HUAZHANG TECHNOLOGY HOLDING LIMITED
華章科技控股有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock code 1673)

SUPPLEMENTAL ANNOUNCEMENT IN RELATION TO THE ANNUAL REPORT FOR THE YEAR ENDED 30 JUNE 2020

Reference is made to the annual report of Huazhang Technology Holding Limited (the "**Company**") for the year ended 30 June 2020 (the "**Annual Report**"). Unless the context otherwise requires, capitalized terms used herein shall have the same meanings as those defined in the Annual Report.

Further to the information disclosed in the Annual Report, the Company wishes to provide to the Shareholders and the potential investors with the following additional information in relation to the trade and other receivables.

Trade and other receivables

Trade and bills receivables increased by approximately RMB69.7 million from approximately RMB494.0 million as at 30 June 2019 to approximately RMB563.7 million as at 30 June 2020, primarily due to the completion of some contracting projects in the year ended 30 June 2020.

Other net receivables decreased by approximately RMB28.8 million from approximately RMB119.9 million as at 30 June 2019 to RMB91.1 million as at 30 June 2020, primarily due to an increase in impairment of other receivable of RMB21.4 million in relation to payment on behalf of an independent third party for the supply chain services.

The impairment of trade and bills receivables and the impairment of other receivables increased from RMB39.5 million and RMB6.0 million, respectively, as at 30 June 2019 to RMB101.3 million and RMB27.3 million, respectively, as at 30 June 2020. Due to overall downward economic environment and the influence of the COVID-19, the financial situation of several customers worsened and they failed to timely make settlement of the receivables in the year ended 30 June 2020. As a result, the Group increased provision for impairment losses on trade receivables and other receivables.

The Group has implemented a credit policy to monitor the performance of its debtors, pursuant to which the Group performs aging analysis, communicates with the debtors, and monitors the subsequent settlements and historical transaction patterns. The provision policy for impairment of trade and bills receivables is based on ongoing evaluation of the collectability and ageing analysis of the outstanding receivables and on management's judgment. A considerable degree of judgment is required in assessing the ultimate realisation of those receivables, including the creditworthiness and the past collection history of each customer. If the financial condition of the customers of our Group continued to deteriorate, resulting in an impairment of their abilities to make payments, additional allowances may be required.

The breakdown of impairment of trade and bills receivables and impairment of other receivables as follows: -

	Business nature	Outstanding balance as at 30 June 2020 (excluding provision for impairment)	Provision for impairment As at 1 July 2019	Provision for impairment Change during the year	Provision for impairment As at 30 June 2020	notes	Net balance as at 30 June 2020 (after provision for impairment)
Trade and bills receivables							
- Customer A (note a(i))	Project contracting service	119,811	(12,421)	(35,011)	(47,432)	d(i)	72,379
- Customer B (note b)	Project contracting service	14,298	(6,577)	(6,185)	(12,762)	d(ii)	1,536
- Customer C (note c)	Project contracting service	37,921	(190)	(18,771)	(18,961)	d(iii)	18,960
- Others	All services	472,611	(20,351)	(1,827)	(22,178)		450,433
- Bills receivables	All services	20,372	-	-	-		20,372
		665,013	(39,539)	(61,794)	(101,333)		563,680
Other receivables							
- Payment on behalf of Customer A (note a(ii))	Supporting services (supply chain service)	81,952	(3,335)	(21,250)	(24,585)	d(i)	57,366
- Others	All services	36,445	(2,646)	(106)	(2,752)		33,694
		118,397	(5,981)	(21,356)	(27,337)		91,060

Each of the Customer A, Customer B and Customer C entered into financing lease arrangements obtaining financing to purchase the Group's products. The Group confirms that two finance leasing companies, both of which are independent third parties to the customer and the Group, were involved in these transactions. The finance leasing companies are licensed to engage in the provision of finance lease, operating lease and related consultation for various industry.

Each customer negotiated directly and entered into a finance leasing agreement with the finance leasing companies to fund the project. The finance leasing agreement typically provided a payment schedule based on the phases of the project.

The Group subsequently entered into a separate sales agreement with the finance leasing companies and the customer in relation to the sale and installation of the relevant equipment in connection with the project. The sales agreement provided that the finance leasing company shall make payment to the Group in according with the repayment schedule, which was typically based on the payment schedule in the finance leasing agreement referenced above. The customers failed to make installment payments to the respective finance leasing companies, and in turn the finance leasing companies did not make payment to the Group. As such, neither the Group nor the finance leasing companies received payment and are working together to recover the respective amount due from the customers.

(a) Impairment in relation to Customer A

(i) Project contracting services

The Group entered into project contracting service agreements with a total consideration of RMB140.7 million with Customer A and one of the finance leasing companies, which are independent third parties to the respective customer and the Group, for the construction of the production line for Customer A in December 2015. At the time of this agreement, Customer A had no operational history, and as a risk management measure the Group agreed to include the finance leasing company in the agreement, as the Group believed that in case of payment default the Group could seek repayment from the finance leasing company in addition to or in lieu of Customer A. After Customer A installed the production line and commenced operations, Customer A entered into three additional agreements in September 2016, September 2017 and December 2017, respectively, for a total consideration of RMB99.0 million to purchase other equipment from the Group for upgrading their production facilities. Since Customer A had an on-going operation and already made partial payment under the first agreement, the Group did not involve the finance leasing company in these three additional agreements. The Board believes the management of the Group acted in the best interest of the Group and was not negligence in entering these agreements, because (i) such agreements, assessed under the circumstance entered into, could be financially beneficial to the Group and expand revenue source for the Group and (ii) the management performed customary due diligence on the financial condition of Customer A and on the dates of the agreements entered, the Group did not identify any financial difficulties of Customer A. The total consideration of the four agreements above was approximately RMB239.7 million. As at 30 June 2020, the group has outstanding balance due from Customer A and the finance lease company (before provision for impairment) was RMB75.0 million and RMB44.8 million, respectively, which was overdue, pursuant to the agreements.

Customer A started to have financial difficulties in the second half of 2018 and stopped making payment since December 2018. In April 2019, Customer A entered into a repayment agreement with the finance lease company in relation to outstanding payables under the first agreement, which granted extension to Customer A on outstanding payments due on the afore-mentioned projects. However, Customer A subsequently failed to make repayment according to the repayment schedule set forth in such repayment agreement.

In the first half of 2020, the finance leasing company initiated a legal proceeding against Customer A to collect the outstanding payable at Zhejiang Hangzhou People's Intermediate Court (浙江杭州中级人民法院). The Zhejiang Huazhang Technology Limited ("Zhejiang Huazhang", a subsidiary of the Group) initiated a legal proceeding against Customer A, such transaction did not involve the finance lease company and the agreements directly entered between Customer A and Zhejiang Huazhang, to collect the outstanding payable at Zhejiang Jiaxing People's Intermediate Court (浙江嘉興中级人民法院). The finance leasing company and Zhejiang Huazhang have won judgement on first instance against Customer A as at the date of the Annual Report.

Based on public search results, Customer A has recently been involved in multiple payment defaults and legal proceedings as a defendant. The Directors believe even if the Group obtained favourable judgments in the afore mentioned legal proceedings, there is significant uncertainty whether the Group can recover a portion or any of the outstanding amount through enforcement of the judgment due to Customer A's financial difficulties.

(ii) Supply chain service

In February 2018, the Group entered into an agency service agreement with Customer A to provide supply chain services. The services includes: (i) purchase of raw materials and spare parts from suppliers for the customer, where the Company will make payment as the purchaser for the raw materials and spare parts purchased will be delivered by the suppliers to the customer directly and (ii) sales of the products produced by the customer to their customers. The Group charges the customer (i) fees that equal to 5% of the purchase amounts with a credit period of 90 days and (ii) an interest at 14.6% per annum for the outstanding balance of the purchase of raw materials, the payable to the selected customers is settled by proceeds received from sales of the products. Customer A started to have financial difficulties in the second half of 2018, and has not made any settlement since November 2019. As at 30 June 2020, the Group has outstanding balance due from Customer A (before provision for the impairment of RMB82.0 million) in relation to provision of supply chain services.

(b) Impairment in relation to Customer B

The Group entered into project contracting service agreements and a purchase agreement with Customer B and one of the finance lease company, which are independent third parties to the respective customer and the Group , for the construction of the production line in the production plant of Customer B with project value of approximately RMB53.4 million in October 2015. Customer B obtained the funding for the project through the finance leasing arrangement with a finance leasing company. On the date of the agreement entered, the Group did not identify the financial difficulties of Customer B. As at 30 June 2020, the Group has outstanding balance due from Customer B (before provision for the impairment of RMB14.3 million), of which RMB1.2 million was not due yet, pursuant to the agreements.

Based on the relevant repayment schedule entered into between the Group and Customer B, Customer B shall settle outstanding payable by installments by monthly payment in relation to certain projects until 25 December 2019 and 5 January 2021, respectively. Since November 2018, Customer B has not made any payment due. Based on public search results, Customer B has recently been involved in multiple payment defaults and legal proceedings as a defendant.

The finance lease company initiated a legal proceeding to collect outstanding payment in May 2019. The court issued the judgment on 12 November 2019 holding Customer B liable for returning the leased equipment and made the repayment. Subsequently, the finance lease company had difficulties enforcing the judgment because Customer B was uncooperative to request for it to performance its obligation under the judgment. The finance lease company applied for compulsory enforcement of the judgment with the court. As of date of the Annual Report, Customer B professed that it cannot make any repayment and is unwilling to return the leased equipment as it relies on the leased equipment for production and revenue generation. As such, the Group and the finance lease company is willing to continue negotiating with Customer B for potential repayment arrangement, including but not limited to restructure the repayment schedule to allow Customer B to make repayment using working capital generated from its operations, instead of repossession of the pledged equipment and force Customer B into bankruptcy in all likelihood.

(c) Impairment in relation to Customer C

The Group undertook an EPC project for Customer C amounting to approximately RMB320.0 million which is started in April 2018. On the date of the agreement entered, the Group did not identify the financial difficulties of Customer C. The project was suspended in January 2019 due to the delay of certain utility and infrastructure constructions undertaken by the relevant government entities, which was in turn due to the lack of funds. The outstanding amount was RMB37.9 million as of 30 June 2020. The project is expected to resume once the relevant government entities receive the necessary funds, but there is uncertain when such fund can be received as at the date of the Annual Report.

(d) Methods, basis and key assumptions of the impairment assessments

The Group assesses impairment of the outstanding receivable amount by applying the following formula:

Impairment = outstanding amount – estimated recoverable amount

Estimated recoverable amount is measured as (i) estimated amount recoverable from customers through collection effort or (ii) estimated value of the pledged equipment, multiplied by chance of disposal.

In the year ended 30 June 2019, while the litigations were still on-going with the customers, the Group estimated that the chances of obtaining favorable judgments was high. As such, the Group estimated impairment with method (i) for estimated recoverable amount.

However, in the year ended 30 June 2020 even though judgment was obtained against the defaulting customers, there were unforeseeable difficulties in enforcing the judgment against the customers. As a result, the Group believe a more likely way of recovery is through the disposal of the pledged equipment, and as a result method (ii) was applied to calculate estimated recoverable amount.

The Group performed the following due diligence to assess the recoverability:

- dispatched engineers with ample relevant industrial experience to inspect the condition of the pledged equipment;
- based on the report of the engineers, the management assessed the value of the pledged equipment taking into consideration of (i) the market value of new comparable equipment, (ii) the condition of the equipment and (iii) potential discount the Group needs to offer to successfully dispose of the equipment; and
- inquired into market interest in purchasing the pledged equipment through its sales representation.

Based on the assessments, the management concluded that

(i) Customer A

For the outstanding receivables generated by the project contracting service, the management believe it is highly likely that the Group can recover the outstanding balance from the Customer A based on favourable judgment against Customer A. The outstanding receivable was secured by pledged equipment with book value of RMB179.0 million of equipment which the Group can dispose of to settle the unpaid amount. The management made assessment on the possible amount that can be collected through the disposal of the equipment based on the equipment condition and market value. Taking into the accounts of book value of equipment and any possible cost for disposal of the equipment, the management believes that a 39.6% impairment on the total outstanding amount, or RMB12.4 million and RMB35.0 million for the fiscal year 2019 and 2020, respectively, is prudent based on such assessment. As at 30 June 2020, the impairment amounts of Customer A and the finance lease company were RMB34.0 million and RMB13.4 million.

For the outstanding receivables generated by the supply chain service, the management believe it is highly likely that the Group can recover the outstanding balance from the Customer A through the insolvency procedures. Once the Group enforces the judgment against Customer A by taking possession of the pledged equipment, which is the sole production line of Customer A, Customer A cannot continue to do any business and would likely to become insolvent. As a result, Customer A would need to dispose of its properties and land to repay its all outstanding debts based on the insolvency procedures. Taking into accounts of book value of land and buildings and any possible enforcement cost, the management believes that a 30% impairment on the total outstanding amount, or RMB3.3 million and RMB21.3 million for the fiscal year 2019 and 2020, respectively, is prudent based on such assessment.

(ii) Customer B

The management believe there is significant uncertainty involved in the on-going legal proceedings against Customer B, as well as the likely outcome of the negotiation with Customer B for repayment schedule restructuring. Taking into accounts of book value of the pledged equipment and any possible enforcement cost, the management believe that the impairment amount shall be approximately 89.3% of the outstanding amount, or RMB6.6 million and RMB6.2 million recognized in the fiscal year of 2019 and 2020, respectively.

(iii) Customer C

Based on its due diligence work, including discussion with Customer C and the relevant government entities, the management believe it is likely the project can resume after the relevant government entities resolve its funding issue. Alternatively, the Group can dispose of the equipment pledged as securities to recover unpaid receivable. Taking into consideration of the likelihood of resumption of the project or the alternative means for recovery, the management believe it's prudent to make provision of 50% of the outstanding amount, or RMB0.2 million and RMB18.7 million recognized in the fiscal year of 2019 and 2020, respectively.

(e) The view from the Board

The Group plans to continue to work with the financing lease companies in a joint effort for collection. The Group holds on-going discussion with those customers with regard to collection. The Group is also considering further engaging legal counsels to enforce the judgment, if a cost-efficient arrangement with legal counsels can be reached.

Since the various finance lease companies are under contractual obligations to make payments to the Group, the Board first explored the possibility to take legal actions against such finance lease companies to enforce repayment. The management had several rounds of communication with the finance lease companies and was informed by the finance lease companies that their ability to make payments to the Group depends on successful recovery from the relevant customer. After due analysis, the management is of the view that at the current stage the most viable option for the Group for payment recovery is to continue to closely monitor the various finance lease companies' legal proceedings and enforcement efforts against the relevant customers because (i) based on discussion with and statement by the respective finance lease companies, the Group reasonably believe the finance lease companies would have no issue in repaying amount owed to the Group once they recover payments owed to them by the customers; (ii) there is still realistic chance that the finance lease companies can recover the outstanding balance through repossession of pledged equipment and/or restructuring of repayment schedule, (iii) the finance lease companies have necessary resources in enforcement efforts against the various customers and (iv) waiting for the finance lease companies to collect repayment by customers are still preferable at this stage as payment obligations by the various finance lease companies are not secured by any pledged assets and thus would be harder to enforce by the Group. The Board reviewed the relevant evidences and the analyses presented by the management and concurred with the management such action plan is in the best interest of the Group giving the circumstances.

Nevertheless, the Company reserves the rights and options to pursue legal actions against the relevant finance lease companies if recovery from the relevant customers become practically impossible and the management consider such actions are likely to result in recovery of payment. The Group will closely monitor the litigation and enforcement process and regularly analyze its best action in relation to the finance lease companies and/or the customers based on the circumstance.

Based on the analyses set forth in details above, the Board of Directors is of the view that the recognition of the relevant impairments at this stage is a prudent and proper measure giving the relevant circumstances.

The above additional information does not affect other information contained in the Annual Report, save as disclosed in this announcement, the remaining contents of the Annual Report remain unchanged.

By order of the Board
Huazhang Technology Holding Limited
Zhu Gen Rong
Chairman

Hong Kong, 2 February 2021

As at the date of this announcement, the executive directors are Mr. Zhu Gen Rong, Mr. Wang Ai Yan, Mr. Liu Chuan Jiang and Mr. Jin Hao, and the independent non-executive directors are Mr. Dai Tian Zhu, Mr. Kong Chi Mo and Mr. Heng, Keith Kai Neng.