# HYBRID KINETIC GROUP LIMITED
# 正 道 集 團 有 限 公 司

*(incorporated in Bermuda with limited liability)*

**(Stock code: 1188)**

# SUPPLEMENTAL ANNOUNCEMENT IN RELATION TO THE ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2019

Reference is made to the annual report of Hybrid Kinetic Group Limited (the "**Company**", and together with its subsidiaries, the "**Group**") for the year ended 31 December 2019 ("**FY2019**") (the "**2019 Annual Report**"). Unless otherwise defined, capitalised terms used herein shall have the same meanings as those defined in the 2019 Annual Report.

## AUDIT QUALIFICATIONS

As disclosed in the 2019 Annual Report, the auditor of the Company (the "**Auditor**") issued a disclaimer of opinion on the Company's consolidated financial statements for the year ended 31 December 2019 (the "**Audit Qualifications**"), the details of which were described in the paragraph headed "Basis for Disclaimer of Opinion" of the independent auditor's report contained in the 2019 Annual Report.

The Board would like to provide further information in relation to the management's and audit committee's views on the Audit Qualifications to supplement the relevant disclosures made in the 2019 Annual Report.

## VIEWS OF MANAGEMENT AND AUDIT COMMITTEE ON AUDIT QUALIFICATIONS

### 1. Material uncertainty related to going concern

***Management's views on the material uncertainty related to going concern***

*Background*

The Group incurred a loss of HK$643,846,000 and operating cash outflow of HK$30,956,000 for FY2019. These conditions indicate the existence of a material uncertainty which may cast significant doubt on the Group's ability to continue as a going concern. Therefore, the Group may be unable to realise its assets and discharge its liabilities in the normal course of business.

The consolidated financial statements of the Company for FY2019 have been prepared on a going concern basis, the validity of which depends on the financial support from the major shareholder, Dr. Yeung Yung (the "**Major Shareholder**"), to the extent which is sufficient to finance the working capital requirements of the Group. The Major Shareholder, who is a substantial shareholder, one of the executive Directors and the chairman of the Group, has agreed to provide adequate funds for the Group to meet its liabilities as they fall due.

As disclosed in the Company's announcement dated 24 April 2020, the Company entered into a shareholder's loan agreement with the Major Shareholder, on 24 April 2020, pursuant to which the Major Shareholder has agreed to make available to the Company the Shareholder's Loan, which is interest-free and unsecured, up to the principal amount of HK$160,000,000, by 31 May 2020 to finance the working capital requirement of the Group.

In order to assess the financial ability of the Major Shareholder and the validity of the financial support from the Major Shareholder, the evidence and supporting documents requested by the Auditor included but not limited to (i) proof of funds of the Major Shareholder for demonstrating that the Major Shareholder has the financial ability to finance the Shareholder's loan; and (ii) the expected timeline for the drawdown of funds from the Shareholder's Loan for demonstrating that the funds from the Shareholder's Loan would be readily available to the Company upon its requests.

Despite the efforts made by and requests from the Major Shareholder to his banks for the proof of funds, the required documents could not be provided before the publication of the audited final results of the Company for FY2019 (the "**Audited Results**") to sufficiently satisfy the Auditor's request.

*Shareholder's Loan*

The Directors consider all possible financial alternatives (including but not limited to equity financing, debt financing, rights issue, open offer or bank borrowings) to alleviate the Group's liquidity pressure and improve its overall financial position from time to time.

The Shareholder's Loan was made available by the Major Shareholder as agreed and deposited to the Group in full in late May 2020. The Directors (excluding Dr. Yeung) have confidence in the Major Shareholder's continued commitment and support towards the Group. After assessment and acknowledgement of the financial support of the Major Shareholder, the Directors believe and are satisfied that the Major Shareholder is ready, willing and able to offer such other assistance (financial or otherwise) to the Group to enhance its financial flexibility and capability as and when the circumstances arise.

*Other fund raising opportunities*

It has always been the Company's strategy to continue to explore proactively fund raising opportunities and collaborations with potential business partners and investors to develop the business of the Group. The Group may establish joint venture(s) or other form of alliance with business partners or potential strategic investors of the Group where (a) the Group may contribute its expertise and intangible assets (such as intellectual property rights owned by the Group) and (b) the potential business partners or investors may contribute working capital to allow each party to fully leverage on each other's capabilities.

The Company has taken the following actions to explore fund raising opportunities:

(a) explored possible fund raising and/or investment opportunities through Directors' business network and connections;

(b) explored to arrange and engage placing agents to explore equity and/or debt financing opportunities in the market on behalf of the Company; and

(c) explored to approach and negotiate with investors, including but not limited to certain overseas electric vehicle manufacturers and sovereign fund for potential investment and/or cooperation opportunities.

Despite the Company's endeavours to continue exploring business opportunities with potential business partners and investors, the worldwide outbreak of the COVID-19 has significantly hindered the negotiation progress and lowered the sentiment of investors and business partners for new potential investments. Nevertheless, the Group will continue its efforts and keep approaching and engaging in negotiations with potential investors and business partners. Please refer to the section headed "Action plans of the Group to address the Audit Qualifications" below for details.

Based on the above, the Directors consider that the Group will have sufficient working capital for the operation and development of its business for at least twelve months from the end of the reporting period of FY2019. With the development and expansion of the Group's business, the Group's overall financial position will be improved gradually. In view of the above and barring any unforeseen circumstances, it is expected that the material uncertainty related to going concern of the Group will not be carried forward to the Group's financial statements for the year ending 31 December 2020 ("**FY2020**")

***Audit Committee's views on the material uncertainty related to going concern***

Taking into account (i) the availability of the Shareholder's Loan; and (ii) the action plans of the Group as further detailed under the section headed "Action plans of the Group to address the Audit Qualifications" below, the Audit Committee agreed with the management's view that the Group will have sufficient working capital for the operation and development of its business for at least twelve months from the end of the reporting period of FY2019. As such, the Audit Committee agreed with the management's view that the consolidated financial statements of the Group for FY2019 should be prepared on a going concern basis.

The Audit Committee considered that the material uncertainties related to going concern will not be carried forward to the Group's financial statements for FY2020 based on the factors listed below:

(a) the Major Shareholder had demonstrated its continued commitment and support towards the Group through the provision of the Shareholder's Loan, which was advanced to and received by the Company in full as agreed;

(b) the Company continued to explore fund raising opportunities and collaborations with potential business partners and investors; and

(c) with the unwavering efforts and commitment of the Company's management, in particular, to implement the action plans in disposing of Ningbo Joint Venture and entering into the Supplemental Agreement to Licensing Agreement as further disclosed in the section headed "Action plans of the Group to address the Audit Qualifications" below, the Group will manage to have sufficient working capital for the operation and development of its business.

## 2. Share of loss of associates and investment in associates

### *Background of Ningbo Joint Venture*

The Company's investment in associates mainly represented the Company's (i) 16.7% equity interest in Shenzhen SUSTC Fuel Cell Company Limited; and (ii) 18% equity interest in Ningbo Joint Venture, the carrying amount of which amounted to approximately HK$3.5 million and HK$165.5 million as at 31 December 2019 respectively. The net assets of Ningbo Joint Venture were approximately RMB822.8 million (equivalent to approximately HK$919.5 million) as at 31 December 2019.

Reference is made to the announcements of the Company dated 14 March 2017 and 28 July 2017. Ningbo Joint Venture was established pursuant to a joint venture agreement dated 10 March 2017 (as supplemented) entered into among the Group with Beijing WKW Automotive Parts Co., Ltd and 北京致云資產管理有限公司(Beijing Zhi Yun Asset Management Limited*). The Group has contributed RMB360 million for 18% of the equity interest in Ningbo Joint Venture.

Ningbo Joint Venture is principally engaged in the research and development production and sales of batteries in the manufacturing aspect of key new energy automobile components and related products and materials. As disclosed in the announcement of the Company dated 14 March 2017, it was intended that Ningbo Joint Venture be used to (i) achieve innovation in the development of new energy power batteries and related products and promote a wider application of such products; (ii) leverage on the synergy expected to be derived from the co-operation and enable the parties to complement each other in the respective resource advantages and network; and (iii) seize investment opportunities in the new energy industry with the support of the capital market professionals and other alliances.

### *Impairment on Loan Receivables*

In view of sourcing investment opportunities to integrate the new energy power batteries business, Ningbo Joint Venture granted a number of loans in the aggregate amount of approximately RMB480.05 million (the "**Loan Receivables**") to an independent third party (the "**Counterparty**"), which is principally engaged in fund and asset management and its beneficial owner had invested in companies principally engaged in new energy power batteries and electric vehicles businesses in the PRC. The Loan Receivables were unsecured.

As at 31 December 2019 and up to the date of this announcement, the Loan Receivables remained overdue. Although the Group had raised concerns on the recoverability of the Loan Receivables to the management of Ningbo Joint Venture, the management of Ningbo Joint Venture maintained that they were confident over the recoverability of the Loan Receivables as the Counterparty (i) has extensive business network in the new energy power battery business in the PRC; and (ii) is not experiencing any financial difficulties.

As a result of the prevalence of the COVID-19 epidemic in early 2020, the operation of Ningbo Joint Venture was seriously affected and its management accounts were only provided to the Company in late March 2020, where the Group noted that the Loan Receivables remained overdue. Given Ningbo Joint Venture is only an associate of the Company with 18% of its equity interest, the Company had difficulties in requesting for further information.

Accordingly, the Company considered it appropriate and prudent to provide for and had made a full impairment on the Loan Receivables under the financial statements of Ningbo Joint Venture during the course of preparing the Audited Results for FY2019.

As a result of such impairment, Ningbo Joint Venture recorded a loss of approximately RMB1,145 million (equivalent to approximately HK$1,298.4 million) for FY2019 and its net assets decreased to approximately RMB822.8 million (equivalent to approximately HK$919.5 million) as at 31 December 2019. Accordingly, the Group (i) recorded a share of loss of associates under the consolidated financial statements of the Company; and (ii) the investment in associates decreased to approximately HK$169.0 million as at 31 December 2019.

***Audit Committee's and the Board's views on the Auditor's disclaimer of opinion in relation to the share of loss of associates and investment in associates***

The Audit Committee and the Board understood that the Auditor's disclaimer of opinion was based on insufficient audit evidence to verify the validity of the management accounts provided by Ningbo Joint Venture, which was primarily due to hindrance of normal operation of Ningbo Joint Venture as a result of the prevalence of the COVID-19 epidemic. As such, there were only limited audit evidences that could be provided to the Auditor.

Taking into account the action plans disclosed in the section headed "Action plans of the Group to address the Audit Qualifications" below, in the event the Potential Disposal (as defined below) materialised, the Group might be able to recover its investment in Ningbo Joint Venture through the disposal of its equity interest and the Group would cease to have any equity interest in Ningbo Joint Venture.

As such, the Board and the Audit Committee are of the views that the disclaimer of opinion in relation to share of loss of associates and investment in associates will not be carried forward in FY2020.

**3. Equity investments at fair value through other comprehensive income**

The equity investments at fair value through other comprehensive income of the Group as at 31 December 2019 represented the investment of the Group in the Meilai Group.

***Background of the Meilai Group***

Reference is made to the announcement of the Company dated 4 September 2020 (the "**Meilai Announcement**") in relation to the subscription of 5% equity interest in the Meilai Group by the Group (the "**Meilai Investment**").

On 27 May 2016, the Group entered into a subscription agreement (the "**Subscription Agreement**") with 天風睿維（武漢）投資中心（有限合伙）("**Tianfeng Investment**") and the shareholders of the Meilai Group, pursuant to which the Group agreed to subscribe for 5% of the equity interest in Meilai Group at a consideration of RMB60 million (the "**Subscription**"). The Subscription constituted a disclosable transaction of the Company under Chapter 14 of the Listing Rules.

The Meilai Group is principally engaged in timber and wood processing industries in the PRC. To the best knowledge of the Directors having made all reasonable enquiries, the major ultimate beneficial shareholders of the Meilai Group are Mr. Cai Liubao（蔡留寶）and Ms. Zhang Huiying（仉慧穎）, who are PRC citizens and shareholders of a number of enterprises related to timber or wood processing industries in the PRC.

***Profit Guarantee***

Pursuant to the Subscription Agreement, certain shareholders of the Meilai Group (the "**Guarantors**") covenanted and guaranteed to the Group that the accumulated audited consolidated net profit should not be less than RMB920 million for the three years ended 31 December 2018 (the "**Profit Guarantee**"), the details of which are set out in the Meilai Announcement and under notes 25 and 26 to the consolidated financial statements of the Company in the 2019 Annual Report.

In the event the Profit Guarantee is not fulfilled, the Guarantors shall compensate the Group on a dollar-for-dollar basis (the "**Compensation Payable**") based on the formula as disclosed in the Meilai Announcement.

Based on the local audit reports, the actual accumulated audited consolidated net loss after taxation of the Meilai Group attributable to its shareholders for the three years ended 31 December 2018 was approximately RMB54.4 million. Accordingly, the Compensation Payable by the Guarantors to the Group amounted to approximately RMB63,546,000 (equivalent to approximately HK$71.0 million). The Compensation Payable was recognised as derivative financial instrument for FY2018 and reclassified to other receivables for FY2019 under the consolidated financial statements of the Company.

***Management's views on the recoverability of the Compensation Payable***

As at 31 December 2019 and up to the date of this announcement, the Compensation Payable remained outstanding. The Group has assessed the recoverability of the Compensation Payable after ascertaining the respective amount. When considering the possibility of recovering the Compensation Payable, the Group had taken into consideration the following factors:

(i) in respect of the financial position of the Meilai Group, the financial performance of the Meilai Group may turnaround in the future as the unfavourable financial performance of the Meilai Group for the year ended 31 December 2018 was mainly attributable to the depreciation of Russian Ruble against Renminbi given the Meilai Group principally operated in Russia; and the decrease in market price of timber products due to the unexpected spike in global timber supply. In addition, the Meilai Group maintained sufficient assets as its total assets and net assets amounted to approximately RMB1,065.7 million and RMB202.0 million as at 31 December 2018 respectively based on the local audit report; and

(ii) when making the investment, the intention of the Group was to be a passive investor in the Meilai Group. It was not the intention of the Group to further increase its shareholding in the Meilai Group through exercising its rights under the Subscription Agreement to transfer further equity interest of the Meilai Group from the Guarantors to the Group.

In view of the above assessment made, the Group held discussion with the Guarantors in relation to the respective compensation under the profit guarantee and negotiated on the settlement date of the Compensation Payable. After the discussion between the parties and reviewing of the then latest unfavourable financial performance of the Meilai Group for the year ended 31 December 2018, the Group was aware that (i) the investment in Meilai Group represented the primary source of income for the Guarantors; and (ii) the Guarantors may not be able to settle the Compensation Payable together with the amount payable to Tianfeng Investment (another subscriber under the Subscription Agreement) by the Guarantors under the same profit guarantee in a short period of time.

As such, in October 2019, the parties to the Profit Guarantee agreed in writing that the Compensation Payable of RMB63,546,000 be settled on or before 30 September 2020.

The Board is of the view that, the Guarantors may have sufficient financial ability to settle the Compensation Payable in the event the financial performance of the Meilai Group recovers. Nevertheless, given the adversity under the COVID-19 epidemic in 2020 and the Company has yet to receive the consolidated management accounts of the Meilai Group and therefore could not fairly assess the financial performance of the Meilai Group. Based on its preliminary assessment, the Board considers that the Compensation Payable may or may not be settled by 30 September 2020. Taking into account of the above, as at 31 December 2019, the Group has provided impairment on the Compensation Payable in full for prudence sake.

***Management's views on the recoverability of the Meilai Investment***

Reference is made to note 20 to the consolidated financial statements as disclosed in the 2019 Annual Report. The carrying amount of the Meilai Investment reduced from approximately HK$23.0 million as at 31 December 2018 to approximately HK$14.0 million as at 31 December 2019, in which an impairment of approximately HK$9.0 million had been recorded for FY2019.

The carrying amount of the Meilai Investment was determined with reference to the valuation report issued by Royson Valuaion Advisory Limited (the "**Valuer**"), an independent valuer engaged by the Company, pursuant to which the Meilai Investment was valued at approximately RMB12.3 million (equivalent to approximately HK$14.0 million) as at 31 December 2019 using the market approach.

Due to the limited availability of the unaudited consolidated management account of the Meilai Group for the year ended 31 December 2019, the valuation was performed under the special assumptions that (i) there is no change in the corporate structure and share capital of the Meilai Group between 31 December 2018 and 31 December 2019; (ii) there was no change in the net book values of certain subsidiaries of the Meilai Group between 31 December 2018 and 31 December 2019; (iii) the net book value of the Meilai Group as at 31 December 2019 was decreased by the change in the shareholders' equity of the Meilai Group and pro-rata share of loss from its certain subsidiary for the year ended 31 December 2019; and (iv) there is no material change in the forest resources held by the Meilai Group between 31 December 2018 and 31 December 2019.

The Company had adopted such valuation regarding the carrying amount of the Meilai Investment in the 2019 Annual Report. As such, the Board considers that the value of the Meilai Investment as at 31 December 2019 had been fairly stated.

***Background of the disclaimer of opinion***

Due to the hindrance of operation of the Meilai Group in the Jilin province and Heilongjiang province in the PRC, as a result of the prevalence of the COVID-19 epidemic, the Company could not obtain the latest consolidated management accounts for the year ended 31 December 2019 before the publication of the Audited Results. As such, the Company could only rely on individual management accounts of the Meilai Group provided by the Meilai Group with management adjustments and provide the same to the independent valuer for the valuation of the Meilai Group and the Profit Guarantee.

Given (i) the hindrance of operation of the Meilai Group and the then travel limitations to the Jilin province and Heilongjiang province as a result of the COVID-19 epidemic, the Auditor could not obtain sufficient audit evidence to verify the individual management accounts of the Meilai Group; and (ii) the valuation of the Meilai Group was based on such individual management accounts, the Auditor was unable to satisfy itself on the fair value of the equity investments, the recoverability of the other receivables and the financial capability of the debtor.

***Audit Committee's and Management's views on the disclaimer of opinion***

Based on the factors listed below, the management and the Audit Committee consider that the disclaimer of opinion relating to the Meilai Investment will not be carried forward to the Group's financial statements for FY2020:

(a) the disclaimer of opinion relating to the equity investments was merely due to the fact that the Meilai Group could not provide consolidated management accounts in March 2020 as a result of the COVID-19 epidemic in early 2020;

(b) the proven record of the timeliness of the Meilai Group to provide the consolidated management accounts in previous financial years without the effect of the COVID-19 epidemic; and

(c) without the hindrance of the COVID-19 epidemic, the Meilai Group is expected to be able to provide consolidated management accounts for FY2020 before the publication of the audited results of the Company for FY2020.

## 4. Intangible assets

### ***Background of the intangible assets***

Reference is made to (i) the announcement of the Company dated 5 December 2016 in relation to the establishment of Anhui Tiankang HK New Energy Technology Co., Ltd (the "**EJV**"); (ii) the announcement of the Company dated 18 October 2018 in relation to the voluntary dissolution of the EJV, an associate of the Company (the "**Dissolution**"); and (iii) note 21 to the consolidated financial statement in the 2019 Annual Report.

The registered capital of the EJV contributed by the Group was satisfied by certain technical know-how owned by the Group in relation to the battery technology of LTO (lithium titanate) cell (the "**Intangible Assets**"), while the joint venture partner contributed its registered capital by the transfer of assets including, but not limited to, land use right, plant and equipment. Upon establishment of the EJV, the Group accounted for the EJV as an associate of the Company under equity method and recognised its share of net assets in the EJV.

Upon completion of the Dissolution in FY2018, the Group had withdrawn such technical know-how from the EJV and recognized the fair value of its technical know-how previously contributed to the EJV of HK$62.6 million as intangible assets, which was based on the valuation performed by the Valuer based on the date of withdrawal of the Intangible Assets.

### ***Impairment of the Intangible Assets***

During the preparation of the announcement for the preliminary unaudited results of the Company for FY2019 dated 31 March 2020 (the "**Unaudited Results**"), the Company had provided an impairment to the Intangible Assets of approximately HK$29.0 million, which was determined with reference to a draft valuation report issued by the Valuer on 23 March 2020, pursuant to which the Intangible Assets was preliminarily valued at approximately HK$33.6 million on 31 December 2019 using the relief-from-royalty method (RRM) under the income approach.

The RRM calculates the value based on the hypothetical royalty payments that would be saved by owning the asset rather than licensing it. Owning an intangible asset means the underlying entity does not have to pay for the privilege of deploying that asset. The RRM contains assumptions from both the market (royalty rate) and income approach (including but not limited to estimate of revenue, growth rates, tax rates and discount rate).

The key assumptions of the preliminary valuation of the Intangible Assets are (i) the Group is operating as a going concern basis; (ii) the economic useful life of the Intangible Assets were assumed to be 10 years from the date of the Group's capital injection to the EJV; and (iii) the Group shall receive license fee at arms-length from independent third parties for the use of the Intangible Assets.

The draft valuation report was not completed as the Group did not intend to adopt the preliminary valuation as further discussed below.

The fair value of the Intangible Assets is measured with reference to the value in use of the CGU (cash-generating unit) which was derived by the cash flow projections of the CGU prepared by the management, and one of the key assumptions of the projection is the Group would be able to obtain additional working capital required for the CGU.

As disclosed in the section under "Material uncertainty related to going concern" above, the Auditor was concerned in relation to the material uncertainty about the Group's ability to continue as a going concern. Under the assumption that the Group was unable to continue as a going concern, the Group would have insufficient working capital which has negative impact on the cash flow projection of the CGU and accordingly the fair value of the Intangible Assets. As such, during the stage of finalising the Audited Results, the Company did not adopt the preliminary valuation of the Intangible Assets and provided impairment in full on the Intangible Assets for prudence sake.

***Background of the disclaimer of opinion in relation to the Intangible Assets***

Due to the factors concerning the material uncertainty about the Group's ability to continue as a going concern as detailed under the section headed "1. Material uncertainty related to going concern" above, the Auditor was unable to satisfy itself that the Group will or will not have sufficient working capital required for the CGU, which is one of the key assumptions of the cash flow projects of the CGU to be used for the measurement of the fair value of the Intangible Assets.

As such, the Auditor was unable to satisfy itself in relation to the carrying amount of the Intangible Assets and the impairment loss of the Intangible Assets for the year ended 31 December 2019.

***Audit Committee's and the Board's views on the Auditor's disclaimer of opinion in relation to the Intangible Assets***

The Board is of the view that, for prudence sake at the material time, a provision for impairment should be provided in full on the Intangible Assets. The Audit Committee agreed with the position of the Board concerning major judgmental areas in respect of the impairment loss on the Intangible Assets.

As disclosed above and taking into account the action plans disclosed in the section headed "Action plans of the Group to address the Audit Qualifications" below, the Board and the Audit Committee are of the views that the Group will manage to have sufficient working capital for the operation and development of its business and the Intangible Assets may generate positive cashflow to the Company in the future.

**5. Value-added tax receivables**

***Background***

The balance represented value-added tax ("**VAT**") receivables of HK$15.6 million as at 31 December 2019, which were generated during the daily operation and ordinary course of business of the Group's subsidiaries in the PRC. Such value-added tax receivables shall be offset against any value-added tax payables from VAT taxable income generated in the PRC. Since the Group's subsidiaries in the PRC did not generate sufficient VAT taxable income to offset the VAT payment in FY2019, the unutilised VAT credits of approximately HK$15.6 million was recorded as VAT receivable in the account of "Trade and other Receivables" in the Unaudited Results.

During the preparation of the Audited Results in May 2020, the Auditor raised its concerns in relation to the material uncertainties about the Group's ability to continue as a going concern, and the Group may not generate sufficient VAT taxable income in the PRC and respective VAT payables to offset such VAT receivables.

As such, the Auditor was unable to satisfy itself that the Group will or will not generate sufficient VAT taxable income in the PRC and respective VAT payables to offset such VAT receivables.

***Audit Committee's and the Board's views on the Auditor's disclaimer of opinion in relation to the value-added tax receivables***

As disclosed above, the Board and the Audit Committee are of the views that the Group will manage to have sufficient working capital for the operation and development of its business. As such, the Group may generate sufficient VAT taxable income to offset the Tax Receivables in the future with the availability of the Shareholder's Loan at the material time and the licensing income to be received by the Company under the Licensing Agreement (as defined below). The Audit Committee agreed the position of the Board concerning major judgmental areas in respect of the recoverability of the VAT receivables.

**6. Prepayment to a supplier**

***Background***

In respect of the settlement of the dispute and the Lawsuit centered on the Supply Agreement between Billion Energy (a subsidiary of the Company) and XALT Energy MI, LLC disclosed and referred to in the 2019 Annual Report (the "**Supply Agreement**"), the Company has continued to seek legal advice to prepare for the initiation of the arbitration proceedings while mediation has also been proposed to XALT by the Company. However, the change of the shareholding structure and management of XALT has disrupted the progress of mediation with the Group. The Group will make efforts to proactively re-activate the negotiation with XALT so as to seek a mutually acceptable solution.

The main actions taken by the Board to address the audit qualification relating to the prepayment to XALT (the "**Prepayment**") during the year ended 31 December 2019 included the followings:

(i) continued to send out request for audit confirmation on the Prepayment;

(ii) continued to make efforts to approach the new management of XALT with a view to re-activating negotiation on the recovery of the Prepayment following the change of the shareholding structure and management of XALT since 2018;

(iii) continued to seek professional advice on the Group's strategies and legal recourse over the Prepayment; and

(iv) explored the feasibility of other means to resolve the disagreement.

The Company had adopted the following strategies for the lawsuit with XALT:

(a) the Company has engaged legal counsel to prepare for the initiation of the arbitration proceedings. It is expected that the arbitration proceedings may commence by late 2020; and

(b) while preparing for the initiation of the arbitration proceeding with XALT, the Board does not give up on the possible mediation with XALT. The Board is of the view that, with this mediation approach, the parties are often more likely to work together amicably to structure a mutually beneficial resolution rather than escalate hostility. After all, the outcome of a lawsuit or arbitration is unpredictable and, even if a judgment was made in favour of the Group, the effectiveness of any enforcement action over the recoverability of the Prepayment may take years to benefit to the Company.

Having said that, the Board will review the strategies from time to time and will not preclude from taking alternative actions (including initiation of the arbitration process at appropriate time) as and when the situation changes.

***Audit Committee's and the Board's views on the Prepayment***

The Board and the Audit Committee are of the views that an impairment on the Prepayment is not appropriate for the following reasons:

(i) the Lawsuit has not yet been concluded and the chance of recovery of the Prepayment remained when finalizing the Audited Results for FY2019;

(ii) the written-off of the Prepayment might give XALT or the investors of the Company the misperception that the Group no longer considers that it has a valid or solid claim against XALT or it would no longer pursue the Lawsuit (which is not the case for or the intention of the Group); and

(iii) the Board did not consider that the treatment of the Prepayment was not fairly stated based on the current status of the matter, and there is no accounting requirement that the Group should make impairment solely based on the duration of the audit qualification.

Taking into account the action plans as disclosed under the section headed "Actions plans of the Group to address the Audit Qualifications" below, the Audit Committee and the Board are of the views that the disclaimer of opinion relating to the Prepayment should not be carried forward to the Group's financial statements for FY2020 if and when any of the above actions is executed on a successful basis.

## ACTION PLANS OF THE GROUP TO ADDRESS THE AUDIT QUALIFICATIONS

The major action plans currently taken by the Company to address the Audit Qualifications are set out as follows:

**(a) Potential disposal of the Group's interest in Ningbo Joint Venture**

The Company is in negotiation with an independent third party in relation to the disposal of the Group's interest in Ningbo Joint Venture (the "**Potential Disposal**"). The consideration under negotiation for the Potential Disposal is RMB360 million, representing the capital contribution made by the Group in Ningbo Joint Venture. Save for the capital contribution of RMB360 million, the Group did not have any commitment or financing provided to the Ningbo Joint Venture as at the date of this announcement.

Up to the date of this announcement, the Company is still in negotiation with this third party in relation to the Potential Disposal. It is expected that the Group may enter into formal agreement in respect of the Potential Disposal by late 2020. In the event any legally binding agreement is entered into by the Group, the Company will comply with the relevant requirements under the Listing Rules accordingly.

**(b) Licensing Agreement**

Reference is made to the announcement of the Company dated 11 June 2019. On 9 June 2019, the Group entered into a licensing agreement with FBHK (the "**Licensing Agreement**"), pursuant to which the Group agreed to license certain intellectual properties and technical know-how to FBHK for the design, development, manufacture and sales of new energy vehicles in Fujian province during the licensed period from 9 June 2019 to 8 June 2029 at a consideration of RMB640,000,000.

Due to the COVID-19 pandemic, the licensing arrangement has been delayed. As such, on 20 May 2020, both parties had revisited the Licensing Agreement and entered into a supplemental agreement to the Licensing Agreement (the "**Supplemental Agreement to Licensing Agreement**"), pursuant to which FBHK shall pay the Group (1) 10% of the consideration (i.e. RMB64,000,000) within 90 days of the date of the supplemental agreement; (2) 20% of the consideration (i.e. RMB128,000,000) within 180 days of the date of the supplemental agreement; and (3) 70% of the consideration (i.e. RMB448,000,000) within 360 days of the date of the supplemental agreement.

The proposed action plans of the Company to address each of the disclaimed items under the disclaimer of opinion are set out as follows:

***(i) Material uncertainty related to going concern***

As disclosed above, the Company has requested to drawdown the Shareholder's Loan, which has already been advanced by the Major Shareholder to the Company in full as at the date of this announcement.

In addition, the consideration that may be received from the Potential Disposal (in the event the Potential Disposal materialises) and the Supplemental Agreement to Licensing Agreement may significantly enhance the working capital of the Group. As such, the Board and the Audit Committee are of the views that the disclaimer of opinion in relation to material uncertainty related to going concern will not be carried forward in FY2020.

### *(ii) Share of loss of associates and investment in associates*

In the event the Potential Disposal materialises, the Group may recover its investment in Ningbo Joint Venture through the disposal of its equity interest and the Group will cease to have any equity interest in Ningbo Joint Venture. As such, the Board and the Audit Committee are of the views that the disclaimer of opinion in relation to material uncertainty related to share of loss of associates and investment in associates will not be carried forward in FY2020.

### *(iii) Equity investments at fair value through other comprehensive income*

Based on the factors listed below, the Board and the Audit Committee consider that the disclaimer of opinion relating to the equity investments at fair value through other comprehensive income will not be carried forward to the Group's financial statements for FY2020:

(a) the disclaimer of opinion relating to the Meilai Investment was merely due to the fact that the Meilai Group could not provide consolidated management accounts in March 2020 as a result of the COVID-19 epidemic in early 2020;

(b) the proven record of the timeliness of the Meilai Group to provide the consolidated management accounts in previous financial years without the effect of the COVID-19 epidemic; and

(c) without the hindrance of the COVID-19 epidemic, the Meilai Group shall be able to provide consolidated management accounts for FY2020 before the publication of the audited results of the Company for FY2020.

***(iv) Intangible assets***

As disclosed above, the Company had requested to drawdown the Shareholder's Loan, which was advanced by the Major Shareholder to the Company in full as at the date of this announcement.

In addition, the consideration that may be received from the Potential Disposal (in the event the Potential Disposal materialises) and the Supplemental Agreement to Licensing Agreement may significantly enhance the working capital of the Group. As such, the Board is of the view that the disclaimer of opinion in relation to the intangible assets will not be carried forward in FY2020.

***(v) Value-added tax receivables***

The Board and the Audit Committee consider the licensing income under the Supplemental Agreement to Licensing Agreement may generate sufficient income and respective value-added tax payable to offset the value-added tax receivables. As such, the Board and the Audit Committee are of the view that the disclaimer of opinion in relation to the value-added tax receivables will not be carried forward in FY2020.

***(vi) Prepayment to a supplier***

The basis on which the Audit Committee and the Board consider that the disclaimer of opinion relating to the Prepayment will not be carried forward to the Group's financial statements for FY2020 is summarized below:

(a) the Board will use all reasonable endeavours to continue to send out request for audit confirmation on the Prepayment to XALT when preparing for the audit of FY2020;

(b) the Company will deploy all resources to prepare documents in advance based on the request from the Auditor for the audit of the Group's financial statements for FY2020;

(c) the Board will continue to approach the new management of XALT with a view of re-activating negotiation on the recovery of the Prepayment following the change of the shareholding structure and management of XALT since 2018; and

(d) the Board will continue to explore the feasibility of other means to resolve the disagreement.

The Audit Committee and the Board are of the views that the disclaimer of opinion relating to the Prepayment should not be carried forward to the Group's financial statements for FY2020 if any of the above actions is executed on a successful basis.

## OTHER INFORMATION – IMPAIRMENT OF RIGHT-OF-USE ASSETS

**Background of the right-of-use assets**

As disclosed in the 2019 Annual Report, the Company recorded an impairment of right-of-use assets of approximately HK$23.2 million for FY2019. The right-of use assets represented the amount equal to the lease liability of the Group's office rentals for the offices of the Group located in Hong Kong and overseas, which were recognised with the adoption of newly revised HKFRS 16 – Leases for FY2019 and entered by the Group in the ordinary and usual course of business of the Group.

On the adoption of HKFRS 16, the Group recognised lease liabilities in relation to leases which had previously been classified as "operating leases" under the principles of HKAS 17 Leases and the lease liabilities were measured at the present value of the remaining lease payments, discounted using the weighted average lessee's incremental borrowing rate applied to the lease liabilities on 1 January 2019 of 4.7%. Meanwhile, the Group also recognised the right-of-use assets measured at the amount equal to the lease liability. As such, the carrying amount of the right-of-use assets under non-current assets, the lease liabilities under current liabilities and the lease liabilities under non-current liabilities were recognised by the Company at approximately HK$23.2 million, HK$13.6 million and HK$10.2 million respectively in the Unaudited Results.

As all of the applicable percentage ratios under Rule 14.07 of the Listing Rules in respect of the recognition of the right-of-use assets under the Group's lease agreements are below 5%, the recognition of the right-of-use assets does not constitute any notifiable transaction for the Company under Chapter 14 of the Listing Rules.

**Impairment on the right-of-use assets**

Pursuant to HKAS 36 – Impairment of Assets, if the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount, which represented an impairment loss. To determine the amount of the provision of impairment on the aforesaid asset, the Company determined the aforesaid asset's fair value less cost of disposal and its value in use.

As the nature of the right-of-use assets was related to several office leases, the fair value less cost of disposal was not applicable, and its recoverable amount should rely on its value in use. The value in use of the right-of-use assets shall be calculated based on the projections of cash outflows necessarily incurred to generate the cash inflows from continuing use of the asset and can be directly attributed, or allocated on a reasonable basis to the right-of-use assets.

During the preparation of the Unaudited Results, the Group did not discover any evidence indicating the existence of any material physical damage in the offices, which would require additional costs for the Group's usage of the offices during the leasing period, or the rent currently paid by the Group was higher than the market value. As such, there was no indication of impairment on the right-of-use assets of the Company.

During the stage of finalising the Audited Results, the Auditor raised its concerns in relation to the material uncertainty about the Group's ability to continue as going concern. Under such assumption, there is an indication for impairment on the right-of-use assets of the Company as a result of uncertainties on the projections of cash outflows necessarily incurred to generate the cash inflows.

As disclosed in the 2019 Annual Report, the Auditor was unable to obtain sufficient and appropriate audit evidence to satisfy itself that an estimate of the future cash flows the Group was expected to derive from the right-of-use assets in the calculation of its value in use. Taking into account of the above and for prudence sake at the material time, the Company has provided the impairment in full for the right-of-use assets.

***Audit Committee's and the Board's view on the Auditor's assessment on the impairment of the right-of-use assets***

The Audit Committee and the Board understood the Auditor's assessment on the impairment of the right-of-use assets was based on the assumption that the Group would not have sufficient working capital for the right-of-use assets to generate sufficient cash inflow, as there is a material uncertainty on the Group's ability to continue as going concern. Taking into account of the above and the factors discussed under the section headed "VIEWS OF MANAGEMENT AND AUDIT COMMITTEE ON AUDIT QUALIFICATIONS – 1. Material uncertainty related to going concern" above, the Audit Committee and the Board agreed with the Auditor's assessment on the impairment of the right-of-use assets.

By order of the Board
**Hybrid Kinetic Group Limited**
**Yeung Yung**
*Chairman*

Hong Kong, 4 September 2020

*As at the date of this announcement, the Board comprises nine executive Directors, namely Dr Yeung Yung (Chairman), Mr Feng Rui (Chief Executive Officer), Dr Huang Chunhua (Deputy Chairman), Dr Wang Chuantao (Deputy Chairman), Mr Liu Stephen Quan, Dr Zhu Shengliang, Mr Li Zhengshan, Mr Ting Kwok Kit, Johnny and Mr Chen Xiao, one non-executive Director, namely Dr Xia Tingkang, Tim and five independent non-executive Directors, namely Dr Zhu Guobin, Mr Cheng Tat Wa, Dr Li Jianyong, Mr Chan Sin Hang and Mr Lee Cheung Yuet Horace.*

* *For identification purposes only*