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Xiezhong International Holdings Limited

協眾國際控股有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock code: 3663)

SUPPLEMENTAL ANNOUNCEMENT TO THE INTERIM REPORT FOR THE SIX MONTHS ENDED 30 JUNE 2019

Reference is made to the interim report (the “**2019 Interim Report**”) of Xiezhong International Holdings Limited (the “**Company**”, together with its subsidiaries as the “**Group**”) for the six months ended 30 June 2019. Unless the context requires otherwise, capitalised terms used herein shall have the same meanings as those defined in the 2019 Interim Report.

The board (the “**Board**”) of directors (the “**Directors**”) of the Company would like to provide additional information in respect of the 2019 Interim Report.

FURTHER INFORMATION IN RELATION TO THE IMPAIRMENT LOSSES FOR CERTAIN IDLE EQUIPMENT

As set out in the paragraph headed “Management Discussion and Analysis — Financial Review — Other net income” in the 2019 Interim Report, the Group incurred impairment losses for certain idle equipment of approximately RMB16.5 million for the six months ended 30 June 2019, of which impairment losses of approximately RMB5.4 million were attributable by the idle equipment specific for production of goods selling to “other customers” (the “**Other Customers**”).

The “idle equipment” refers to the moulds specifically developed by the Group for the production of different HVAC components, including the HVAC system body, air outlets, compressor brackets, evaporator housings, supplied to Yinxiang and the Other Customers.

As the space of an automobile for the installation of the HVAC components varies across different automobile models of the same automobile brand, let alone the automobile models of different automobile brands, the moulds developed by the Group are unique and different from one another. Such differences include the structure and size of the moulds, the positions of the flow gates, the position and size of the ejection systems. Accordingly, each mould is specifically designed for the production of the relevant HVAC components of one automobile model, the scrap or residual value of disposing moulds are generally estimated to be zero.

The Board would like to provide additional information on (i) the descriptions and principal businesses of the Other Customers; (ii) the circumstances leading to the increased credit risk of the Other Customers; and (iii) whether legal proceedings have been initiated against the Other Customers as follows:

| Descriptions of the Other Customers (<i>Note</i>) | Principal businesses of the Other Customers | Circumstances leading to the increased credit risk and whether legal proceedings have been initiated |
|--|--|--|
| A company established in Hangzhou, Zhejiang Province, the PRC with limited liability in August 2009, with a registered capital and paid-up capital of RMB700 million (“ Customer A ”) | Research & development and production of the front wall, side wall, top cover, floor of automobiles, automobile body welding, and automobile maintenance | As a result of the disruption of the capital chain of Customer A and its immediate holding company, the supply of HVAC systems which are fitted to the automobile models of Customer A has been ceased by the Group since April 2019. The Company has initiated legal proceedings against Customer A in the PRC in June 2019 to recover the debt amount, which full provision amounting to approximately RMB6.8 million has been made as at 30 June 2019. |
| A company established in Jinhua City, Zhejiang Province, the PRC with limited liability in September 2003, with a registered capital and paid-up capital of RMB660 million (“ Customer B ”) | Development, manufacturing and sales of household appliances, building materials and decorative materials; import and export of goods and technology | Manufacturing of certain automobile models of Customer B, which are fitted with the HVAC systems supplied by the Group, have been ceased since April 2019 due to the decline in sales of such models. |

As at the date of this announcement, the Company is in the course of discussing with its PRC legal advisers as to initiating legal proceedings against Customer B to recover the debt amount. Full provision of the debt amount, which amounts to approximately RMB86,000, has been made as at 30 June 2019.

A company established in Chengdu City, Sichuan Province, the PRC with limited liability in January 2011, with a registered capital of RMB1,200 million and a paid-up capital of RMB500 million (“**Customer C**”)

Manufacturing and sales of automobile, provision after-sales service, automotive research and development

Manufacturing of certain automobile models under the Customer C Group, which are fitted with the HVAC systems supplied by the Group, have been ceased since April 2019 due to the problem of insufficient operating cash flow of the Customer C Group.

A branch company of Customer C established in Mianyang City, Sichuan Province, the PRC in February 2012 (“**Customer D**”)

Manufacturing and sales of automobile, automotive research & development, manufacturing and sales of auto parts and accessories

The Company has initiated legal proceedings against each of the three entities under the Customer C Group in the PRC in April 2019, May 2019 and April 2019, respectively, to recover the debt amount in respect of the trade receivables and the inventories of the Group, which full provision in the amount of approximately RMB1.5 million, RMB3.8 million and RMB92,000 for each of Customer C, Customer D and Customer E, respectively, has been made as at 30 June 2019.

A company established in Chengdu City, Sichuan Province, the PRC with limited liability in October 2010, with a registered capital and paid-up capital of RMB10 million (“**Customer E**”, together with Customer C and Customer D, the “**Customer C Group**”)

Sales of own-brand cars, automobile control equipment

In respect of the legal proceedings against Customer C and Customer E, the court has ruled in favour of the Group.

The legal proceedings against Customer D is in trial at the date of this announcement.

A company established in Changsha City, Hunan Province, the PRC with limited liability in December 2008, with a registered capital of RMB163.4 million and a paid-up capital of approximately RMB147.1 million (“**Customer F**”)

Development, design, manufacture and sales of tower cranes, mobile cranes and components

Due to the higher technical requirements on the HVAC components supplied by the Group as requested by Customer F, the profit margin of the Group for supplying such HVAC components to Customer F has dropped. Accordingly, the management of the Group decided to stop supplying to Customer F and the business dealings between Customer F and the Group reduced gradually during the second quarter of 2019.

As at the date of this announcement, the Company has recovered the debt amount from Customer F, save for the quality deposit (質保金) in the amount of approximately RMB2.1 million in respect of the products already supplied to Customer F by the Group. Such quality deposit shall be returned to the Group after the warranty period of two years following the delivery of products.

Note: The descriptions of the Other Customers have been based on publicly available information as at the date of this announcement.

FURTHER INFORMATION IN RELATION TO THE IMPAIRMENT LOSSES FOR CERTAIN CAPITALISATION PROJECTS OF DEVELOPMENT COSTS

As set out in the paragraph headed “Management Discussion and Analysis — Financial Review — Other net income” in the 2019 Interim Report, the Group incurred impairment losses for certain capitalisation projects of development costs of approximately RMB10.6 million for the six months ended 30 June 2019, of which impairment losses of approximately RMB8.7 million were attributable by the project with capitalised development costs for “another customer”.

The “another customer” is a company established in Changzhou City, Jiangsu Province, the PRC with limited liability in July 2007, with a registered capital and paid-up capital of RMB140 million (“**Customer G**”) (*Note*), which is principally engaged in the development, design, production, sales and after-sales service of automobile, chassis, engine, front and rear axles and their spare parts. Customer G is owned as to 100% by Beijing New Energy

Automobile Co., Ltd.* (北京新能源汽車股份有限公司), which is in turn owned as to 60% by Beijing Automotive Group Co., Ltd* (北京汽車集團有限公司) (“**Beijing Automotive**”). Accordingly, Customer G is a subsidiary of Beijing Automotive.

Note: The description of Customer G has been based on publicly available information as at the date of this announcement.

FURTHER INFORMATION IN RELATION TO RELEVANT SAFEGUARDS AGAINST THE INVENTORY WRITE-DOWN, IMPAIRMENT LOSSES OF INTANGIBLE ASSETS AND PROPERTY, PLANT AND EQUIPMENT IN RELATION TO YINXIANG AND THE OTHER CUSTOMERS

The Board would like to provide additional information on the relevant safeguards against the inventory write-down, impairment losses of intangible assets and property, plant and equipment (“**PPE**”) in relation to Yinxiang and the Other Customers as follows.

Upon the customers’ request for production and manufacturing of HVAC components specifically designed for their automobile models, the Group will conduct a feasibility study to assess and estimate the production cost, development cost and the cost of the moulds based on the estimated purchase volume as communicated with the customers and the profitability of the production and sale of such HVAC components. If the Group considers that the production and manufacturing of HVAC components is feasible based on the conclusion of the feasibility study, the Group will provide a fee quotation to the customers, which, if agreed by the customers, a research & development agreement (開發協議) (the “**R&D Agreement**”) will be entered into between the Group on one hand and Yinxiang or the Other Customers on the other in relation to the trial-manufacture of new products and the development of the moulds specifically for such HVAC components.

After trial products and the moulds are developed by the Group, a supply agreement (the “**Supply Agreement**”) will be entered into between the Group on one hand and Yinxiang or the Other Customers on the other before the Group commences mass production of the relevant HVAC components, pursuant to which the parties agreed on, among other things, the unit price of the products, the time of delivery and the payment terms. In line with the industry practice in the automobile industry, the volume of the products to be supplied is separately agreed in the individual purchase orders placed by the customers following the Supply Agreements, rather than in the Supply Agreements themselves. Pursuant to the Supply Agreement, the unit price of the products took into account (i) the cost of the research and development efforts the Group would put into; and (ii) the unit cost (the “**Unit Cost**”) of manufacturing the moulds based on estimated purchase volume based on the discussion with the customers. The Unit Cost will be taken out from the unit price of products at the time when the cost of developing the moulds are fully amortised. Usually, the sales amount of the products Yinxiang or the Other Customers ordered under the Supply Agreement is required to be settled monthly. Failure to settle the amount payable under the Supply Agreements shall constitute a breach of contract under the relevant Supply Agreements.

The Group generally asks for prepayments from new customers and customers with annual purchase amount less than RMB2 million as their commitments on the research and development efforts put into by the Group, however, in respect of the existing customers with long-term business relationship, prepayments are generally not required, and instead, the Group will take into account the Unit Cost when negotiating the unit price of the products with such customers. Due to the then long-term business relationship with Yinxiang and the Other Customers, the Group did not require Yinxiang and the Other Customers to make prepayments as their commitments on such research and development.

In some cases, when the management of the Group understands from the customers of the Group or anticipates according to the customers' historical demands that there will be a steady demand for the particular HVAC components, based on the long-term relationship with Yinxiang and the Other Customers, the Group will manufacture and stock up the particular HVAC components in advance to satisfy the potential demand from such customers.

In August 2019, the Group filed an application for litigation to Chongqing First Intermediate People's Court (重慶市第一中級人民法院) to claim against Yinxiang for (i) the trade and other receivables from Yinxiang; and (ii) the outstanding inventories for Yinxiang. However, the Group did not initiate a claim against Yinxiang for the amount of the idle equipment specific for production of goods selling to Yinxiang, because the relevant contract did not specifically encompass compensation terms for such idle equipment, and that as advised by the PRC legal advisers of the Group, it is not likely that the Group can recover such amount of the idle equipment through legal proceedings in the absence of relevant compensation terms. The Company will endeavour to negotiate with Yinxiang on the compensation terms for such idle equipment.

In order to minimise the risk of significant impairment or provision to be made on inventory, intangible assets and PPE of the Group in the future, the Group has adopted the following internal control measures as at the date of this announcement:

- (1) The Group will look into the possibility of requesting the customers to undertake for a minimum purchase volume in the R&D Agreement and make down payment before commencement of mass production of products for both the new customers and the existing customers, especially when the large orders are received from the customers. The Group will also pay specific attention to keep minimum level of inventory for those customers to which the products and moulds are specific.

- (2) In respect of the moulds the Group specifically designed for the customers, and as preventive measures for significant impairment of capitalised development costs of the Group in the future, the Group will look into the possibility of (i) adding an additional clause in the R&D Agreement with pre-agreed minimum purchase volume of products, and (ii) adding compensation terms that the customers shall compensate the Group in case the pre-agreed minimum purchase volume is not reached.

By order of the Board
Xiezhong International Holdings Limited
Chen Cunyou
Chairman

Hong Kong, 29 October 2019

As at the date of this announcement, the Board comprises four executive Directors, namely Mr. Chen Cunyou, Mr. Ge Hongbing, Ms. Chen Xiaoting and Mr. Shen Jun; one non-executive Director, namely Mr. Huang Yugang; and four independent non-executive Directors, namely Mr. Lau Ying Kit, Mr. Cheung Man Sang, Mr. Zhang Shulin and Mr. Lin Lei.

* *for identification purpose only*