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# CGS

## CHINA GROUND SOURCE ENERGY LIMITED

### 中國地能有限公司

*(Incorporated in the Cayman Islands with limited liability)*

**(Stock Code: 8128)**

### **DISCLOSEABLE TRANSACTION DEEMED DISPOSAL**

Reference is made to the announcement of the Company dated 27 October 2009. On 21 May 2010, the Investor and BE Ever Source entered into a conditional Joint Venture Cooperation Agreement, pursuant to which the Investor has agreed to make a total capital investment of RMB26,804,004.33 (equivalent to approximately HK\$30,288,524.89) into BEHP, an indirect wholly-owned subsidiary of the Company. The Joint Venture Cooperation Agreement will become effective after being approved by the relevant approval authorities. Upon completion of the Investment, BEHP will cease to be a subsidiary of the Company and will be owned as to 51% by the Investor and 49% by BE Ever Source.

The Investment constitutes a deemed disposal in respect of an indirect wholly-owned subsidiary of the Company pursuant to Rule 19.29 of the GEM Listing Rules. Based on the aggregate amount of the maximum total capital investment to be contributed by the Investor and the maximum Compensation to be paid by the Investor to BE Ever Source, the consideration ratio of the Investment and the Compensation exceeds 5% but is less than 25%. The revenue ratio and the gross profit ratio (as an alternative test) of the Investment also exceed 5% but are less than 25%. As such, the Investment will constitute a discloseable transaction pursuant to the GEM Listing Rules.

### **BACKGROUND**

Reference is made to the announcement of the Company dated 27 October 2009. BEHP is an indirect wholly-owned subsidiary of the Company, which has a registered capital and a total investment of US\$300,000 (equivalent to approximately HK\$2,340,000) and US\$300,000 (equivalent to approximately HK\$2,340,000) respectively. The Investor intends to invest in BEHP through its equity contribution to BEHP. For the purpose of the Investment, the relevant parties have entered into the Joint Venture Cooperation Agreement, the major terms of which are as follows:

## **JOINT VENTURE COOPERATION AGREEMENT**

### **Date:**

21 May 2010

### **Parties:**

- (1) Investor; and
- (2) BE Ever Source

To the best knowledge of the Directors, the Investor is an imported bearing machinery (devices to permit fixed direction motion between two parts of the machinery, typically rotation or linear movement) processing enterprise and is a wholly-owned subsidiary of China Southern Industrial Group (中國南方工業集團). It is principally engaged in research, development and production of national defence weapons and equipments and civilian products. The main civilian products are fire products. China Southern Industrial Group is a renowned state-owned enterprise in the PRC. Its principal business is the manufacturing of automobiles, motorcycles, vehicle components, optical-electronic products and new energy. To the best of the Directors' knowledge, information and belief having made all reasonable enquiry, the Investor and its ultimate beneficial owners are third parties independent of the Company and its connected persons (having the meaning ascribed to it under the GEM Listing Rules).

## **CONDITION OF THE INVESTMENT**

The Joint Venture Cooperation Agreement will become effective after being approved by the relevant approval authorities.

## **PROPOSED CAPITAL CONTRIBUTION**

Pursuant to the Joint Venture Cooperation Agreement, after the transfer of all debts and liabilities of BEHP accrued before 30 April 2010 (30 April 2010 inclusive) to BE Ever Source, both parties agreed that the tangible assets as at 31 December 2009 at a discounted price per valuation shall be deemed to be the equity contribution by BE Ever Source to the joint venture company which was confirmed as 49% attributable share by BE Ever Source. On that basis, the amount of capital contribution of 51% shareholding in the joint venture company for the Investor was correspondingly calculated.

As such, subject to certain adjustment events described under the section headed "Proposed Equity Holding Structure of BEHP", the total investment and registered capital of BEHP will both be increased to RMB52,556,871.24 (equivalent to approximately HK\$59,389,264.50) upon completion of the Investment, in which BE Ever Source will contribute RMB25,752,866.91 (equivalent to approximately HK\$29,100,739.61). The contribution of BE Ever Source will be in the form of (i) share capital US\$300,000.00 of BEHP as at 31 December 2009 (equivalent to approximately HK\$2,340,000); (ii)

statutory reserves RMB2,021,069.29 of BEHP as at 31 December 2009 (equivalent to approximately HK\$2,238,808); (iii) cash RMB918,547.52 (equivalent to HK\$1,037,959); and (iv) retained earnings and reserves RMB20,330,090.10 of BEHP as at 31 December 2009 (equivalent to approximately HK\$23,438,972). The remaining RMB26,804,004.33 (equivalent to approximately HK\$30,288,524.89) will be contributed by the Investor in cash within 5 days of BEHP obtaining approval for the Investment from the relevant department of the Ministry of Commerce. Any party which could not fully contribute capital in accordance with the timeframe stipulated in the Joint Venture Cooperation Agreement shall pay to the other party a compensation of 0.05% of the capital investment of BEHP that remains outstanding for each day of such breach as compensation. In the event that such breach continues for more than 30 days, the non-defaulting party may terminate the Joint Venture Cooperation Agreement and demand the defaulting party to compensate its direct economic loss as a result of such breach.

The amount of Investment was determined after arm's length negotiation between BE Ever Source and the Investor taking into account the following factors: (i) the capital requirement of BEHP; (ii) the proposed equity holding structure of BEHP; (iii) the book value of the net assets of BEHP as at 31 December 2009 in the amount of RMB25,455,109 (equivalent to approximately HK\$28,871,185); (iv) the value of the tangible assets of BEHP as at 31 December 2009 in the amount of RMB27,752,866.91 (equivalent to approximately HK\$31,360,739.61) as set out in a valuation report; (v) the nature of capital contribution by the Investor and BE Ever Source; and (vi) the valuable opportunity to cooperate with the Investor, which is a member of a group with an established presence in the PRC.

## **PROPOSED EQUITY HOLDING STRUCTURE OF BEHP**

Assuming that the adjustment events described below which may affect the proposed equity holding structure of BEHP will not occur, BEHP will be owned as to 51% by the Investor and 49% by BE Ever Source upon completion of the Investment.

In the event that either the Investor or BE Ever Source does not contribute capital to the entirety as agreed in the Joint Venture Cooperation Agreement but only a certain portion of it, the parties may agree to adjust the equity interest holding structure according to their actual capital contribution.

After completion of the Investment and when BEHP has developed to a certain scale, the Investor shall also be mainly responsible for any further capital contribution of BEHP required for its future development and expansion and that the equity holding structure of BEHP may be further adjusted. In any event, capital contribution by BE Ever Source shall not fall below 25% of the registered capital of BEHP.

Further announcements on the change of equity holding structure of BEHP will be made in compliance with the GEM Listing Rules.

## **OTHER TERMS IN THE JOINT VENTURE COOPERATION AGREEMENT**

BEHP shall also purchase other assets in relation to the development of the BEHP from the Investor after completion of the Investment. The aggregate consideration of these assets shall not exceed RMB2,000,000 (equivalent to HK\$2,260,000).

Pursuant to the Joint Venture Cooperation Agreement, during the period from 1 May 2010 to the date on which BEHP completes the relevant registration and formalities for the change and obtains a new business licence, the Investor shall nominate (i) an Investor representative; (ii) a finance affairs responsible person; and (iii) a finance affairs person to BEHP to participate in the manufacturing and operation activities of BEHP. The finance affairs responsible person shall have the right of knowledge and supervision (but not veto right) over certain documents in BEHP during such period.

It was also agreed between the Investor and BE Ever Source that all the economic benefits and legal liabilities of BEHP incurred on or before 30 April 2010 shall be passed to or borne by BE Ever Source.

## **FINANCIAL EFFECT OF THE INVESTMENT**

Upon completion of the Investment and subject to the possible adjustments outlined in the section headed "Proposed Equity Holding Structure of BEHP", BEHP will cease to be a subsidiary of the Company. The Company expects to recognise a gain of approximately HK\$1,150,000 on the deemed disposal of its interest in BEHP, which is the difference between the capital contribution of RMB25,752,866.91 (equivalent to approximately HK\$29,100,739.61) by BE Ever Source and the unaudited net assets value of BEHP as at 31 December 2009. Shareholders should note that the actual gain on the deemed disposal to be recorded by the Company will depend on the net asset of BEHP as at the date of completion.

## **TERM OF BEHP**

Upon completion of the Investment, it is expected that BEHP will be converted from a wholly-owned foreign enterprise to a sino-foreign equity joint venture company with a term of 20 years from the completion of the registration of the capital investment.

## **BOARD COMPOSITION OF THE BEHP**

The board of the BEHP, upon completion of the Investment, shall comprise 5 directors and 1 supervisor. 3 directors and the chairman of the board shall be appointed by the Investor, 2 directors, the vice-chairman of the board and 1 supervisor shall be appointed by BE Ever Source. The general manager of BEHP shall be nominated by BE Ever Source and the assistant general manager and the chief financial officer shall be nominated by Investor.

## **NON-COMPETITION AND NON-DISPOSAL UNDERTAKINGS**

Pursuant to the Joint Venture Cooperation Agreement, upon completion of the Investment, both of the Investor and BE Ever Source shall not, without reaching prior consensus with the other party, invest, be interested or operate in any other way a company that carries out the same business as BEHP or competes with the business carried out by BEHP. The Investor and BE Ever Source further agreed that they will not transfer their equity interest in BEHP to any third party or entrust another to actually manage their equity interest within 10 years of BEHP obtaining a new business licence without prior consensus of the parties.

## **TECHNICAL COMPENSATION TO BE PAID TO BE EVER SOURCE**

BEHP is the registered holder of the following patents (1) double heat source heating supply equipment (雙熱源供熱設備) with registration number 03137731.9; (2) double temperature heat pump system (雙溫熱泵系統) with registration number ZL200420058674.9; (3) dual air-conditioning equipment (複合空調設備) with registration number 032664575; (4) multi-heat source air-conditioning system (多熱源空調系統) with registration number 032647190; (5) Soil energy extraction heat pump system (提取土壤能量的熱泵系統) with registration number ZL200410086367.6 ; and (6) hydro power extraction heat pump system (提取水能量的熱泵系統) with registration number ZL200410086366.1. Pursuant to the Joint Venture Cooperation Agreement, BEHP shall pay to BE Ever Source (i) a nominal amount of RMB1 (equivalent to HK\$1.13); and (ii) a technical Compensation (the amount of which is to be determined by the annual revenue of BEHP generated by the sale of products) as recognition of the contribution of BE Ever Source on the development of such patents within 10 years from the date of the completion of the Investment and the issue of the new business license of BEHP. In the event that the annual revenue of BEHP generated by the sale of products is equal to or less than RMB50,000,000 (equivalent to approximately HK\$56,500,000), the annual Compensation paid by BEHP to BE Ever Source shall be 3% of the annual revenue of BEHP generated by the sale of products. In the event that the annual revenue of BEHP generated by the sale of products is more than RMB50,000,000 (equivalent to approximately HK\$56,500,000) but is equal to or less than RMB200,000,000 (equivalent to approximately HK\$226,000,000), the annual Compensation paid by BEHP to BE Ever Source shall be (a) 3% of the annual revenue of BEHP generated by the sale of products for the amount within RMB50,000,000 (equivalent to approximately HK\$56,500,000); and (b) 2% of the annual revenue of BEHP generated by the sale of products for the amount that is equal to or exceeds RMB50,000,000 (equivalent to approximately HK\$56,500,000). In the event that the annual revenue of BEHP generated by the sale of products is more than RMB200,000,000 (equivalent to approximately HK\$226,000,000), the annual Compensation paid by BEHP to BE Ever Source shall be (a) 3% of the annual revenue of BEHP generated by the sale of products for the amount within RMB50,000,000 (equivalent to approximately HK\$56,500,000); (b) 2% of the annual revenue of BEHP generated by the sale of products for the amount equal to or exceeds RMB50,000,000 (equivalent to approximately HK\$56,500,000) but is less than RMB200,000,000 (equivalent to approximately HK\$226,000,000); and (c) 1% of the annual revenue of BEHP generated by the sale of products for the amount that is equal to or exceeds RMB200,000,000 (equivalent to approximately HK\$226,000,000). In any event, the total Compensation to be paid by BEHP to BE Ever Source during the 10-year period shall not be more than RMB100,000,000 (equivalent to approximately HK\$113,000,000). Should the aggregate Compensation received by BE Ever Source reach RMB100,000,000 (equivalent to approximately HK\$113,000,000), notwithstanding whether the said 10-year period has expired, BEHP shall not be obliged to pay to BE Ever Source any Compensation.

The Compensation was determined after arm's length negotiation between BE Ever Source and the Investor taking into account the costs and expenses incurred by BE Ever Source (and its subsidiaries) in developing the patents and the expected sale revenue of BEHP had the products using these patents were developed and made available on the market by BE Ever Source alone.

## **FURTHER PURCHASES FROM BEHP**

Pursuant to the Joint Venture Cooperation Agreement, BE Ever Source undertakes that itself, 恒有源科技發展有限公司 (Ever Source Scientific and Technology Development Co., Ltd.) and its subsidiaries shall preferentially purchase products of BEHP. BEHP shall give discounts as approved by its board of directors to them.

## **INFORMATION OF BEHP**

As at the date hereof, BEHP is an indirectly wholly-owned subsidiary of the Company established in the PRC in November 2002 and is engaged in research, development and production of cold water mechanical units, heat pump mechanical units and refrigeration air-conditioning spare parts and technology transfer of self-produced products, technical advisory and technical services and sale of self-produced products. Based on the unaudited financial statement of BEHP for the 6-months period ended 30 September 2008 and the 12-months period ended 30 September 2009, the unaudited net assets value of BEHP as at 30 September 2009 was approximately RMB21,366,676.02 (equivalent to approximately HK\$24,216,990.61) and the unaudited net profits (both before and after taxation and extraordinary items) of BEHP for the 6-months period ended 30 September 2008 and the 12-months period ended 30 September 2009 are as follows:

	<b>6-months ended 30 September 2008 RMB (approximate HK\$) unaudited</b>	<b>12 months ended 30 September 2009 RMB (approximate HK\$) unaudited</b>
Net profit before taxation and extraordinary items	755,078.84 (854,885)	9,786,908 (11,119,884)
Net profit after taxation and extraordinary items	499,066.28 (565,033)	8,380,659 (9,522,105)

## **REASONS FOR THE INVESTMENT**

The principal activities of the Group are the promotion of new energy with a focus on ground energy as an alternative energy for the supply of heat and environmental protection. Given the limitations on the existing small production scale, the production capacity and efficiency of BEHP was directly impacted and the growth of the profitability of BEHP was restrained. By introducing new investment, BEHP will have a good opportunity to expand its production capacity as well as enhancing its profitability level. In addition, with the co-operation with the Investor, BEHP will also be benefited through the introduction of personnel, management, technology and quality assurance that are possessed by the Investor. The Directors believe that the Investment will improve the productivity as well as the profitability of BEHP and in turn will enable BEHP to deliver a better return to the Group.



Taking into account of the above factors, the Directors (including the independent non-executive Directors) consider that the terms of the Joint Venture Cooperation Agreement are fair and reasonable and are in the interest of the Company and the Shareholders as a whole.

## **LISTING RULES IMPLICATIONS**

Upon completion of the Investment and subject to the possible adjustments outlined in the section headed “Proposed Equity Holding Structure of BEHP” in this announcement, it is expected that the Investor will own 51% of the equity interest of BEHP and the Company will, through BE Ever Source, own 49% of BEHP. As a result, BEHP will cease to be a subsidiary of the Company.

The Investment constitutes a deemed disposal in respect of an indirect wholly-owned subsidiary of the Company pursuant to Rule 19.29 of the GEM Listing Rules. Based on the aggregate amount of the maximum total capital investment to be contributed by the Investor and the maximum Compensation to be paid by BEHP to BE Ever Source, the consideration ratio of the Investment and the Compensation exceeds 5% but is less than 25%. The revenue ratio and the gross profit ratio (as an alternative test) of the Investment also exceed 5% but are less than 25%. As such the Investment will constitute a discloseable transaction pursuant to the GEM Listing Rules.

## **DEFINITIONS**

In the announcement, the following expressions shall, unless the context requires otherwise, have the following meanings:

“BE Ever Source”	Beijing Enterprises Ever Source Technology Ltd. (北控恒有源科技有限公司), an indirect wholly owned subsidiary of the Company established in the Cayman Islands
“BEHP”	(北京永源熱泵有限責任公司) Beijing Ever Hot Pumps Co., Ltd, an indirect wholly owned subsidiary of the Company established in the PRC
“Company”	China Ground Source Energy Limited, a company incorporated in the Cayman Islands with limited liability, the shares of which are listed on the GEM
“Compensation”	technical compensation to be paid by BEHP to BE Ever Source as recognition of the contribution of BE Ever Source on the development of the patents owned by BEHP, details of which are described in the paragraph headed “Technical Compensation to be paid to BE Ever Source”
“Directors”	directors of the Company

“GEM”	Growth Enterprise Market of the Stock Exchange
“GEM Listing Rules”	the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange
“Group”	the Company and its subsidiaries
“HK\$”	Hong Kong dollars, the lawful currency of the Hong Kong Special Administrative Region of the PRC
“Investment”	the proposed increase in total capital investment of BEHP to RMB52,556,871.24 (equivalent to approximately HK\$59,389,264.50) in which the amount of RMB26,804,004.33 (equivalent to approximately HK\$30,288,524.89) is to be contributed by the Investor
“Investor”	(北京北機機電工業有限責任公司) Beijing BeiJi Mechanical Industrial Company Limited
“Joint Venture Cooperation Agreement”	the conditional agreement entered between the Investor and BE Ever Source dated 21 May 2010 regarding the Investment
“PRC”	the People’s Republic of China
“RMB”	Renminbi, the lawful currency of the PRC
“Shareholders”	shareholders of the Company
“Share(s)”	share(s) of the Company
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“US\$”	United States dollars, the lawful currency of the United States of America

By order of the Board  
**China Ground Source Energy Limited**  
**Chan Wai Kay, Katherine**  
*Chairman*

Hong Kong, 24 May 2010



*As at the date of this announcement, the Board comprises Ms. Chan Wai Kay, Katherine, Mr. Xu Shengheng, Mr. Wu Shu Min and Mr. Jeffrey Soo Kim Fui as executive Directors, Mr. Fu Hui Zhong as non-executive Director, Ms. Laura Chan Man Kuen, Mr. Jia Wenzeng and Mr. Paul Chow Wan Hoi as independent non-executive Directors.*

*This announcement, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief: (1) the information contained in this announcement is accurate and complete in all material respects and not misleading; (2) there are no other matters the omission of which would make any statement in this announcement misleading; and (3) all opinions expressed in this announcement have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.*

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