Kiu Hung International Holdings Limited
僑雄國際控股有限公司
(incorporated in the Cayman Islands with limited liability)
(Stock Code: 00381)

CLARIFICATION ANNOUNCEMENT ON FINAL RESULTS ANNOUNCEMENTS FOR THE YEARS ENDED 31 DECEMBER 2016 AND 31 DECEMBER 2017

References are made to the final results announcement of Kiu Hung International Limited (the "**Company**", together with its subsidiaries, the "**Group**") dated 29 March 2018 for the year ended 31 December 2017 (the "**Results Announcement**") and the Company's final results announcement dated 30 May 2017 for the year ended 31 December 2016 (the "**2016 Results Announcement**"). Unless the context herein otherwise requires, capitalised terms in this announcement shall have the same meanings as defined in the Results Announcement and 2016 Results Announcement.

The board (the "**Board**") of the directors (the "**Directors**") of the Company would like to provide additional information in relation to the Results Announcement and 2016 Results Announcement as follow:

A. INVESTMENT IN ASSOCIATES (FUJIAN YUGUO)

As set out on pages 32 to 35 under the section headed "Extract of the auditor's report" in the Results Announcement, it was disclosed that the Company's auditors have not been able to obtain sufficient appropriate audit evidence for the investment in associates i.e. Fujian Yuguo and other items (the "**Qualified Opinion**"). It was also disclosed on page 16 of the Results Announcement that the Company recognised impairment losses of HK$15 million (2016: nil) on its investment in Fujian Yuguo (the "**Impairment Loss**").

Reasons and details of the Qualified Opinion

The Auditor issued Qualified Opinion on investment in associates ("**Fujian Yuguo**" or the "**Associate**") because the management of Fujian Yuguo was not able to provide certain information that the Auditor considered necessary to perform its audit.

The Auditor commenced the audit on the financial statements of the Associate in late January 2018. In the middle of February 2018, the Board was first notified by the Auditor and became aware that certain information requested by the Auditor for performing its audit was still yet to be obtained. Subsequently, the Board has from time to time urged the management of the Company to keep communication with the Associate in order to manage providing the Auditor with those information (the "**Arrangement**"). Meanwhile, the Board has also requested the management of the Company to keep the Board updated on the latest status of the Arrangement from time to time.

The Company would like to supplement that the management of the Company had put their best endeavours to manage the Associate to provide the necessary information to the Auditor. However, the Company has no effective control over the Associate and has no board seat in the Associate. The Auditor was arranged to continue the audit on the financial statements of the Associate on 20 March 2018. However, on 22 March 2018, the Associate informed the Company that no further information would be provided to the Auditor. Since the Associate could not provide necessary information about the financial statements of the Associate, the Auditor issued the Qualified Opinion.

The following were major audit evidence/documents the Auditor required but could not be obtained and the effect on audit:

Revenue and purchase

The Auditor requested to send audit confirmations to selected customers and/or suppliers of Fujian Yuguo to the responsible persons' registered addresses which could be verified from reliable sources. However, up to the date of the Results Announcement, the Associate failed to provide the corresponding address of the responsible persons of these selected customers and/or suppliers to the Auditor. As per the Associate, the main reason for failing to provide the corresponding address of the responsible persons of the selected customers or suppliers was due to the fact that the responsible persons are usually not the major shareholder or the legal person of the customers or suppliers, but are the persons in charge of the sales and purchase. These responsible persons are more familiarised with the details of the transactions of the relevant companies and balances to be confirmed by the Auditor. However, given that the relevant responsible persons might not work at the registered office or warehouse of the selected customers and suppliers, the Associate encountered difficulty to provide the verifiable corresponding addresses to the Auditor.

The Auditor's request to arrange for various interviews with major customers and/or suppliers was not acceptable to the Associate because the Associate considered that this might cause unnecessary inconvenience to and might create avoidable administrative issue(s) to the Associate, which may affect the business relationship with its customers and/or suppliers.

On the other hand, as per the Associate, all the original bank advices affixed with bank chops have been attached to the vouchers and the copies of bank statements reproduced from the originals for the Year have been provided to the Auditor, the Auditor should have sufficient information to verify the transaction selected by the Auditor. Moreover, the Associate did not apply for the online banking service, and therefore it was impossible for the Auditor to check against the online banking statements or transaction history.

In view of the above, the Auditor considered that it was not able to verify sales and purchase transactions from independent third parties or sources.

Tax

Files of the monthly VAT returns have been provided to the Auditor. Since these VAT returns are printed from electronic documents and not affixed with the company chop of the Associate, the Auditor considered these documents were not sufficient audit evidence. The Auditor requested to confirm the accuracy and completeness of the VAT returns submitted by the Associate with the PRC tax authority in person and to conduct an interview with the PRC tax authority regarding the tax matters of the Associate. The Associate has agreed to arrange for the audit confirmation with the PRC tax authority, but the interview would be difficult to be arranged because the PRC tax authority might not entertain such special request. As per the Associate, the Auditor had tried to arrange the audit confirmation and an interview with the PRC tax authority but to no avail because it was not the usual practice for the tax authority officers to accept such interview with the Auditor. Therefore, no audit confirmation and interview with the tax authority was arranged and completed. On the other hand, since the deadline for filing of the VAT and income tax returns for the Year falls on the end of May 2018, the Associate could not provide such documents during the audit of the Associate.

As for the proposed checking of VAT invoices against the tax system maintained by the Associate, the Associate was reluctant to allow the Auditor to have access to the relevant tax information because the Associate considered that all the VAT payment supporting had already been attached to the vouchers and should be sufficient for audit purposes.

In view of the above, the Auditor considered that it was not able to verify the occurrence of sales transactions from independent third parties, amount of VAT and corporate income tax paid and payables.

Bank

As part of the audit procedures, the signed bank confirmations from the Associate would be delivered to the bank in person by the Auditor for confirming the bank balances of the Associate. As per the Associate, the company chop was in the possession of its staff who were on a business trip that required the use of the company chop for executing certain contract of the Associate when the Auditor was performing the field works in March 2018. Consequently, one of the bank confirmations could not be arranged as the company chop of the Associate was not available while the auditor was on site to carry out the audit work.

In view of the above, the Auditor considered that it was not able to verify the bank balance and bank transactions (including payment received from customers, payment made to suppliers and tax authority) during the Year from independent third parties or sources.

Stock

As for the request by the Auditor for the stock count for stocks kept by third parties as at 31 December 2017 (there were no consignment stocks as at 31 December 2016), and the preparation of the stock movements for these consignment stocks, the Associate encountered a technical problem that required the full co-operation of the responsible persons of the customers to update the movements of the consignment stocks from the date of delivery up to the date of the stock count as well as the availability of the responsible persons during the stock count. The Associate considered that this could not be accomplished before the Results Announcement due to time constraint and other factors which were out of the control of the Associate.

As for the stock movement records, as per the Associate, they have provided the details of the stock movement of the Associate for the Year to the Auditor, except those movements of the consignment stocks as mentioned above.

In view of the above, the Auditor considered that it was not able to verify the completeness, existence and valuation of stocks as at 31 December 2017.

Since certain audit procedures during the audit for the Year, including the request for arranging an interview with officers of tax authority and certain customers and/or suppliers, the stock count of consignment stocks were (a) out of the control of the Associate; or (b) required the full co-operation of the customers, as a result, the effectiveness and efficiency of the audit for the Year were adversely affected. Furthermore, certain audit procedures could not be arranged for or completed prior to the publication of the Results Announcement. As a result, the Auditor disclosed that it could not obtain sufficient audit evidence and a qualified opinion was issued on the investment in the Associate for the year ended 31 December 2017 as disclosed in the Results Announcement.

Reasons for no similar audit qualifications in 2016

There was no similar audit qualification in 2016 for the investment in the Associate because the Auditor was able to obtain sufficient audit evidence. The following were the major audit evidence obtained by the Auditor during the audit of the Associate in 2016:

(a) the Auditor was able to obtain bank confirmation (only one bank in 2016), and therefore was able to (i) verify the bank balance of the Associate; and (ii) rely on the bank statements provided by the Associate to check payment received from customers and payment made to suppliers and tax authority.

(b) the Auditor was able to perform observation of stock counting and obtain stock movement records for the year.

(c) for selected sales transactions and trade receivables balances, the Auditor was able to obtain delivery notes, VAT invoices and agreements with customers and check payment received from customers from bank statements.

(d) for selected purchase transactions and trade payables balances, the Auditor was able to obtain stock-in records, VAT invoices and agreements with suppliers and check payment paid to suppliers from bank statements.

In light of the above, there was no similar audit qualification last year for the investment in Associate because the Auditor was able to obtain sufficient audit evidence.

The Auditor was able to obtain similar documents / audit evidence for the audit of the Company's 2017 results in respect of the Associate, including but not limited to the following: (a) full book of accounts; (b) full address of customers and suppliers of the Associate for sending confirmation letters; (c) detail aging reports of both debtors and creditors; (d) stock list of stocks at the year; and (e) supporting documents for the accounting transactions. However, the Auditor had requested for additional audit evidence for the audit of the Company's 2017 results, which the Associate could not provide to the Auditor's satisfaction in time. In particular, the Auditor requested to visit the customers' shops of the Associate located in the PRC because the Company, being a minority shareholder, was not in control of the Associate, thus the Auditors would like to verify the existence of sales channel of the Associate for the 2017 audit. The Auditor considered that this audit procedure could reduce the audit risk of the Associate to acceptable level. The Auditor also requested to retrieve the stock movement of the consignment stocks of the Associate during the year 2017 in order to complete the audit procedure on the inventories. As the Associate did not have any consignment stocks as at 31 December 2016, the Auditor did not make similar request during the audit of the Associate for the 2016 audit. With regards to the Auditor's request for sending out the audit confirmation letters to selected customers and/or suppliers of the Associate to the responsible person's registered addresses, the Auditor explained that this was because there had been instances in the past that the auditors in the industry identified false confirmations provided by clients which increased audit risk. To lower the audit risk, the Auditor would like to seek further proof of customers' and suppliers' addresses for audit confirmations sent, and the Auditor considered that would reduce the related audit risk to acceptable level with regard to giving audit opinion on the Associate.

Audit evidence/documents provided

Set out below are the audit evidence/documents provided by the management of Fujian Yuguo to the Auditor and the basis which the Auditor considered such audit evidence/ documents to be insufficient:

Documents provided to Auditor	Reasons to be not sufficient
Audit report issued by Fujian Ruizhi Certified Public Accountants (the "**PRC Auditor**") for the year ended 31 December 2017.	The Auditor considered that audit report issued by the PRC Auditor was not sufficient audit evidence as the PRC Auditor was not engaged as component Auditor in accordance with HKSA 600.

Documents provided to Auditor	Reasons to be not sufficient
Copy of bank statements for the Year.	The Auditor was not able to confirm the bank balances from banks, as such, the Auditor was not satisfied with the authenticity of the copy of bank statements. The Auditor was also unable to verify payment received from customers and payment made to suppliers and tax authority.
Delivery notes, VAT invoices, stock out records and agreements with customers for revenue transactions selected by the Auditor.	The Auditor was not able to verify sales and purchase transactions from independent third parties or sources.
Stock in records, VAT invoices and agreements for purchase transactions selected by the Auditor.	The Auditor was not able to verify the payment received from customers and payment made to suppliers due to the reason explained above.
VAT and corporate income tax returns for the Year printed from computer.	Since it was not original copy, the Auditor did not satisfy with the completeness and valuation of the information included in the VAT and corporate income tax returns without the confirmation from independent third parties.

The Qualified Opinion will have an impact on the Company's financial statements. As at 31 December 2017 and for the year ended 31 December 2017, the carrying amount, the share of results, the share of exchange translation difference and the impairment loss of the Associate was approximately HK$46,110,000, HK$770,000, HK$1,997,000 and HK$15,000,000 respectively. The Qualified Opinion in relation to the investment in the Associate would mean that there is no assurance from the Auditor that the figures included in the consolidated financial position and performance of the Company in relation to the Associate would be true and fair.

The Directors' position

The management of the Company had put their best endeavours to manage the Associate to provide necessary information to the Auditor. However, as a result of unwillingness of the Associate's cooperation which the Company has no effective control and no board seat in the Associate, the Auditor was not provided with sufficient audit evidence and issued the Qualified Opinion in relation to the investment in the Associate.

The Board understood this situation and concurred with the basis of the Qualified Opinion on each of (a) the recoverable amount of the investment; (b) the impairment loss; (c) the share of the results; and (d) the share of exchange translation difference.

Audit Committee's view

The audit committee of the Company (the "**Audit Committee**") confirmed that they understood the basis of the Qualified Opinion. They have also reviewed and agreed with the Board's position as set out above.

The Company's proposed plan to address the Qualified Opinion

Subsequent to the Results Announcements, the management of the Company had several communications with the Associate. It is the intention of the Company to retain such investment in view of its fair value of the Fujian Yuguo and the stable return on investment through annual dividend declaration and payout to the Company. Nevertheless, the Company also observes the potential impact of the Qualified Opinion and communicates with the Associate to ensure the full cooperation with the Auditor in the future.

Up to the date of this announcement, the Company is yet to have a defined plan with timetable to address the Qualified Opinion because the Company is unsure about whether the Associate can provide evidence that can fulfill the Auditor's expectations. Assuming the Associate will provide the necessary audit evidence to the Auditor in the years 2018, 2019 and 2020 audits, the Qualified Opinion in the Results Announcement will be uplifted in the 2020 results announcement.

According to Article 125 of the PRC Company Law, regarding shareholders' right to access and the reproduction of information, the shareholders of a limited liability company have the right to inspect and reproduce the company's articles of association, minutes of shareholders' meetings, resolutions of the board of directors, resolutions of the board of supervisors, and financial and accounting reports (excluding the accounting books). The shareholders have the right to examine the accounting books and may submit a written application to the relevant company stating their purposes for checking the accounting books. Shareholders can also engage professional agencies for inspecting the accounting books. However, the shareholders do not have the right to reproduce the accounting books of the company, which includes journals, ledgers, and other classified records comprising a company's set of accounts, being confidential information, under the relevant PRC Company Laws.

According to the PRC Company Laws, there are no mandatory provisions or specific clauses to empower the minority shareholders to appoint director to the board of the private company or to fully co-operate with the minority shareholders' group audit arrangement. The appointment of directors will be subject to the majority shareholders approval at the shareholders' meeting. Since the Group holds only 33% of the equity interest of the Associate, the appointment of director and the co-operation with the Group's annual audit will require the cooperation of the existing majority shareholder.

Since the PRC Company Law has provisions that govern most of the shareholders' rights of a limited company in the PRC, the Company did not signed a detailed shareholders agreement with the major shareholder upon the completion of the acquisition of 33% equity interest in the Associate. However, in relation to the annual dividend distribution policy, the Group has signed a written agreement with the major shareholder upon completion of the acquisition of the Associate because the Company considered that this is the major concern and purpose of the investment in the Associate.

The Group is currently negotiating with the majority shareholder of the Associate with regards to entering into a shareholder's agreement to set out the rights of the Company as a minority shareholder in the Associate i.e. the right to obtain copy of all management accounts of the Associate and to cooperate with the auditors appointed by the Company for the annual audit of the Associate as well as the right for the Company to appoint directors to the Associate. Should the said measures be implemented, the Company is confident that the Associate will be able to provide the information for audit purpose in the future and it is expected that there will not be any qualified opinion in the future in relation to the investment in the Associate. It is expected that the shareholder's agreement will be entered into between the relevant parties on or before end of July 2018 and the Company's appointment of directors to the Associate will take place by the end of September 2018.

Background of the Associate

The Company acquired the investment in Associate in 2015. On 18 December 2015, an indirect wholly-owned subsidiary of the Company (the "**Purchaser**"), entered into the sale and purchase agreements with Lin Qunzhu and Li Qingsheng, the vendors of Fujian Yuguo (the "**Vendors**"), pursuant to which the Purchaser has conditionally agreed to acquire and the Vendors have conditionally agreed to sell 33% equity interest of Fujian Yuguo at a consideration of RMB47,880,000 and RMB8,550,000 respectively, resulting in a total consideration of RMB56,430,000.

The consideration of RMB56,430,000 (equivalent to HK$67,490,280), was satisfied by the issue of promissory notes in the aggregate principal amount of HK$67,490,280 by the Company to the Vendors (or their respective nominees) in proportion to their respective selling interest in Fujian Yuguo at the date of completion. On 5 January 2016, the acquisition of Fujian Yuguo was completed and promissory notes were issued to the Vendors.

Details of the Impairment Loss

With regards to the method and basis used in determining the amount of Impairment Loss, the management of Fujian Yuguo provided the audited report issued by the PRC Auditor to the Company. Based on the said audited report, the management of the Company and the Associate have prepared a five-years' forecast and engaged Roma Appraisals Limited ("**Roma**" or the "**Valuer**") to prepare a valuation on the fair value of Fujian Yuguo.

The amount of Impairment Losses was calculated as follows:

	HK$'000
Group's share of net assets	29,750
Goodwill	31,360
	61,110
Fair value of Fujian Yuguo	46,110
Impairment Loss	15,000

For the underlying business reasons and events leading to the Impairment Loss, Fujian Yuguo has been experiencing keen competition in the tea industries along with the changing business model and customer needs recently. As mentioned in the section headed "Management Discussion and Analysis" of Results Announcement, most of the traditional businesses are facing fierce competition from the online sales platform in the recent years, including the tea distribution business of the Associate. Since the Associate has been established for years and selling its tea products under its own brand names, the unit selling prices of most of its tea products remained more or less the same compared with the previous years. As a result, the revenue and profit after tax of Fujian Yuguo decreased from approximately HK$77,410,000 to HK$51,574,000 and from approximately HK$13,752,000 to HK$2,334,000 respectively for the year ended 31 December 2017. The management of the Company and the Associate prepared the 5-years forecast based on the latest financial performance of Fujian Yuguo and resulted in the Impairment Loss.

To tackle the keen competition faced by the Associate and its customers, beginning from the second half of the year 2017, the Associate modified its sales terms with the customers by using a combination of consignment sales and mandatory sales model, whereby the sales of tea products to its major customers are under consignment sales terms and the tea products will be deemed to be sold to its major customers only upon the expiry of a period of three to five months and provided that such tea products are not returned to the Associate unsold. Under such terms, the working capital of its major customers are improved significantly and the relationship between the Associate and its major customers are also strengthened, which in turn may increase the competitiveness of the Associate in the tea distribution business.

The estimate of fair value of Fujian Yuguo as at 31 December 2016 was performed by Witz International Consultants Group Limited ("**Witz**") using market approach ("**PE Approach**"). Fair value of 100% equity interest of Fujian Yuguo using PE approach was approximately RMB170,000,000.

The details of the valuation performed by Witz are as follows:

Inputs	**Range**
Comparable's PE	16.6
Marketability discount	15%
Discount for poorer network	10%
Earnings (exclude deferred tax credit and amortization)	Approximately RMB13,670,000

The management of the Company was satisfied that Fujian Yuguo had no impairment issue base on the above valuation. In addition to the above valuation, the management of the Company reviewed the financial performance of Fujian Yuguo for the year ended 31 December 2016. Fujian Yuguo had revenue and profit after tax of approximately HK$77,410,000 and HK$18,336,000 respectively for the year ended 31 December 2016 and paid dividend of approximately HK$2,284,000 in March 2017. The management of the Company concluded that Fujian Yuguo had strong financial performance and no indication of impairment. The methodology of valuation would not affect the amount of impairment.

However, the revenue and profit after tax of Fujian Yuguo decreased during the year 2017 which was an indication of impairment. The management engaged Roma to estimate the fair value of Fujian Yuguo as at 31 December 2017.

The estimate of fair value of Fujian Yuguo as at 31 December 2017 was performed by Roma using income approach.

The details of valuation performed by Roma are as follows:

Inputs	**Range**
Profit after tax (next 5 years)	Approximately RMB10,000,000 to RMB24,000,000
Marketability discount	14.8%
Discount rate	14.48%
Long term growth rate	2.6%

Market approach was not adopted because most of the important assumptions of the comparable transactions, such as discount or premium on the transaction prices or considerations, were hidden. Income approach is more suitable and appropriate in valuing the market value of the Associate in 2017 because future economic benefits in relation to the income producing capabilities of the Associate could be fully considered in the financial projection. In fact, the financial performance of the Associate in 2017 was not as good as those in the previous years. As stated above, the profit after tax of the Associate decreased due to keen competition in 2017, and the Directors believed that such downturn of the business is temporary because of the introduction by the Associate of the new sales terms to its major customers in 2017, the adoption of market approach may no longer be able to reflect the actual market value of the Associate. The Company was optimistic that the financial performance of the Associate would be improved and to reach the level in years 2014 to 2016 in the coming years. The earnings of the Associate in 2017 was not representative for the Target Company's long-term profitability. After discussion with the Valuer, the directors were of the view that the income approach was more suitable for assessing the value of the Associate taking into account the above factors. Therefore, the valuation approach changed from market approach to income approach.

The Auditor considered that the Associate had sufficient revenues and cash inflow in 2016, there was no indication for impairment, regardless of the valuation approach being adopted. As for the year 2017, both the Auditor and the Audit Committee agreed with the Directors' view on the use of the income approach to assess the value of the Associate for reason mentioned above.

B. INVENTORIES (CERAMIC ITEMS)

As set out on pages 32 to 35 under the section headed "Extract of the auditor's report" in the Results Announcement, it was disclosed that inventories (ceramic items) are one of the items the Company's auditors have not been able to obtain sufficient audit evidence on and it is one of the basis for Qualified Opinion.

Reasons and details of the Qualified Opinion

Ceramic items held by the Group (the "**Ceramics**") were classified as inventories as at 31 December 2016 and 31 December 2017. Inventories should be stated at the lower of cost and net realisable value in accordance with Hong Kong Accounting Standard 2 "Inventories". Since each of the Ceramics is unique, the selling of the Ceramics cannot make reference to recent similar ceramic sold in the market. The Auditor requested subsequent selling price of the Ceramics as evidence on net realisable value.

However, the Company has not sold any Ceramics since acquiring the Ceramics in 2015 and up to the date of the Result Announcement. Hence, the Company was not able to provide information on the subsequent selling price of the Ceramics. Due to the above, no sufficient evidence has been provided to satisfy the Auditor as to the net realisable value of the Ceramics with carrying amount of approximately HK$35,303,000 as at 31 December 2017 and 31 December 2016.

The Board had been aware of the qualified opinion on Inventories since the 2016 Results Announcement. As mentioned in the 2016 Annual Report, the Company intended to look for potential buyers for the Ceramics as well as to participate in the related auctions so as to realise certain number of the Ceramics in the coming future. The Company has approached several agencies (including auction companies and agencies in the PRC and Hong Kong) to solicit potential buyers for the Ceramics since the second half of 2017 either by way of auction or direct sales to interested collectors. Unfortunately, up to the date of the Results Announcement, no agreements have been reached with any potential buyers, and the Company failed to participate in any public auction events due to a variety of scheduling, arrangements and commission issues with the agencies. However, as the Company failed to solicit and conclude any transactions for disposing of the Ceramics from 31 December 2017 and up to the date of the Results Announcement, the Auditor was not able to obtain audit evidence for the net realisable value of the Ceramics.

As at the date of this Reply, the Company is currently in discussions with an auction company, which will arrange for an auction of the similar ceramic items of Mr. Zhang Song Mao (張松茂) ("**Mr. Zhang**") and other artists in two months' time in Macau.

The Qualified Opinion will have an impact on the Company's financial statements. As at 31 December 2017, the carrying amount of the Ceramics was approximately HK$35,303,000. The Qualified Opinion would mean that there is no assurance from the Auditor that the figures under the consolidated financial position and performance of the Company in relation to the net realisable value of the Ceramics would be true and fair.

The Directors' position

As the management of the Company failed to sell the Ceramics subsequent to 31 December 2017, the Auditor was not provided with sufficient audit evidence in relation to the net realisable value to determine (1) the carrying amount of the Ceramics and (2) whether provision for impairment loss is required and issued a qualified opinion on the carrying amount of the Ceramics. The Board understood this situation and concurred with the basis of qualified opinion on each of (a) the net realisable value; and (b) provision for impairment loss.

Audit Committee's view

The Audit Committee confirmed that they understood the basis of the Qualified Opinion. They have also reviewed and agreed with the Board's position as set out above.

The Company's proposed plan to address the Qualified Opinion

It is the intention of the Company to sell the Ceramics through private tender or public auction. The Company observes the potential impact of the qualified opinion and will address the issues in the near future.

Up to the date of this announcement, the Company is yet to have a defined plan with timetable to address the qualified opinion because the plan of selling the Ceramics has not yet finalised. However, as mentioned above, whether or not the Company could attend or successfully dispose the Ceramics in the coming auction, the latest market values of the similar ceramic items of Mr. Zhang may be obtained from the auction, which will be used as the reference price for the determination of the valuation of the Ceramics. If the reference price is obtained, the Directors considered that there will be at least a most up-to-date price range of the Ceramics held by the Group, which will provide a more concrete basis for the Directors, valuers and auditors to assess the fair values of the Group's Ceramics in the coming year(s). As per the Auditor, assuming (a) a considerable amount of Ceramics held by the Group are sold at a price higher than the carrying value of the Ceramic Items; and (b) the fair value of the remaining Ceramics, assessed by an independent professional valuation firm, is higher than the carrying value of the Ceramic Items as at 31 December 2018, the qualified opinion will be uplifted in the 2018 results announcement.

As set out on page 30 of the 2016 Results Announcement, it was disclosed that the Group will look for potential buyers for the ceramic items and participating in the related auctions to realise certain ceramic items in the coming future such that the Company could address the qualified opinions in the 2016 Results Announcement (the "**2016 Qualified Opinion**").

The Company cannot provide the Auditor with sufficient audit evidence in relation to the net realisable value of the Ceramics as at year end. As the Ceramics are unique, market price of similar ceramic items is not comparable.

It is the intention of the Company to sell the Ceramics through private tender or public auction. The Company observes the potential impact of the qualified opinion and will address the issues in the near future.

C. PREPAYMENT, DEPOSIT AND OTHER RECEIVABLE (THE DEPOSIT PAID)

As set out on pages 32 to 35 under the section headed "Extract of the auditor's report" in the Results Announcement, the Deposits Paid under Prepayment, and other receivables are one of the items the Company's auditors have not been able to obtain sufficient appropriate audit evidence on and it is one of the basis for the Qualified Opinion.

Reasons and details of the Qualified Opinion

In 2015, the Group acquired 100% equity interest of Shun Jun Ventures Limited ("**Shun Jun**"). Shun Jun entered into the investment sale agreement and the supplemental agreement ("**Investment Sale Agreement**") with a property developer (the "**Developer**") on 7 November 2014 and 19 July 2015 respectively, pursuant to which the Developer appoints Shun Jun as the exclusive agent to sell the Properties located at Nanjing. Shun Jun had paid deposit of approximately RMB85,345,000 (the "**Deposit**") to the Developer in accordance with the terms of the Investment Sale Agreement.

In January 2016, the Directors became aware that, one of the required certificates, Property Developing Quality Certificate* (房地產開發資質證書), had expired while the Developer was applying for the Pre-sale Permits. As such, the Developer was in the progress of renewing the Property Developing Quality Certificate. Meanwhile, the Developer has obtained the Interim Property Developing Qualification Certificate* (暫定房地產開發資質證書) on 2 August 2016. Subsequently, the Developer was found to be involved in a number of litigations. In the absence of sufficient appropriate audit evidence to verify the financial ability of the Developer, the Auditor was unable to ascertain the recoverability of such Deposit.

The Board had been aware of the qualified opinion on the Deposit since the 2015 results announcement. As mentioned in the 2016 Annual Report, the Company noted some progress in relation to obtaining of the Pre-sale Permits as well as considered some alternatives to recover the prepayment. During the year ended 31 December 2017 and up to the date of the Results Announcement, however, the Company still failed to provide sufficient evidence regarding the recoverability of the Deposit. As a result, the Auditor issued a qualified opinion on the Deposit.

The Auditor requested the current status of the Nanjing project and subsequent settlement of the Deposit to justify the recoverability of the Deposit.

Since there was no progress in the Nanjing project and the Company had not received the refund of the Deposit, the Company was not able to provide the requested information.

The Qualified Opinion will have an impact on the Company's financial statements. As at 31 December 2017, the carrying amount of the Deposit was approximately HK$102,100,000 (2016: approximately HK$95,000,000). The Qualified Opinion would mean that there is no assurance from the Auditor that the figures under the consolidated financial position and performance of the Company in relation to the Deposit would be true and fair.

The Directors' position

The Company had been communicating with the Developer regarding the latest situation of obtaining the Pre-sale Permits as well as its financial viability. As disclosed in the section under "Management Discussion and Analysis" on page 10 of 2016 Annual Report of the Company, the existing major obstacle of obtaining the Pre-sale Permits is the pending litigation of the Developer, which amounts to approximately RMB51.2 million. If the Developer could successfully enter into co-operation agreement with other interested property developer as mentioned below, the Company is optimistic to the recoverability of the Deposit Paid in view of the booming property market in Nanjing City. However, due to the slow permit-application process and response from the Developer, the Auditor was not provided with sufficient audit evidence regarding recoverability of the Deposit and issued the qualified opinion. The Board understood this situation and concurred with the basis of qualified opinion on each of (a) the recoverability of the balances; and (b) the provision for impairment loss.

Audit Committee's view

The Audit committee confirmed that they understood the basis of the Qualified Opinion. They have also reviewed and agreed with the Board's position as set out above.

The Company's proposed plan to address the Qualified Opinion

It is the intention of the Company to continue working with the Developer because of the booming property market in Nanjing. According to a number of public available information sources (including but not limited to government's statistical report, articles from industrial expert and public news, etc.), the property market in Nanjing City has recorded double-digit annual growth in the recent years. According to the website (http://nj.58.com/xiaoqu/aidahuayuanlanhuayuan), the latest average second-hand unit selling price was approximately RMB29,500 per square metre for May 2018 for the nearby residential properties of the Nanjing properties, representing an annual increment of over 13% for the past four years with reference to the target unit selling price of RMB18,000 as specified in the Investment Sale Agreement entered into between Shun Jun and the Developer at the end of 2014. The website is owned by the information service provider "58.com Inc (WUBA.N)" (the "**Organisation**"), which is a company listed on New York Stock Exchange. The Organisation operates the website (http://www.58.com), known as "58.com", and is owned by "北京五八信息技術有限公司. The Board considered that the Organisation is a reliable and credible source of information for the following reasons: (a) the Organisation had been established for over 10 years in China; (b) the Organisation had been listed on the New York Stock Exchange; (c) the Organisation's major shareholder was Tencent Holdings Limited which is listed on the Stock Exchange (Stock code: 700); (d) the Organisation operated the largest real time information website in the PRC; and (e) the Organisation has good reputation in the internet information service industry.

The Company believes that the growth in the property market in Nanjing City will increase the development value of the Properties. As the exclusive agent to sell the Properties, the Company and its shareholders will be able to enjoy the profits from the investments in the future. Nevertheless, the Company also observes the potential impact of the qualified opinion and communicates with the Developer to ensure the full cooperation with the Auditor in the future. For instance, the Developer may provide further information about its financial viability and business continuity to demonstrate its ability to repay the Deposit. Meanwhile, the Company is in discussion with other PRC property developers to transfer the exclusive right. During the year 2017 and up to the date of this announcement, the Company has introduced two property developers and one agency to the Developer and taken part in the negotiation of the terms of the co-operation agreement. Once the co-operation agreement could be finalized, the Company may consider either to transfer the right of Deposit Paid to the property developer to realize the funds at the early stage or to hold the exclusive right on the sales of Nanjing properties until the completion of its sales. The Company will also consider to enforce its rights under the Investment Sale Agreement and to initiate legal proceedings against the Developer.

The Company has been communicating with the Developer regarding the latest updates on the Pre-sale Permits, and up to the date of this announcement, the Developer is under negotiation with and seeking financial assistance from other property developers to jointly complete the construction of the remaining parts of the properties in Nanjing City. The Company considered that if the Developer could successfully enter into co-operation agreement with other property developer, the financial problem of the

Developer will be resolved and the major obstacle for obtaining the Pre-sale Permits will be cleared. The Company will continue to monitor the situation and keep the public informed as and when necessary.

Up to the date of this announcement, the Company is yet to have a defined plan with timetable to address the qualified opinion because the discussion of alternative plans is in preliminary stage and still ongoing. If the co-operation agreement could be successfully entered into between the relevant parties in 2018 and the new property developer is able to demonstrate financial ability to develop the property, the Company will be able to provide the necessary audit evidence to the Auditor for the audits of 2018 and the related qualified opinion in the Results Announcement will be uplifted in the 2018 results announcement. It is expected that the co-operation agreement could be entered into between the relevant parties in the third quarter of 2018.

The increase in the balance from HK$95 million as at 31 December 2016 to HK$102 million as at 31 December 2017 was a result of exchange differences. Conversion of RMB into HK$ was based on the exchange rate of RMB1 to HK$1.118 and HK$1.196 as at 31 December 2016 and 31 December 2017 respectively. As such, the Deposit amounted to approximately HK$95 million and HK$102 million as at 31 December 2016 and 31 December 2017 respectively.

As set out on page 31 of the 2016 Results Announcement, it was disclosed that the Group may consider to (a) transfer its rights on the Deposits to potential buyers; (ii) identify another developer; or (iii) take legal actions to recover the amounts of the Deposits such that the Company could address the relevant 2016 Qualified Opinion.

The Company cannot provide the Auditor with sufficient audit evidence in relation to the recoverability of the Deposit. As the application of Pre-sale Permit is still in progress and the Developer was unable to prove its financial viability and ability to repay the Deposit, the Auditor issued a qualified opinion on the Deposit in the Results Announcement.

The Company's proposed plan to address the 2016 Qualified Opinion

It is the intention of the Company to continue working with the Developer because of the booming property market in Nanjing. Nevertheless, the Company also observes the potential impact of the 2016 Qualified Opinion and communicates with the Developer to ensure the full cooperation with the Auditor in the future. For instance, the Developer may provide further information about its financial viability and business continuity to demonstrate its ability to repay the Deposit. Meanwhile, the Company is in discussion with other PRC property developers to transfer the exclusive right. The Company will also consider to enforce its rights under the Investment Sale Agreement and to initiate legal proceedings against the Developer.

D. IMPAIRMENT OF EXPLORATION AND EVALUATION ASSETS

As set out on page 12 of the Results Announcement, it was disclosed that the Company recognised an impairment of exploration and evaluation assets of HK$34 million (2016: reverse of impairment of HK$11 million) (the "**Impairment**").

Background of exploration and evaluation assets

The Group owns the exploration rights of Bayanhushuo Coal Field ("**BCF**") and Guerbanhada Coal Mine ("**GCM**"), all of which are located in Inner Mongolia Autonomous Region, the PRC.

BCF

BCF is held by Inner Mongolia Run Heng Mining Company Limited which was acquired by the Group in 2008. The details of this acquisition is as follows:

On 28 March 2008, Growth Gain Investments Limited, an indirectly wholly owned subsidiary of the Company, acquired the entire equity interest of Lucky Dragon Group. The fair value of the consideration of the acquisition was HK$599,555,000, of which HK$6,393,000 was paid by cash and the remaining balance was satisfied by (i) the issue of 600,000,000 consideration shares, (ii) the issue of convertible notes with fair value of HK$369,750,000 and (iii) promissory notes of HK$95,416,000 on 28 March 2008.

GCM

GCM is held by Inner Mongolia Mingrunfeng Energy Co. Limited ("**Mingrunfeng**") which was acquired by the Group in 2007. The details of this acquisition is as follows:

On 26 May 2007, Bright Assets Investments Limited ("**Bright Assets**"), an indirectly wholly-owned subsidiary of the Company, acquired the entire equity interest of Jumplex Investments Limited ("**Jumplex**"), First Choice Resources Limited ("**First Choice**") and Wise House Limited ("**Wise House**"). After completion of the acquisition of Jumplex, First Choice and Wise House, Bright Assets obtained 67.35% indirectly equity interest in Mingrunfeng and Mingrunfeng became a subsidiary of the Company. On 20 June 2007, an additional 16.65% equity interest of Mingrunfeng was acquired by Bright Assets as a result of the capital contribution. The total equity interest in Mingrunfeng was then increased to 84%. On 27 September 2007, Bright Assets acquired the remaining 16% equity interest in Mingrunfeng and Mingrunfeng became an indirectly wholly owned subsidiary of the Company.

The total cost of acquisition of HK$315,785,000, of which HK$20,700,000 was paid by cash and the remaining balance settled by the issue of 243,792,000 and 118,208,000 consideration shares on 29 May 2007 and 2 October 2007 respectively. The fair value of consideration shares issued were approximately HK$153,223,000 and HK$141,862,000 as at the date of issue and allotment of the shares on 29 May 2007 and 2 October 2007 respectively.

Details of the Impairment

With regards to the method and basis used in determining the amount of Impairment, the Company engaged Roma to estimate the fair value of exploration rights as at 31 December 2016 and 31 December 2017 using market approach.

The impairment losses are calculated as follows:

	2017	2016
	RMB'000	*RMB'000*
Far value at the end of the year	95,853	126,019
Carrying value at the beginning of the year	126,019	116,603
(Impairment losses)/Reversal of impairment	(30,166)	9,416
Average exchange rate	1.154	1.170
(Impairment losses)/Reversal of impairment in HK$	(34,804)	11,016

The main reason of decrease in fair value of the exploration rights was due to the decrease in the ask price on coal mine which caused the most important multiple, the price-to-resources multiple per tonne, to decrease from HK$0.37/tonne for the year ended 31 December 2016 to HK$0.26/tonne for the year ended 31 December 2017.

The fair values were developed primarily through the application of a market valuation methodology, where comparable acquisition of exploration and evaluation assets were identified and analysed to determine the approximate value of the Group's assets.

The major basis and/or assumptions and valuation inputs applied in the valuations of the exploration rights for the years ended 31 December 2016 and 31 December 2017 are set out as follows:

Inputs	2017	2016
Price-to-area multiple per km^2	RMB1,323,219	RMB476,167.68
Price-to resources multiple/tonne	RMB0.26/tonne	RMB0.37/tonne
Marketability discount	30%	30%

The price-to-area multiple is estimated by the adjusted transaction price of the exploration right divided by the exploration area as stated in the exploration right in each of the guideline comparable transactions. The transaction prices of guideline comparable transactions have been adjusted for difference in coal quality as there were no transactions of exploration right of coal mines with the type of coal same as the subject coal fields as at 31 December 2017.

To derive the fair values, such approximate values were adjusted to reflect (i) the estimated difference in coal quality and coal type among the identified comparable transactions and the mines owned by the Group; and (ii) the estimated time difference between the comparable transactions and the valuation date; and (iii) the estimated likelihood that the licences would be sold in open market or returned to the government to seek for compensation.

In order to reflect the difference in quality of coal in the guideline comparable transactions, a coal quality factor was applied to each of the transaction prices of the guideline comparable transactions with respect to the type of coal of the guideline comparable transactions in arriving at the price-to-area multiple. The factor was made with reference to 內蒙古公布煤炭礦業權有償出讓最低價 published by 國際煤炭網. The adjustment was determined as follows:

$$P_a = \frac{P_{GT}}{MP_{GTC}} * MP_{BC}$$

In which

Pa	=	Adjusted transaction price of the guideline comparable transaction;
PGT	=	Transaction price of the guideline comparable transaction;
MPGTC	=	Minimum price of the guideline comparable transaction coal type; and
MPBC	=	Minimum price of brown coal as set out by Inner Mongolia Government.

Guideline comparable transactions in 2015, 2016 and 2017 were adopted in arriving at the price-to-area multiple. To account for the time difference between guideline comparable transaction in 2015, 2016 and that of 2017, further adjustment was applied:

The time difference adjustment was based on the ratio between the ask price of exploration right in China in 2015, 2016 respectively and that in 2017. The adjustment was determined as follows:

$$VM_a = \frac{VM_{GT}}{AP_{2015,\ 2016}} * AP_{2017}$$

In which

VMa	=	Adjusted valuation multiple on time difference;
VMGT	=	Valuation multiple from guideline comparable transaction;
AP2015, 2016	=	Average of valuation multiples based on ask price in 2015and 2016 respectively; and
AP2017	=	Average of valuation multiples based on ask price in 2017

The increase in price-to-area multiple is due to (i) higher price-to-area multiple for the guideline comparable transactions in 2017 and (ii) higher average price-to-area multiple based on ask price of coal mines in 2017. The market value of exploration and evaluation assets decreased in 2017 as compared with 2016. The increase in price-to-area multiple from guideline comparable transactions was consistent with the increase in the price-to-area multiple calculated based on the ask price of coal mine in 2017. The decrease in the market value of exploration and evaluation assets was due to the decrease in price-to-resources multiple from guideline comparable transactions in 2017.

The valuation of the market value of exploration and evaluation assets was based on the price-to-area multiple and price-to-resources multiple from guideline comparable transactions, with weighting of 5% and 95% respectively. Although the price-to-area multiple increased in 2017, the price-to-resources multiple decreased in 2017 and the effect of the decreasing price-to-resources multiple outweighed the increasing price-to-area multiple, which resulted in a decrease in the market value of exploration and evaluation assets.

The average price-to-area multiple based on ask price of the coal mines (i.e. AP2017 mentioned in reply I) was applied to adjust for the time difference between the guideline comparable transactions adopted. Since the respective averages of price-to-area multiple based on the ask price in 2015 and 2016 were lower than that in 2017, there were upward adjustments for the price-to-area multiples in 2015 and 2016 respectively, which also resulted in an increase in price-to-area multiple.

E. GAIN ON SETTLEMENT OF PROMISSORY NOTES USING CONVERTIBLE BONDS

As set out on page 12 of the Results Announcement, it was disclosed that the Company recorded a gain on settlement of promissory notes using convertible bonds of HK$22 million (2016: a loss of HK$4 million), representing 23% of the net loss after tax.

Details of the background, facts and circumstances leading to the recognition of the significant amount of other revenue are as follows:

On 7 December 2015, the Company issued a promissory note with a principal amount of HK$100,767,000 (the "**Juice PN**"), as part of the consideration for the acquisition of 19% equity interests of USO Management & Holding Co Ltd.

On 7 November 2017, the Company issued convertible bonds (the "**Juice CB**") to set off against the Juice PN. The Juice CB was non-interest bearing and had principal amount of approximately HK$100,766,000 with the rights to convert into 1,007,665,620 shares at conversion price of HK$0.10 per share. The promissory note had carrying value of HK$91,835,000 on 7 November 2017.

Pursuant to the Juice CB agreement, the conversion rights shall be deemed to be automatically exercised after the expiry of the conversion period. The Juice CB holders had no right to demand the Company to redeem the Juice CB.

According to Hong Kong Accounting Standard 32 "Financial Statements: Presentation", the Juice CB was an equity instrument as (1) the Juice CB included no contractual obligation to deliver cash or another financial asset to the Juice CB holder; (2) the Juice CB would be only settled by the Company's shares; and (3) the Juice CB was a non-derivative that included no contractual obligation for the Company to deliver a variable number of the share of the Company.

Pursuant to HK(IFRIC)-Int 19 "Extinguishing Financial Liabilities with Equity Instruments", Juice CB should be measured at fair value when the Juice CB issued to the Juice CB holder to settle the Juice PN. The difference between the carrying amount of the Juice PN settled and the fair value of the Juice CB issued should be recognised in profit or loss.

In accordance with HK(IFRIC)-Int 19, gain on settling the Juice PN using the Juice CB are calculated as follows:

	HK$'000
Carrying value of the Juice PN	91,835
Less: fair value of the Juice CB (valued by Ravia Global Appraisal Advisory Limited)	(69,529)
Gain on settlement of the Juice PN using Juice CB	22,306

Save for the above clarification, the content of the Results Announcement and 2016 Results Announcement remains unchanged.

By Order of the Board
Kiu Hung International Holdings Limited
Hui Kee Fung
Chairman

Hong Kong, 13 July 2018

As at the date of this announcement, the Board comprises four executive Directors, Mr. Hui Kee Fung, Mr. Yu Won Kong, Dennis, Mr. Zhang Yun and Mr. Zhang Qijun; and three independent non-executive Directors, Mr. So Chun Pong, Ricky, Mr. Wang Xiao Ning and Mr. Cheung Man Loon, Michael.