润东汽车

China Rundong Auto Group Limited
中國潤東汽車集團有限公司
(Incorporated in the Cayman Islands with limited liability)
(Stock code: 1365)

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

Reference is made to (i) the announcement (the "**Unaudited Annual Results Announcement**") of China Rundong Auto Group Limited (the "**Company**", together with its subsidiaries, the "**Group**") dated 31 March 2020 in relation to the unaudited annual results of the Group for the year ended 31 December 2019 ("**FY2019**"); (ii) the announcement of the Company dated 29 May 2020 in relation to the audited annual results of the Group for FY2019 (the "**Audited Annual Results Announcement**"); and (iii) the annual report of the Company for FY2019 (the "**Annual Report**"). Unless otherwise defined, terms used herein shall bear the same meanings as defined in the Annual Report.

In addition to the information provided in the Audited Annual Results Announcement and Annual Report, the Board would like to provide further information in relation to the following:

(A) the disclaimer of opinion (the "**Disclaimer Opinion**") expressed by the then auditor of the Company for FY2019 on the Company's financial statements for FY2019 relating to the going concern basis for the preparation of the financial statements;

(B) the impairment of prepayments, other receivables and other assets as well as impairment on goodwill, property, plant and equipment, intangible assets, trade receivables and right of use assets of RMB3,484 million in aggregate for FY2019 (the "**Impairments**"); and

(C) the differences between certain unaudited and audited financial information for FY2019 set forth in the Unaudited Annual Results Announcement and Audited Annual Results Announcement respectively.

(A) FURTHER INFORMATION RELATING TO THE DISCLAIMER OPINION

As set out in the Annual Report, the then auditor expressed the Disclaimer Opinion on the Company's financial statements for FY2019 relating to the going concern basis and considered that material uncertainties existed in the Company's plans which may cast significant doubt on the Group's ability to continue as a going concern.

In order to resolve the Disclaimer Opinion on the Group's ability to continue as a going concern, the Directors have been undertaking the following measures to improve the Group's overall liquidity, working capital and cash flow position and to mitigate its liquidity pressure:

(i) negotiating with financial institutions and other lenders to seek for extension of due dates of bank and other loans on a continuing basis;

(ii) seeking to implement a consensual resolution of the terms of repayments with creditors on a continuing basis;

(iii) seeking to obtain additional new sources of financing and new strategic capital investments; and

(iv) carrying out the Group's business strategy plans and cost control measures.

Set out below are the further details of the aforementioned measures adopted by the Company.

Detailed Action Plan by the Company to Resolve the Disclaimer Opinion

(i) Negotiating with financial institutions and other lenders to seek for extension of due dates of bank and other loans

As set forth in the 2020 interim report of the Company, as at 30 June 2020, certain borrowings of the Group of RMB2,250,936,000 were overdue and not paid in accordance with the repayment schedules pursuant to the borrowing agreements (the "**Overdue Loans**"), and the non-current portion of these borrowings of RMB265,720,000 have been reclassified as current liabilities. As stipulated in the relevant loan and financing agreements in respect of certain borrowings of the Group other than those mentioned above, any default of the Group's borrowings may result in cross-default of these borrowings. As a result of such default events, the borrowings of RMB184,322,000 was considered as cross default and had been classified as current liabilities as at 30 June 2020.

The Company has been taking steps to negotiate with the banks and financial institutions to seek for extension of due dates for the Overdue Loans, and will use its best endeavours to negotiate with the banks and financial institutions to seek for extension of due dates on a continuing basis.

As at the date of this announcement, the Group has entered into extension agreements with four financial institutions to extend the repayment date of loans in the aggregate principal amount of RMB210,000,000 to October 2020, December 2020, July 2021 and November 2021 respectively. As at 30 June 2020, several banks and financial institutions had demanded repayment for the overdue principal of borrowings through commencing legal proceedings.

Provision has been made to the consolidated financial statements to accrue for any potential interest or other penalties that may arise.

(ii) Seeking to implement a consensual resolution of the terms of repayments with creditors

The Company will also use its best endeavours to negotiate with creditors on a continuing basis to reach a consensual resolution of repayments terms. As of the date of this announcement, the Group has reached consensual resolutions with some of the creditors, including but not limited to (i) varying the payment terms such as delaying or extending the payment date or payment by instalment; (ii) setting off the overdue balance by inventory, sometimes with discount or allowance on the overdue balance and (iii) setting off the overdue balance with rebate receivables.

(iii) Seeking to obtain additional new sources of financing and new strategic capital investments

The Company has been actively exploring various sources of financing, including but not limited to debt financing/bank borrowings and equity financing to raise additional fund.

(1) Debt financing/bank borrowings

In respect of debt financing, the Company has approached several commercial banks and financial institutions to seek new banking facilities and/or term loans. As of the date of this announcement, the Company is still in negotiation with all of these banks and financial institutions to obtain financing terms acceptable to the Company. No legally binding agreement has been entered into with any of these banks and financial institutions yet.

(2) Equity financing

In respect of equity financing, the Company plans to seek investment from independent investor(s) in the form of strategic business collaboration and/or capital investment into the Company (which may take in the form of possible issuance of new securities of the Company). As at the date of this announcement, no memorandum of understanding, arrangement or legally binding agreement has been entered into with any potential independent investor(s).

*(iv) **Carrying out business strategy plans and cost control measures***

In order to improve financial performance and operating efficiency, the Group has implemented the following income-generating and cost control measures during the year:

(1) Business Strategy Plans

Set out below are the details of the Company's business strategy plans in implementation:

(a) Streamline and consolidation of stores and realignment of brand portfolio

The Group has been rolling out the business optimisation plan since the second half of 2019 after evaluating the overall automobile market challenge, operating performance and available financial resources of the Group. In doing so, the Group has reassessed the economic development level, power of consumption of the areas where the stores are located, as well as taken into consideration of the automobile brands, operation scale of stores and operation capability. It is the Group's business strategy to gradually shut down stores with poor performance and consolidate stores of same brand in the same city, with a view to reducing operating costs and losses, and enhancing the Group's overall competitiveness, profitability and liquidity. As part of the business optimisation plan, the number of stores was reduced from 85 as of 30 June 2019 to 38 as of 31 December 2019 and to 8 as of 30 June 2020.

As at 30 June 2020, the Group operated eight stores in total, and the Group's brand portfolio includes seven brands, namely BMW, Lexus, FAW-Volkswagen, Shanghai-Volkswagen, Dongfeng Honda, Nissan and FAW-Toyota.

The management of the Group will carry out regular review of its brand portfolio, operation scale of regional business, operation performance of individual stores, so as to optimise the overall operating structure of the Group and achieve the most optimal use of resources. The Directors expect that the plan will help to reduce operating costs and losses. The optimisation plan aims to cease under-performing or loss-making stores with a view to enhancing the Group's overall operating efficiency and performance. The Group will maintain its business with a sufficient level of operations and assets of sufficient value to support its operations to warrant its continued listing.

(b) Revitalisation and optimisation of asset utilisation

Due to the Group's business optimisation plan leading to streamline of the overall operation scale as set forth above, the Group currently has certain self-owned or rented exhibition halls and parking lots remaining idle and unused. In order to further revitalise assets and optimise asset utilisation, the Group has been leasing and will continue to lease unused exhibition halls and parking lots to other independent third party vehicle dealers on a short-term basis. Moreover, the Company also plans to rent out upper floors of these exhibition halls to other independent third parties for office or storages uses on a short-term basis.

As of 30 June 2020, the Group had entered into lease agreements in respect of properties which generate a rental income of approximately RMB31.7 million. It is the Group's plan to continue to rent out the remaining idle properties on a short-term basis during the year. Given the Group's stores location in central areas where the vehicle dealers are based on, the Group expects to achieve satisfactory utilisation rate of its idle properties and generate a stable income and cash flow therefrom.

(c) Exploring strategic business collaboration

The Company actively seeks for strategic business collaboration opportunities with new business partners in order to broaden its source of income and generate new operating income.

On 31 August 2020, Rundong Automobile Group Co., Ltd. ("**Rundong Automobile**"), a wholly-owned subsidiary of the Company, entered into an agreement of intent for joint operation (the "**Agreement of Intent**") with Shanghai Lanhai Automobile Development Co., Ltd. (the "**Business Partner**") in relation to the proposed business cooperation to the joint operation and management of certain 4S dealership stores (the "**Joint Operation**"). The Directors consider that the Joint Operation will provide an opportunity to the Group for better utilisation of its existing operational resources and expansion of its business activities for additional sources of incomes through joint operation of 4S dealership stores. Pursuant to the Agreement of Intent, the parties shall further negotiate and enter into a formal agreement in respect of, among others, the term of cooperation, the profit and loss sharing mechanism, the operational decision-making, staff arrangement, provision of ancillary resources and liabilities for breach, etc. As of the date of this announcement, no formal agreement has been entered into with the Business Partner. For further details of the Joint Operation, please refer to the announcement of the Company dated 31 August 2020.

(d) Negotiating with vendors on the wholesale target to maintain vendor rebate

Amidst the impact brought by the COVID-19 epidemic, the Group has taken steps to negotiate with vendors of various core automobile brands to downward adjust the pre-set wholesale target in order to maintain its entitlement to vendor rebate at a stable level, thereby alleviating the working capital pressure of the stores. The Company has begun negotiations with several automobile manufacturers. Among which, one automobile manufacturer has agreed to reduce the wholesale target to 90% of the original one, whilst another automobile manufacturer has agreed to adjust the wholesales assessment from monthly to bi-monthly, and negotiations with other manufacturers are still ongoing.

(2) Cost Control Measures

As set forth in the Annual Report, the Group is committed to optimising the organisation structure and employee head-counts and tightening cost controls over the daily administrative and other operating expenses, aiming at improving the working capital and cash flow position of the Group.

Since the beginning of 2020, the Company has been taking measures to streamline its organisational structure, flatten management structure and improve management efficiency. The Group has adopted brand management model in replacement of regional management model, whereby a brand management department is newly established in the Group level to directly manage all core brands and handle under-performing stores. As such, the Group manages to streamline the organisation by reducing middle-management layers and simplify the business procedures. The Group is confident that the new measures could improve management efficiency while saving staff costs.

With the aforementioned cost control measures implemented, the Group has reduced its number of employees from 5,351 as of 31 December 2019 to 2,751 as of 30 June 2020. The total staff costs of the Group amounted to RMB89.9 million for the six months ended 30 June 2020, representing a decrease of approximately 44.7% from RMB162.4 million for the same period in 2019.

Management' assessment on resolving the Disclaimer Opinion

Based on the Company's internal projection and forecast, for the year ending 31 December 2020, assuming all the plans or measures in the paragraph headed "Detailed Action Plan by the Company to Resolve the Disclaimer Opinion" can be completed as planned and after given considerations to (i) the anticipated improved performance and cash flow from operations upon implementation of income-generating and cost control measures and (ii) available financial resources in terms of both new and extended sources of finance, and having reviewed the

Group's business strategy plans and cash flow projections for the year ending 31 December 2020, the Directors believe that the Group will have sufficient liquidity to finance its operations for the next twelve months from 31 December 2019 and therefore expect that the Group would be able to continue as a going concern basis for the year of 2020.

The management's assessment of the Company's ability to continue as a going concern as at 31 December 2020 would need to take into consideration the outcome of the mitigating action plans, the prevailing conditions and circumstances, and cash flow projections up to 31 December 2020.

Should the Group fail to achieve the abovementioned plans and measures, it might not be able to continue as a going concern, and should the going concern assumption be inappropriate, adjustments may have to be made to write down the values of assets to their recoverable amounts, to provide for any further liabilities that might arise, and to reclassify non-current assets and non-current liabilities as current assets and current liabilities, respectively. The effects of these adjustments have not been reflected in the consolidated financial statements of the Annual Report.

(B) FURTHER INFORMATION RELATING TO THE IMPAIRMENTS

(i) Factors, events and circumstances leading to the Impairments

The Group has, over the years, acquired a total of 34 entities which are mainly 4S dealership stores. The Group had been undertaking its post-acquisition integration with these acquired entities but the aftermath synergies and combined results were not crystalised as per the Group's expectation, mainly due to, among others, the realignment in the overall organisation structure, transitional changes of key management and staff relocation. In addition, the increase in total financing amount arising from the acquired entities also contributed to the increase in the Group's financial costs.

In view of the overall declining growth in the automobile industry, and the Group's post acquisition integration did not crystalise as per the Group's expectation, the Group assessed and made assets impairment in the financial years ended 31 December 2018 and 2019, respectively. As disclosed in the 2018 annual report of the Company, the Group recorded assets impairment charge of RMB489 million to the income statements for the year ended 31 December 2018, based on the Company's annual impairment assessment for goodwill associated with the acquisition of dealerships stores. For FY2019, the Group carried out business optimisation plan, the realignment of automotive brands and internal organisation structure restructuring etc. The Group's business strategy has expedited closure of dealership stores during the year, which attributed to the increase in assets impairment charges to RMB3,484 million to the income statements for FY2019, upon the Company's annual impairment assessment for FY2019.

In addition, with the outbreak of the COVID-19 epidemic in early 2020, the management has incorporated the estimated effect of COVID-19 assessment into the Group's profit and cash flow forecast for the year ending 31 December 2020, coupled with the Group's business optimisation plan that includes possible further cessation of certain operating dealership stores in the financial year of 2020. All the above factors have contributed to further impairment being made in FY2019.

(ii) Overview of the Impairments and Methods, Basis and Key Assumptions of Impairment Assessments

According to the Annual Report, the Company recorded the following impairment allowance of prepayments, other receivables and other assets as well as impairment on goodwill, property, plant and equipment, intangible assets, trade receivables and right of use assets for FY2019:

	Impairment in FY2019 *(RMB'000)*	***Notes***
Non-current assets		
Goodwill	869,107	*1*
Intangible assets	449,986	*2*
Property, plant and equipment	761,933	*3*
Right of Use	84,260	*3*
Current assets		
Trade receivables	99,384	*4*
Prepayments, other receivables and other assets	1,220,032	*4*
Total	3,484,702	

Notes:

1. **Goodwill**

   The method, basis and key assumptions used in determining the amount of the impairments on goodwill are summarised below:

   The Group's goodwill balance comprised 34 acquired stores, and as at 31 December 2019, a total of 27 stores had been closed and 7 stores were of poor performance, and based on the Group's assessment, the carrying amounts of these stores exceeded its recoverable amount, and an impairment loss of approximately RMB869 million was charged to the statement of profit or loss for FY2019.

As required under the Group's accounting policies on goodwill impairment, the management is required to perform an impairment test for goodwill annually. The impairment assessment process includes management estimation, degree of subjectivity of expected future cash flow forecasts, associated growth rates and discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the recoverable amount, which is the higher of its fair value less costs to sell and its value in use of the cash-generating units ("**CGUs**") to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the CGUs and also to choose a suitable discount rate in order to calculate the present value of those cash flows. An impairment loss is recognised only if the carrying amount of the CGU or group of CGUs exceeds its recoverable amount.

Goodwill acquired through business combinations has been allocated to the respective CGUs for impairment testing.

The Company engaged the Independent Valuer (as defined below) to perform its appraisal under the value-in-use basis, and concluded value in use of CGUs for each of the 34 stores was substantially decreased to insignificant amounts. The value-in-use calculation using cash flow projections is based on financial budgets covering a five-year period approved by senior management. The growth rate used to extrapolate the cash flows of the cash-generating units beyond the five-year period from the end of the reporting period is 3% (2018: 3%) for all years. The pre-tax discount rate applied to the cash flow projections is 17.0% (2018: 15.0%).

The key assumptions used by the management in their estimation are as follows:

- *Revenue from the sale and service of motor vehicles* — the bases used to determine the future earnings from the sale and service of motor vehicles are historical sales and the growth rate of similar 4S stores of the Group over the last two years.

- *Operating expenses* — the bases used to determine the values assigned are cost of inventories, staff costs, depreciation, amortisation and other operating expenses. The values assigned to the key assumptions reflect past experience and management's commitment to maintain its operating expenses at an acceptable level.

Independent valuation

The Company has engaged TGS Nortex (the "**Independent Valuer**"), an independent valuer, to value and assess certain CGUs in connection with assessment on the impairment of goodwill as of 31 December 2019 (the "**Valuation Date**"), pursuant to the following valuation methodology and with the following key assumptions adopted:

Valuation Methodology

The Independent Valuer adopted income approach to perform value in use analysis in accordance with the requirement of Hong Kong Accounting Standard 36. The income approach focuses on the profitability of assets. The indication of estimated value of the assets is calculated as the present value of economic benefits (cash income less cash expenditure) that accrue over the useful life of the assets. Such approach includes procedures from estimating the expected pre-tax cash flows from the asset over its economic life and discount the cash flows using a discounted rate, which is the rate of return taking into account of time value of money and risk factors of investment. The sum of discounted present value of the pre-tax cash flows is the value-in-use of the assets or CGUs.

Key assumptions

The valuation is subject to the following key assumptions:

(i) CGUs will be operated to generate cash flow with an indefinite useful life;

(ii) cash flow projections of the CGUs were based on reasonable and supportable assumptions of financial forecasts that represent management's best estimate; and

(iii) there are no significant changes in tax regulations of the country in which the CGUs located.

2. Intangible assets

The method, basis and key assumptions used in determining the amount of the impairments on intangible assets are summarised below:

The Group's intangible assets balance mainly comprised dealership agreements, customer relationship and insurance licenses, arising from 34 acquired stores through business combinations, and as at 31 December 2019, a total of 27 stores had been closed and 7 stores were of poor performance. Based on the Group's assessment on the basis and key assumptions set forth below, the carrying amounts of these stores exceeded its recoverable amount, and an impairment loss of approximately RMB450 million was charged to the statement of profit or loss for FY2019.

As required under the Group's accounting policies on assets impairment, the management is required to perform an impairment test annually, if there is indication of such impairment exists at balance sheet date. The impairment assessment process includes management estimation, degree of subjectivity of expected future cash flow forecasts, associated growth rates and discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

In view of the closure and poor performance of these stores set forth above, the Group performed an impairment test to determine whether intangible assets are impaired at year end in accordance with the Group's accounting policies. This requires an estimation of the recoverable amount, which is the higher of its fair value less costs to sell and its value in use of the CGUs to which the intangible assets are assigned to. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the CGUs and to choose a suitable discount rate in order to calculate the present value of those cash flows. An impairment loss is recognised only if the carrying amount of the CGU or group of CGUs exceeds its recoverable amount.

Intangible assets acquired through business combinations have been allocated to the respective CGUs for impairment testing. Based on the management impairment testing performed under the value-in-use basis, the management concluded value in use of CGUs for each of the 34 stores was substantially decreased to insignificant amounts.

The value-in-use calculation using cash flow projections is based on financial budgets covering a five-year period approved by senior management. The growth rate used to extrapolate the cash flows of the cash-generating units beyond the five-year period from the end of the reporting period is 3% for all years. The pre-tax discount rate applied to the cash flow projections is 17.0%.

The key assumptions used by the management in their estimation are as follows:

- *Revenue from the sale and service of motor vehicles* — the bases used to determine the future earnings from the sale and service of motor vehicles are historical sales and the growth rate of similar 4S stores of the Group over the last two years.

- *Operating expenses* — the bases used to determine the values assigned are cost of inventories, staff costs, depreciation, amortisation and other operating expenses. The values assigned to the key assumptions reflect past experience and management's commitment to maintain its operating expenses at an acceptable level.

3. Property, plant and equipment ("PPE") and right of use ("ROU") assets

The Group's PPE & ROU assets balance mainly comprised buildings, leasehold improvements and operating lease assets, located in 85 stores. Based on the Group's assessment, the carrying amounts of these stores exceeded its recoverable amount, and an impairment loss of approximately RMB846 million was charged to the statement of profit or loss for FY2019. The impairment of PPE was primarily related to showroom fixtures, leasehold improvements, machinery and construction in progress, of which were related to dealership stores that had been closed or of poor performance. The impairment of ROU was mainly related to potential cancellation of lease contracts due to closure of applicable stores.

The carrying values of PPE and ROU assets amounted to approximately RMB3,275 million and RMB278 million, respectively as at 31 December 2019. Under the Group's accounting policy, these non-current assets are reviewed to see whether there are any indications of impairment at each reporting period end. An impairment test must be carried out if there are such indications. The impairment test is based on the higher of its fair value less costs to sell and its value in use of each of the CGUs or group of CGUs, to which the PPE and ROU are assigned to.

Independent valuation

In addition to the impairment test performed by the Company, the Company also made reference to the valuation on the fair value of selected buildings as of 31 December 2019 (i.e. the Valuation Date) performed by the Independent Valuer. The Independent Valuer performed valuation on the fair value of the buildings and lands held by 42 stores of the Group as of 31 December 2019, pursuant to the following valuation methodology and with the following key assumptions adopted:

Valuation Methodology

The Independent Valuer adopted market approach to assess the fair value of land and buildings of the stores. The market approach references to actual transactions, considers prices recently paid for the same or similar assets in the market, and through comparing or analyzing to determine the estimated fair value of the appraised assets.

Key Assumptions

The valuation is subject to the following key assumptions:

(i) valuation of the assets are based on their actual conditions as of the Valuation Date, and the current market price of the assets is based on the effective price in the PRC as of the Valuation Date;

(ii) the assets will be continued to be used for current purposes; and

(iii) there are no significant changes in tax regulations of the country in which the CGUs the appraised assets operate.

There are no significant changes in the value of the inputs and assumptions used in the valuation as compared to those previously adopted.

4. Trade receivables and prepayments, other receivables and other assets

The Group performed an impairment analysis by considering the probability of default of the debtors under the expected credit losses ("**ECL**") approach, including assessment of payments patterns and the situation under the COVID-19 environment, the credit worthiness subsequent to the balance sheet up to the date of 29 May 2020. Further details of ECL approach are set forth in the Note 2.4 - "Summary of Significant Accounting Policies" of the Annual Report. The assessment of impairment allowance is a management estimate as disclosed in Note 3 - "Significant Accounting Judgements and Estimates" of the Annual Report. The Group performed an impairment analysis at the end of reporting period by considering the probability of default of the debtors. The impairment reflects the probability-weighted outcome, the time value of money and reasonable and supportable information that is available at the reporting date about the debtor and past events, management's assessment on current conditions, COVID-19 environment and forecasts of future economic conditions.

For trade receivables, the Group applies the simplified approach to provide for expected credit losses prescribed by Hong Kong Financial Reporting Standard 9, which permits the use of the lifetime expected loss provision for all trade receivables. To measure the expected credit losses, trade receivables have been grouped based on the days past due with shared credit risk characteristics.

Set out below is the information about the credit risk exposure on the Group's trade receivables assessed by the management using a provision matrix:

As at 31 December 2019

		Past due		
	Current	**Less than 3 months**	**3 to 12 months**	**Total**
Expected credit loss rate	0%	3%	100%	47.4%
Gross carrying amount *(RMB'000)*	70,149	41,044	98,152	209,345
Expected credit losses *(RMB'000)*	–	1,232	98,152	99,384

The Group performed an impairment analysis at the end of reporting period by considering the probability of default of the debtors. The management estimated that the probability of default is minimal for debtors other than defaulted receivables. Defaulted receivables refer to trade receivables for which the balances are overdue with age more than three months and the counterparties failed to make the demanded repayments. The Group has provided for 100% of the defaulted receivables at the end of the reporting period. The average expected credit loss rate was 47.4% as at 31 December 2019.

Per the Group's accounting policy, the Group has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment. The provision rates are based on the ageing of groupings of various customer segments with similar loss patterns. The calculation reflects the probability-weighted outcome, the time value of money and reasonable and supportable information that is available at the reporting date about the debtor and past events, management's assessment on current conditions, COVID-19 environment and forecasts of future economic conditions.

Based on the abovementioned analysis, the Board and the Audit Committee are of the view that the Impairments are fair and reasonable on the following grounds:

(a) the Impairments are made in accordance with the applicable Hong Kong Financial Reporting Standards and the Group's accounting policies on assets impairment; and

(b) the Impairments are in line with the prevailing market conditions and reflects more truly and fairly the actual status and financial position of the Company for FY2019.

(iii) Details of the nature of the prepayments, other receivables and other assets

Set out below are the details of the nature of the prepayments, other receivables and other assets as at 31 December 2019:

Overview of the prepayments, other receivables and other assets

	As at 31 December 2019			
	Balance *(RMB'000)*	**Impairment** *(RMB'000)*	**Net** *(RMB'000)*	*Notes*
Prepayment to suppliers	792,487	–	792,487	*1*
Rebate receivables	85,092	–	85,092	*2*
Consideration receivable	54,419	(54,419)	–	*3*
VAT recoverable	18,392	–	18,392	*4*
Prepaid expenses	4,006	–	4,006	*5*
Other assets	126,062	(126,062)	–	*6*
Other receivables	1,141,734	(1,141,734)	–	*7*
Total	2,222,192	(1,322,215)	899,977	

Notes:

1. Prepayment to suppliers comprised the prepayment and deposits for vehicle purchase, which are interest-free with no fixed repayment terms.

2. Rebate receivables represent the accruals of vendor rebate at the end of each reporting period in accordance with the applicable terms and conditions of the suppliers' agreements. Rebate receivables are interest-free with no fixed repayment terms and are settled by deducting the rebate amounts from the purchase price payable by the Company for subsequent vehicle purchases.

3. In May 2018, the Group entered into equity transfer agreements with three independent third parties (the "**Former Purchasers**") respectively to dispose of three subsidiaries of the Group in the PRC ("**Disposed Subsidiaries**") with a total consideration of RMB255,000,000. Pursuant to the equity transfer agreements, the Former Purchasers shall pay the remaining purchase price within ten business days after the date on which any one of the following conditions having been satisfied (whichever is earlier) (the "**Closing Conditions**"):

   (a) the expiration of the 12-month period from the date on which the audited closing results are confirmed by the parties; and

   (b) the relevant automobile manufacturer(s) have approved the equity transfer and the transfer of the equity interest and ownership has been registered with the relevant governmental authority.

   The Former Purchasers shall pay the remaining purchase price after adjustment by net asset value/liabilities position of the Disposed Subsidiaries upon closing.

   As at 31 December 2019, RMB200,581,000 of the total consideration was received, while the remaining balance of RMB54,419,000 was not settled as stipulated under the terms of agreement, which is largely due to disputes between the parties on the contractual performance including that the parties have yet to agree upon the satisfaction or waiver of the Closing Conditions to the disposals. Although the Company has transferred the operation and management rights of the Disposed Subsidiaries to the Former Purchasers, the Former Purchasers alleged that they have difficulties to complete the legal transfer of certain assets owned by the Disposed Subsidiaries, as the Company has pledged certain land use rights and buildings owned by the Disposed Subsidiaries for guaranteeing the Company's bank loans prior to the disposal. The Company has been in close negotiation with the Former Purchasers and used its best endeavours to resolve and reach a settlement on good faith, but in view of the current situation under COVID-19 situation that the credit risk is increasingly significant at the counter parties, and based on the management's assessment, the eventual recoverability of these receivables would be in doubt and loss rate was estimated to be fully impaired.

4. The Company's sales of motor vehicles are subject to the Mainland China Value Added Tax ("**VAT**"). Input VAT on purchases can be deducted from output VAT payable. The VAT recoverable is the net difference between output and deductible input VAT, which is interest-free with no fixed repayment terms and is settled by deducting the output amounts by subsequent vehicle sales.

5. Prepaid expense represents mainly insurance expenses that the Company prepaid for certain motor vehicles in fixed assets, which are interest-free with no fixed repayment terms.

6. Other assets represent a variety of other receivables, mainly comprising deposits for advertising activities, deposits for operation leasing facilities, insurance and other miscellaneous amounts. In view of the closure of stores and downsizing of non-strategical stores as part of the internal reorganization effort undertaken by the Group during the financial year and subsequent to balance sheet date, of which led to early termination of these leasing agreements, and the deposits associated with these agreements were therefore to be forfeited and not to be refundable as stipulated under the applicable terms of the agreements. While the management will endeavor to negotiate with the respective parties for a possible refund, in view of the current situation under COVID-19 situation that the credit risk is increasing significant at the counter parties, and based on the management's assessment, the eventual recoverability of these receivables would be in doubt and loss rate was estimated to be fully impaired.

7. Other receivables (the "**Other Receivables**") mainly comprised the receivables from former shareholders (being the sellers) of certain entities acquired by the Group in an aggregate amount of approximately RMB950 million, with the remaining balances represented other receivables from independent third parties. Please see below paragraph headed "Details on Other Receivables" for further details.

Details on Other Receivables

The breakdown of Other Receivables is set forth as below, which were overdue and no subsequent payment was made by these third parties as of 29 May 2020. According to the management's assessment, in view of the current situation under COVID-19 situation that the credit risk is increasing significant at the counter parties, the eventual recoverability of these receivables would be in doubt and loss rate was estimated to be fully impaired.

	As at 31 December 2019 *(RMB'000)*	*Note*
(i) Amount due from the former shareholders of Huawei Auto Entities (as defined below)	943,905	*(a)*
(ii) Other receivables from independent third parties	46,177	*(b)*
(iii) Receivables from a Disposed Subsidiary	85,850	*(c)*
(iv) Receivables from a Disposed Subsidiary	60,920	*(c)*
(v) Others	4,882	*(d)*
Subtotal	1,141,734	

Notes:

(a) The balance represents receivable arose from the acquisition of Yangzhou Huawei Automobile Investment Management Company Limited and its subsidiaries (collectively referred to as "**Huawei Auto Entities**") as set out in the announcement of the Company dated 20 October 2016, of which it represents the amount due from the former shareholders (as sellers) of Huawei Auto Entities prior to acquisition. The receivable amount is interest free with no fixed terms of repayment and secured by pledge of buildings and land use rights.

At the time of the acquisition, the Company obtained a pledge of certain land use rights and buildings (which mainly comprises commercial buildings and lands for residential use) (the "**Pledged Huawei Auto Lands**") from the former shareholders of Huawei Auto Entities to secure for its receivable balances. At the relevant time, part of the Pledged Huawei Auto Lands are pledged by the former shareholders of Huawei Auto Entities for bank loans of Huawei Auto Entities prior to acquisition by the Company, where the bank agreed to release such pledges upon the settlement of loan amounts.

In assessing the estimated value of the Pledged Huawei Auto Lands, the management performed internal key assessments as follows: (i) made an initial consultation to the local appraisal company to understand the preliminary value of the Pledged Huawei Auto Lands; (ii) conducted internet searches on property sales websites and made reference to the market price of the recent sales of properties with similar size and nature in proximity; and (iii) carried out site visits in the course of due diligence; and (iv) made reference to the pledges of the commercial banks for the usual loan-to-value ratio. At the relevant time, the management considered that one of the Pledged Huawei Auto Lands, being a 20-acre residential-use land primely located at the city center of Yangzhou, Jiangsu Province adjacent to school district, had substantial development potentials and future appreciation in land value, and would generate high capital gains and/or annual yields returns if it could be developed into a real estate project over a short period of time. In addition, the management assessed from the publicly available information that the former shareholders of Huawei Auto Entities, at the relevant time, were considered as reputable businessmen with other substantial hotel and trading businesses with sufficient repayment capabilities with their own financial resources. Based on the value of the Pledged Huawei Auto Lands, the development potentials of one of the prime lands, and the substantial personal financial resources of the former shareholders of Huawei Auto Entities having sufficient repayment capabilities at the time of the acquisition, the Directors considered that the recoverability of amount due from the former shareholders of Huawei Auto Entities was reasonable, commercially justifiable and secured at the time of the acquisition.

During the COVID-19 situation, and in light of the overall decline in market demand of China automobile industry and the adverse impacts on the operation, the Company encountered tight working capital constraints that resulted in its failure to timely settle loan interests in respect of those bank loans obtained by Huawei Auto Entities on due dates. Under such circumstance, the banks could not release the pledges on such part of the Pledged Huawei Auto Lands, that hindered the Company to register its pledge over such part of the Pledged Huawei Auto Lands at the local real estate registration bureau. Notwithstanding that the amount due from the former shareholders of Huawei Auto Entities was secured by the pledge, the management assessed that the Company's rights amongst the creditors of Huawei Auto Entities would be at a lower priority ranking than that of commercial banks. In additions, during FY2019, these former shareholders of Huawei Auto Entities have been sued by their creditors and/or associated in a number of lawsuits, which resulted some of their properties to be seized or frozen under the court enforcement. Moreover, the Pledged Huawei Auto Lands are of large in size, which also limit capable buyers and/or restrict the potential buyers to crystalise the disposal of the Pledged Huawei Auto Lands.

(b) The balance represents a loan advanced to a Group's customer and its subsidiaries (collectively referred to as "**Former Customer**") by the Company in 2018. The Former Customer was a customer of the Company with long-term business relationship and good track record. In 2018, the Former Customer entered into a loan agreement with the Company, pursuant to which the Company advanced a loan in the principal amount of RMB46.177 million for a term of 12 months which carried an interest of 8% per annum.

(c) The balances represent the amounts due from two of the Disposed Subsidiaries and their respective subsidiaries (as the case may be) to the Company prior to the disposal. Each of these two Disposed Subsidiaries is a former subsidiary disposed of by the Company to the Former Purchasers in May 2018. Please refer to note 3 to the sub-paragraph headed "Details of the nature of the prepayments, other receivable and other assets" above for further details of the disposals.

(d) The balance represents receivable arose from the acquisition by the Group of several companies in the PRC which have become subsidiaries of the Company (collectively referred to as "**Acquired Subsidiaries**") in the year of 2017, of which it represents the amount due from the former shareholders (as sellers) to the Acquired Subsidiaries ("**Former Sellers**") prior to acquisition. There is no securities or collateral to secure such amount.

(iv) Basis for the doubt of the management over the recoverability of Other Receivables

With respect to the impairment of Other Receivables, set forth below are the main basis for the doubt of the management over its recoverability:

1. as affected by the overall decline in automobile market and the impact of the COVID-19 epidemic, according to the management's assessment, these debtors have limited solvency and the management considered the chance of recovery of such other receivables to be remote, the credit risk has increased significantly, and the loss rate was estimated to be 100% with the balances fully impaired; and/or

2. there are disputes between the debtors and the Group over the performance of the contract, or certain debtors are still acting as guarantors of certain loans obtained by the Company, and according to the management's assessment, the Company considered the chance of recovery of such other receivables in the near future is remote.

Notwithstanding the impairment losses with respect to the Other Receivables have been fully provided in the financial statements, the management of the Company will continue to maintain close communication with debtors and assess and evaluate their repayment ability, in order to determine whether to take future actions or non-actions. The decision will be dependent on a few parameters and consideration, including but not limited to, the overall cost benefit analysis, whether the expected recovery amount would outweigh the associated professional costs and expenses to be incurred, the assessment of final outcome (i.e. likelihood of recoverability from particular debtors), the estimated duration to recover the overdue receivables and any potential implication to the Group's reputation and adverse publicity in the process.

With respect to Other Receivables that the management considers to be in the interest of the Company to take action after balancing the aforementioned factors, the Company will utilise all appropriate and feasible actions and use its best endeavours to recover Other Receivables to the extent possible and within a reasonable period of time, including to establish a committee working group to follow up on the payment collection from these debtors and to negotiate and settle with these debtors on good faith with a view to recover other receivables to the extent possible.

The Company will assess the development and action plan from time to time and issue further announcement(s) as and when appropriate on any major developments as required under the Listing Rules.

(C) FURTHER INFORMATION RELATING TO THE DIFFERENCES BETWEEN CERTAIN AUDITED AND UNAUDITED FINANCIAL INFORMATION FOR FY2019

Set forth below is a comparison table illustrating the differences between certain unaudited and audited financial information for FY2019 set forth in the Unaudited Annual Results Announcement and Audited Annual Results Announcement respectively and the explanation of such difference therein:

	Year ended 31 December 2019			
	Disclosure in the Audited Annual Results Announcement	**Disclosure in the Unaudited Annual Announcement**	**Difference**	*Notes*
	RMB'000	*RMB'000*	*RMB'000*	
CONSOLIDATED STATEMENT OF PROFIT OR LOSS				
Cost of sales	(8,667,565)	(8,632,237)	(35,328)	*1,8*
Administrative expenses	(759,341)	(677,513)	(81,828)	*1,8*
Other expenses	(3,550,601)	(3,175,895)	(374,706)	*2,3,8,9*
Finance costs	(353,920)	(350,225)	(3,695)	*4,8*
CONSOLIDATED STATEMENT OF FINANCIAL POSTION				
Current Assets				
Trade receivables	109,961	214,059	(104,098)	*2,3,8,9*
Prepayments, other receivables and other assets	899,977	1,415,616	(515,639)	*1,2,3,5,8,9*
Pledged bank deposits	73,188	76,188	(3,000)	*6,10*
Non-current Liabilities				
Interest-bearing bank and other borrowings	299,215	621,269	(322,054)	*7,11*
Current Liabilities				
Trade and bills payables	408,085	399,098	8,987	*1,8*
Other payables and accruals	3,279,177	3,402,344	(123,167)	*4,5,8*
Interest-bearing bank and other borrowings	3,848,140	3,529,086	319,054	*6,7,10,11*

Notes:

1. The adjustment was related to timing difference arose with respect to the reconciliations of balances with confirmations of suppliers, subsequent to 31 March 2020 and up to the date of the announcement of 29 May 2020. The cumulative effect was adjusted to the accounts of rebates receivables and prepayments of approximately RMB35,328,000 and RMB81,828,000, respectively, which resulted in the decrease of prepayments, other receivables and other assets, and the corresponding increase in the accounts of cost of sales and administrative expenses.

2. The adjustment was related to timing difference arose from provision with respect to the reconciliations of balances with confirmations of suppliers for recharge of promotion and miscellaneous expenses of approximately RMB4,714,000, that resulted in the increase in the accounts of other expenses, and the corresponding decrease in the accounts of receivables.

3. The adjustment was related to the impairment under the ECL approach with respect to other receivables, prepayments and other current assets of approximately RMB369,992,000 based on more prudent judgements and estimation, upon the subsequent review period from 31 March 2020 and up to 29 May 2020.

4. The adjustment was related to the under-accruals of finance costs of approximately RMB3,695,000 arising from confirmations of creditors, and the corresponding increase in other payables and accruals.

5. The adjustment was related to the gross-up amount per confirmations of certain other receivables and other payables of approximately RMB126,862,000, which were offset in the accounts of prepayments, other receivables and other assets, and other payables and accruals.

6. The adjustment was related to the reconciliations arising from confirmations of banks, which confirmed that the pledged bank deposits of approximately RMB3,000,000 had been deducted for the repayment of bank borrowings, that resulted in the decrease in pledge deposit and bank borrowings respectively.

7. The adjustment was related to the reclassification of long-term portion of bank borrowings of approximately RMB322,054,000 which was overdue and classified into the short-term portion of bank borrowings.

8. The Company recorded the relevant amounts in the first place by accruing the best estimated amounts according to the stipulated terms of contracts. Due to the internal reorganisation involving change in position, staff internal transfer of the Group's finance staff as a result of the Group's cost control initiatives and closure of stores, the year-end annual reconciliation was interrupted and could not be completed in January 2020. Such work was further delayed due to intervening Chinese New Year holidays and impact of the COVID-19 outbreak. The reconciliation process progressed in April when the suppliers, creditors and banks gradually resumed work and that the Group finally obtained their reconciliation results to finalize the balance by end of April/early May 2020, which was after the date of the Unaudited Annual Result Announcement.

9. The Company recorded the amounts in the first place by management estimation and assessment as at 31 December 2020. The additional provision was due to more prudent judgements and estimation under the COVID-19 situation, upon the subsequent review period from 31 March 2020 and up to 29 May 2020.

10. The Company recorded the amounts in the first place by reference to the actual amounts in respective accounts. Due to certain loans and borrowings owed by the Group to certain banks and creditors being overdue and remained outstanding as of 29 May 2020, certain banks have forfeited the Group's pledged deposit for repayment of the bank borrowings.

11. The Company recorded the amounts in the first place according to repayment due dates as stipulated under the terms of loan contracts. In view of the several banks and financial institutions had demanded repayment for the overdue loans through commencing legal proceedings, the borrowings portions of RMB322,054,000 were considered as cross-defaulted and classified into the short-term portion accordingly.

The above additional information does not affect other information contained in the Annual Report or the Audited Annual Results Announcement. Save as disclosed in this announcement, the remaining contents of the Annual Report and the Audited Annual Results Announcement remain unchanged.

By Order of the Board
China Rundong Auto Group Limited
Yang Peng
Chairman

Shanghai, the People's Republic of China, 3 November 2020

As at the date of this announcement, the executive Director is Mr. Yang Peng; and the independent non-executive Directors are Mr. Mei Jianping, Mr. Lee Conway Kong Wai, Mr. Xiao Zhengsan and Mr. Li Xin.