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CHINA TAIFENG BEDDINGS HOLDINGS LIMITED
中國泰豐床品控股有限公司

(incorporated in the Cayman Islands with limited liability)

(Stock Code: 873)

**UPDATE ON INVESTIGATIONS MADE BY
THE SPECIAL INVESTIGATION COMMITTEE
– REPORT BY PRC LEGAL ADVISOR**

Reference is made to the announcements by China Taifeng Beddings Holdings Limited (the “**Company**”, together with its subsidiaries, the “**Group**”) dated 25 June 2015, 19 July 2015, 28 October 2015, 5 February 2016, 18 May 2016, 27 June 2016, 29 September 2016, 22 November 2016 and 29 May 2017 (collectively the “**Announcements**”) in relation to, among others, the Audit Issues raised by BTHK and progress of the investigations made by the Special Investigation Committee. Unless otherwise defined, terms used herein shall have the same meanings as in the Announcements.

BACKGROUND LEADING TO THE REPORT OF THE PRC LEGAL ADVISOR

On 25 June 2015, BTHK, the then auditors of the Group tendered its resignation and in its resignation letter raised issues of concern leading to the delay in the publication of the annual results of the Company for the year ended 31 December 2014 (the “**Audit Issues**”). The Audit Issues raised by BTHK include: (i) the reasonableness and rational of the lump sum payment of RMB649 million paid by the Group to existing and/or previous distributors in respect of the Group’s channel restructuring plan during 2014; (ii) the recognition of certain sales and corresponding trade receivables in 2014; and (iii) the value of certain provisions and guarantees. Details of the Audit Issues are more specifically set out in the announcements by the Company dated 25 June 2015 and 19 July 2015, respectively.

The Company established the Special Investigation Committee, which comprises of all of the three then independent non-executive directors of the Company. As stated in the announcement made by the Company dated 25 June 2015, the terms of reference of the Special Investigation Committee is to investigate the Audit Issues. With the changes to the Board since then, the Special Investigation Committee now comprises of Dr. Cheung Wai Bun, Charles, Mr. Li Yuchun and Mr. Dai Shunlin, all of whom are independent non-executive Directors.

On 28 October 2015, the Company engaged FTI Consulting (Hong Kong) Limited (“**FTI**”) as the independent forensic specialist in fulfillment of one of the resumption conditions (“**Resumption Conditions**”) mentioned in the announcement made by the Company dated 7 August 2015. In fulfilling the resumption conditions, the Company has also on 28 October 2015 engaged Elite Partners Risk Advisory Services Limited as internal control advisor to conduct a thorough review of the internal control systems of the Company.

The summary of the major findings of FTI as contained in the draft forensic investigation report is set out in the announcement made by the Company dated 22 November 2016. Since the draft forensic investigation report has not provide any conclusion and set out a number of unresolved issues, the Special Investigation Committee has been actively pursuing the management of the Company to resolve the findings and deficiencies in the Company’s internal policies as identified by FTI.

On 29 May 2017, the Special Investigation Committee appointed the PRC Legal Advisor to assist to follow up on the current situation of the Company, and to further investigate the Audit Issues and findings of FTI in its draft forensic investigation report.

On 31 October 2017, the PRC Legal Advisor issued its report (the “**Report**”).

REPORT OF THE PRC LEGAL ADVISOR

Scope of work of the PRC Legal Advisor

The scope of work of the PRC Legal Advisor has been set out in the paragraph headed “Appointment of PRC Legal Advisor” in the announcement made by the Company dated 29 May 2017.

Limitation on the work of the PRC Legal Advisor

As mentioned in the Report, the investigation of the PRC Legal Advisor is subject to the following limitations:

1. The work of the PRC Legal Advisor has focused on 山東泰豐紡織有限公司 (Shandong Taifeng Textile Co., Ltd.*) (“**Shandong Taifeng**”), a company established in the PRC and a wholly owned subsidiary of the Company. The principal business of Shandong Taifeng is production and distribution of cotton yarns and bedding products.
2. Shandong Taifeng has not provided the PRC Legal Advisor with complete documents as per questionnaire of the PRC Legal Advisor. Such documents include, evidence of ownership and usage of the machineries listed in the list of machineries, information on legal proceedings and enforcement actions against Shandong Taifeng.
3. Shandong Taifeng has not provided the PRC Legal Advisor with necessary assistance to facilitate the verification of information against public records. Such public records include records of the land and buildings owned by Shandong Taifeng kept by 萊蕪市政務服務中心國土局 (State Land Bureau of Laiwu City Administration Services Centre*), information on payment of tax by Shandong Taifeng kept by 萊蕪市政務服務中心稅務局 (Tax Bureau of Laiwu City Administration Services Centre*). As a result, the PRC Legal Advisor was not able to obtain the public records to verify the land and buildings owned by Shandong Taifeng and payment of tax and whether there is any penalty imposed.

4. Oral information provided by staff of Shandong Taifeng was not substantiated with related documentation.
5. Apart from agreements with distributors signed on 10 April 2013, 30 June 2014 and 1 July 2014, respectively (as set out in the sub-paragraph headed “Summary of findings of the PRC Legal Advisor – Distribution channel restructuring plan” below), the PRC Legal Advisor has not been provided with further information relating to the distribution channel restructuring plan, including payment of restructuring fees and the performance of the respective obligations of the parties under the channel restructuring agreements.

Summary of the findings of the PRC Legal Advisor

The following is a summary of the findings of the PRC Legal Advisor.

1. Distribution channel restructuring plan

The PRC Legal Advisor has been provided with the following agreements:

- (a) agreement dated 10 April 2013 between Shandong Taifeng, Party A and Party B pursuant to which Party A agreed to transfer its bedding products cooperation with Shandong Taifeng to Party B;
- (b) agreement dated 10 April 2013 between Shandong Taifeng, Party C and Party D pursuant to which Party C agreed to transfer its bedding products cooperation with Shandong Taifeng to Party D, and Shandong Taifeng agreed to give the same favourable treatment to Party A, Party B and Party D;
- (c) agreements dated 30 June 2014 between Shandong Taifeng on one part and each of Party A, Party B, Party C, Party D, Party E and Party G (collectively the “**Six Distributors**”) on the other part pursuant to which Shandong Taifeng agreed to provide to each of the Six Distributors subsidies equivalent to 20% of the total monetary value of bedding products obtained from Shandong Taifeng from 2012 to 2014 commencing from July 2014, and the Six Distributors agreed to obtain bedding products from Shandong Taifeng for such value as designated by Shandong Taifeng; and

- (d) agreement dated 1 July 2014 between Shandong Taifeng on one part and each of Party B, Party D, Party E and Party G (collectively the “**Four Distributors**”) on the other part pursuant to which (i) the Four Distributors agreed to complete the designated sales target within the stipulated time in accordance with the distribution channel restructuring plan, (ii) the Four Distributors have to obtain bedding products from Shandong Taifeng for such value as designated by Shandong Taifeng, (iii) Shandong Taifeng shall provide to each of the Four Distributors cash subsidies based on the monetary value of bedding products obtained from Shandong Taifeng from 2012 to 2014.

Apart from the agreements mentioned above, the PRC Legal Advisor has not been provided with information relating to the performance of the agreements relating to the distribution channel restructuring plan. Accordingly, the PRC Legal Advisor cannot opine on the legality of the agreements provided, the settlement of the restructuring fees and performance of the obligations under the agreements by the distributors.

2. Guarantees provided by Shandong Taifeng

According to information provided to the PRC Legal Advisor by staff of Shandong Taifeng:

- (a) Shandong Taifeng has provided guarantees in respect of borrowings of Party F and Party G for an aggregate amount of RMB197.8 million based on 企業信用報告 (corporate credit report) and the guarantee contracts provided.
- (b) Outstanding indebtedness of Party F in the amount of RMB130 million is still guaranteed by Shandong Taifeng.
- (c) Party G repaid RMB11 million of the borrowings guaranteed and outstanding indebtedness in the amount of RMB57 million is still guaranteed by Shandong Taifeng.

The PRC Legal Advisor stated in the Report that:

- (a) Based on records obtained by the PRC Legal Advisor from 萊蕪市政務服務中心市場監管局 (Market Supervision Bureau of Laiwu City Administration Services Centre*), the PRC Legal Advisor concluded that both Party F and Party G are not associate companies of Shandong Taifeng.

- (b) The PRC Legal Advisor also stated that it is not possible to confirm whether Party F and Party G have repaid the borrowings guaranteed by Shandong Taifeng due to the lack of evidence to substantiate information provided by the staff of Shandong Taifeng.
- (c) As the PRC Legal Advisor has not been provided with board resolutions of Shandong Taifeng approving the provision of the guarantees, the PRC Legal Advisor cannot opine on whether the provision of the guarantees is in compliance with the internal procedures of Shandong Taifeng.

3. *Bank balances of Shandong Taifeng*

Based on information obtained from The Bank of China, Laiwu branch, where Shandong Taifeng maintained its bank accounts, as at 23 October 2017, Shandong Taifeng has a total of 21 accounts. Out of the 21 accounts, 13 accounts have been cancelled, 2 accounts have been suspended and 6 accounts are still in normal operation. As at 23 October 2017, the total bank balances of the 2 suspended accounts was RMB22.46 and that of the 6 accounts still in normal operation was RMB4.97.

Upon enquiry, the PRC Legal Advisor also found out that the bank account opened with The Industry and Commerce Bank, Laiwu branch, on 5 September 2012 has been cancelled by the bank.

4. *Indebtedness of Shandong Taifeng*

In addition to contingent liabilities under the guarantees as provided to Bailuen Paper and Taifeng Group set out in the sub-paragraph headed “Summary of findings of the PRC Legal Advisor – Guarantee provided by Shandong Taifeng” above:

- (a) according to information showed in 企業信用報告 (corporate credit report), the outstanding indebtedness due to banks as at the date of the Report is RMB837.97 million;
- (b) the amounts due to 國銀金融租賃有限公司 (Guoyin Finance Leasing Co., Ltd.*) under the finance leasing agreement dated 15 May 2013 was RMB200.28 million; and
- (c) the amount due to Even Link Creation Limited, a wholly owned subsidiary of the Company and the shareholder of Shandong Taifeng is HK\$70 million.

5. *Proceedings, arbitration and enforcement actions against Shandong Taifeng*

Having checked the information available on on the 中國執行信息公開網 (China Enforcement News Web) (<http://shixin.court.gov.cn>), 全國法院被執行人信息查詢系統(National Courts Enforcement News Enquiry System*) (<http://zhixing.court.gov.cn/search>) and 中國裁判文書網(China Judgment Web*) (<http://wenshu.court.gov.cn>), it was identified that:

- (a) Shandong Taifeng is on the list of discredited persons (失信被執行人名單) in respect of enforcement actions for an aggregate amount of RMB117,878,914;
- (b) Shandong Taifeng has yet to settle enforcement actions in the amount of RMB229,321,245.60;
- (c) enforcement actions against Shandong Taifeng for an aggregate amount of RMB74,893,887.50 were suspended due to failure to enforce against any assets;
- (d) civil actions with judgment against Shandong Taifeng (other than those which have commenced enforcement proceedings) for an aggregate amount of RMB10,094,858.68; and
- (e) enforcement actions with court order and yet to be settled by Shandong Taifeng for an aggregate amount of RMB189,797,365.30.

As the PRC Legal Advisor has not been provided with information relating to the abovementioned proceedings and/or enforcement actions apart from judgment for two proceedings for an aggregate amount of RMB1,856,156.91, the PRC Legal Advisor cannot opine on the liabilities of Shandong Taifeng under legal proceedings, arbitrations and enforcement actions and completeness of the abovementioned information.

6. *Payment of value added tax*

The PRC Legal Advisor was informed that Shandong Taifeng has not paid all value added tax (“VAT”) in 2014. However, no further information has been provided to the PRC Legal Advisor, including the record of the transactions and the value of such transactions.

The PRC Legal Advisor advised that failure to issue VAT certificates may constitute criminal offence depending on the amount of tax payable.

Views of the Special Investigation Committee

Having considered the Report, the Special Investigation Committee noted that:

- (a) One of the resumption conditions is the conduct of a forensic investigation into the Audit Issues and disclosure of the findings of the investigation and the taking of remedial actions, if necessary. As disclosed in the announcement by the Company dated 22 November 2016, the investigation of FTI failed to draw any conclusions. The PRC Legal Advisor is also not able to provide complete findings of facts relating to the various issues due to limitation to the work of the PRC Legal Advisor.
- (b) It is noted that the bank balance as noted in the Report represented a substantial discrepancy from the bank balance of over RMB1 billion as at end of 2014 as previously recorded.
- (c) Members of the Special Investigation Committee were also concerned that the current cash on hand is insufficient to maintain the operation of the Company.

Further announcement will be made by the Company on further developments as and when necessary.

CONTINUED SUSPENSION OF TRADING OF THE SHARES OF THE COMPANY

Trading of the shares of the Company on the Stock Exchange will continue to be suspended until further notice.

By Order of the Board
China Taifeng Beddings Holdings Limited
Zou Shengzhong
Executive Director

Shandong, the PRC, 15 December 2017

As at the date of this announcement, the Board comprises of one executive Director, namely Mr. ZOU Shengzhong; and three independent non-executive Directors, namely, Dr. CHEUNG Wai Bun Charles, J.P., Mr. LI Yuchun and Mr. DAI Shunlin.

* *literal translation of the Chinese names for references only*