the parameters adopted by the Valuer, including but not limited to the calculation of the discount rate, marketability discount and size adjustment. After careful consideration, the Directors considered the calculations to be fair and reasonable.

After considering the above factors and the uncertainties of using the market approach where there is limited comparable market data available, the Directors concluded that the Valuation using the income approach is more reliable.

Furthermore, the Directors acknowledged that the Consideration offered for Beijing Yuntu is higher than its appraised value based on the income approach. However, the Directors have taken into account several factors, including (a) the signed contracts that have already realized 90% of the first year’s revenue, which indicated a low equity risk and uncertainties; (b) the Projection was prepared on a conservative basis, and Beijing Yuntu probably can achieve better performance with the rapid growth of the relevant industry; (c) the competitive advantage that Beijing Yuntu has over its competitors due to its proprietary technology that uses big data analytics to enhance data mining capabilities, which is difficult to replicate or patent; and (d) the specific entry barriers of the IT solutions market, including the need for extensive experience, deep know-how, and a successful track record in providing IT solutions services, the ability to adapt to emerging technologies and provide one-stop customized IT solutions services, as well as having solid relationships with market participants such as hardware equipment suppliers and software service providers. Based on these factors, the Directors believed that the Projection was prepared with prudent assumptions and that Beijing Yuntu has a bright future. Therefore, the Directors believed that the intrinsic value of Beijing Yuntu is higher than the market price or the assessed value based on the Valuation.

THE BASIS AND KEY INPUTS UNDER THE INCOME APPROACH WAS DETERMINED

As mentioned above, the fair value of Beijing Yuntu was determined using the income approach by taking into account a financial projection prepared by its management for the years of 2023 to 2027 (the “**Projection**”).

Below is a table showing the basis to determine the Projection, which included projected revenue, the projected gross profit margin of Beijing Yuntu, the terminal growth rate, the discount rate and the discount on lack of marketability (“**DLOM**”):

Projected revenue **For the year ending 31 December 2023 (“FY2023”)**

The projected revenue of Beijing Yuntu for FY2023 was determined based on the cash inflow expected from the completion of contracts in 2023.

It was expected that Beijing Yuntu would be able to contribute approximately RMB170.45 million for FY2023. Out of the total projected revenue, 90% of which was supported by a contract pipeline with a contract value of approximately RMB140.84 million.

As advised by the management of Beijing Yuntu, the contract value of RMB140.84 million only represents the signed contract amount from the first three quarters of 2023. It does not include any potential projects that may be signed in the fourth quarter of 2023. It is anticipated that the existing contract value will increase by approximately 20% in FY2023 due to the start of the 2nd stage of development for certain projects. The revenue projection for FY2023 is based on this expectation.

For the year ending 31 December 2024 (“FY2024”) to the year ending 2027 (“FY2027”)

The projected revenue of Beijing Yuntu for FY2024 to FY2027 was calculated using a 5% annual growth rate, factoring in anticipated inflation and industry growth. According to a report titled “Software – China” by Statista.com, a website that provides market and consumer data, the software market in China is projected to grow at an annual rate of 11.70% (CAGR 2023-2028). This growth is expected to result in a market volume of RMB433.60 billion by 2028. The Projection has made reference to these statistics and applied a prudent annual growth rate of 5%.

Projected gross
profit margin

The projected gross profit margin was calculated based on the gross profit for the first quarter of 2023, which was determined using the projected financial statements of Beijing Yuntu for the period ending on 31 March 2023 (the “**1Q Accounts**”).

The management of Beijing Yuntu considered that the cost incurred in the final stages of each project would cost slightly more than the initial stages, as such, they have included a 11% adjustment increase in the cost while projecting the full-year gross profit margin as a prudent assumption. The relevant figures extracted from the 1Q Accounts are provided below:

	<i>RMB</i>
Revenue	6,952,864
Less:	
Cost of Sale	(2,941,868)
Tax	(11,600)
Other sales-related expenses	<u>(2,111)</u>
Gross Profit	3,997,285
Gross Profit Margin	57.49%
Less: Projected increase in cost	<u>11%</u>
Projected gross profit margin after adjustment	46.49%

After considering the fact that Beijing Yuntu’s management has taken into account the following factors: (i) the shift in Beijing Yuntu’s role from being a sub-contractor in 2022 to a main contractor in 2023; (ii) a change in project scope from traditional construction-oriented services to solution-oriented services; and (iii) the cost structure of the potential contract backlog that has already been reflected in the 1Q Account, the Company agrees that the gross profit margin will be higher than that of 2022 and that it is fair and reasonable.

Projected operating expenses The projected operating expenses were determined based on an operating-to-revenue ratio of 14.27%, which was determined based on the 2023 first quarter financial performance of Beijing Yuntu.

Terminate growth rate The rate of 2% was based on the long-term inflation rate in the PRC. According to a report titled “Inflation rate in China from 2012 to 2022 with forecasts until 2028” by Statista.com, the inflation rate in China is predicted to increase from 1.69% in 2024 to 2.22% in 2028. The Valuation has utilized this data and applied a terminal growth rate of 2%.

Discount rate

The rate of 14%, was determined based on the weighted average cost of capital (the “WACC”) with similar companies operating in Beijing Yuntu’s industry. Below are the key parameters in calculating the WACC as extracted from the Valuation Report:

	Low	High
Cost of equity		
Risk-free rate ¹	2.9%	2.9%
Unlevered beta	1.05	1.05
Levered beta ²	1.05	1.05
Equity risk premium ³	6.0%	7.0%
Cost of equity	9.2%	10.2%
Size premium ⁴	5.0%	5.6%
Specific risk premium ⁵	0.0%	1.0%
Cost of equity	14.2%	16.8%
Cost of debt⁶		
Tax ⁷	25.0%	25.0%
Cost of debt (after tax)	3.7%	3.7%
Proportion of debt ⁸	0.3%	0.3%
Proportion of equity	99.7%	99.7%
WACC	14.1%	16.8%
WACC (rounded)	14.0%	17.0%

1. The risk-free rate is the yield of 10-Year PRC Government Bond as of the valuation date. 10-year period is commonly adopted to represent a long-term risk-free rate. The government bond yield of the PRC is referenced as Beijing Yuntu is based in the PRC.
2. The beta of the Beijing Yuntu as the re-levered beta based on the averaged unlevered beta of the publicly traded guideline comparable companies selected by the Valuer.

In order to comprise a representative set of guideline public companies to derive the valuation result, the Valuer has set certain criteria for selecting a representative set of guideline public companies that are similar to Beijing Yuntu. The criteria include: (i) selecting listed companies engaged in developing information technology systems and providing IT solutions in China; (ii) choosing companies with sufficient operating histories; and (iii) selecting companies whose financial information is available to the public. The details of the selected publicly traded guideline comparable companies and the relevant calculations are summarized in the table below.

Stock code	Company name	Principal business	Unlevered beta
002230 CH Equity	Iflytek Co Ltd.	The provision of development of a connected and intelligent education platform.	1.13
600718 CH Equity	Neusoft Corp	The provision of software technology solutions, industry solutions, product engineering solutions, software products, platforms, and related services.	0.95
600845 CH Equity	Shanghai Baosight Software Co Ltd	The provision of providing information solutions.	0.87
002415 CH Equity	Hangzhou Hikvision Digital Technology Co Ltd	The provision of providing smart city and intelligent traffic solutions for security and urban governance.	1.12
002236 CH Equity	Zhejiang Dahua Technology Co Ltd	The provision of development services for machine vision, robotics, video collaboration, smart fire safety, automotive electronics, and other areas.	1.16
000977 CH Equity	Inspur Electronic Information Industry Co Ltd	The provision of software development and other software services, and cloud services in the PRC.	1.05
600756 CH Equity	Inspur Software Co Ltd.	The provision of information technology products and services in China and globally.	1.08
		Average	1.05

3. The equity risk premium is determined by in-house research of the Valuer, including that published by Professor Aswath Damodaran. The equity risk premium published by Professor Aswath Damodaran is attempted to measure the implied risk premium expected from the market using forecast growth rates, earnings, dividends, payout ratios and current values. It represents the additional return required by an investor as the compensation for investing in equities rather than a risk-free instrument.

4. The size premium is the additional return required by small company investors to compensate the higher perceived risks of small companies. The small company risk premium is made reference to the Center for Research in Security Prices (CRSP) Decile Size Premia Study.
5. The company specific risk premium is the risk premium added to the cost of equity to reflect the additional risk factors specific to the Subject Company. The company specific risk factors may include the revenue growth and profit expansion and illiquidity of the company.
6. Cost of debt is determined with reference to the 5-year best lending rate in the PRC as of the valuation date.
7. PRC standard corporate profit tax rate as of the valuation date.
8. The debt to equity ratio reflect the estimated long-term capital structure of Beijing Yuntu.

Based on the Valuation Report, it has been revealed that both the equity risk premium and specific risk premium exhibit significant variation in the low and high-end scenarios. The Valuer has advised to use the low-end scenario for the Valuation as it seems more appropriate. Beijing Yutun has signed contracts indicating a lower equity risk, and these contracts are currently being executed. Therefore, a decision has been taken to use the lower end of WACC instead of the higher end.

DLOM

A DLOM of 6% was adopted. The Valuer used the Finnerty model, a quantitative method, to determine the DLOM. The model assumption is supported by guidelines comparable companies, focusing on the magnitude of volatility.

This announcement is supplemental to and should be read in conjunction with the Announcement. Save as disclosed above, the Board confirms that the above supplemental information does not affect other information contained in the Announcement and the content of the Announcement remains correct and unchanged.

By Order of the Board
MOG Digitech Holdings Limited
Zhou Yue
Executive Director

Hong Kong, 4 January 2024

As at the date of this announcement, the Company has three executive Directors, namely Mr. Deng Zhihua (Chairman), Ms. Tang Tsz Yuet and Mr. Zhou Yue, and three independent non-executive Directors, namely Mr. Yau Tung Shing, Ms. Jiao Jie and Mr. Gao Hongxiang.