STARLIGHT CULTURE ENTERTAINMENT

STARLIGHT CULTURE ENTERTAINMENT GROUP LIMITED
星光文化娛樂集團有限公司
(Incorporated in Bermuda with limited liability)
(Stock Code: 1159)

SUPPLEMENTAL ANNOUNCEMENT IN RELATION TO 2021 ANNUAL REPORT

Reference are made to (i) the announcement of the Company dated 21 June 2022 in relation to the audited annual results for the year ended December 2021 (the "**2021 Results Announcement**"); and (ii) the 2021 annual report of the Company dispatched on 5 July 2022 (the "**2021 Annual Report**"). Unless the context requires otherwise, capitalised terms used herein shall bear the same meanings as defined in the 2021 Results Announcement and the 2021 Annual Report.

The Company wishes to provide additional information regarding i) impairment losses recognized for the year (the "**Impairments**") and ii) Disclaimer of Opinion (the "**Audit Modification**"), to its shareholders and potential investors as supplemental information to the 2021 Results Announcement and 2021 Annual Report, as follows:–

Impairments

In FY2021, the Company recognized impairment losses amounted to approximately HK$288,636,000, comprising impairment losses on trade receivables of approximately HK$6,823,000, impairment losses on contract assets of HK$48,406,000, impairment loss on a film investment of HK$80,223,000 and impairment losses on prepayments, other receivables and other assets of HK$153,184,000, and details of which are set out below:–

a. **Impairment losses on trade receivables and contract assets**

This comprised impairment loss on trade receivables of HK$6,823,000 and impairment loss on contract assets of HK$48,406,000. The Group assessed the loss allowance of trade receivables and contract assets taking into account the probability-weighted outcome, the time value of money, and reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions, and became aware of the impairment on trade receivables and contract asset through the assessments conducted during the financial reporting process.

Please also refer to the disclosure in relation to the impairment analysis of trade receivables and contract assets are set out in "Notes to Financial Statements-17. Trade Receivables" and "Notes to Financial Statements-19. Contract Assets" in the 2021 Annual Report respectively.

The below table provides for the ageing of those trade receivables and contract assets impaired:

Ageing of trade receivables and contract assets impaired as at 31 December 2021	Impairment amount (HK$)
Within 1 year	59,000
Over 1 year	55,170,000
Total	55,229,000

b. Impairment loss on a film investment

An impairment provision of HK$80,223,000 (2020: nil) for the film investment was made. Please also refer to the disclosure in relation to the impairment analysis of film investment set out in "Notes to Financial Statements-20. Investment in Film and Television Programs and Program Rights" in the 2021 Annual Report.

The Company engaged an independent valuer to perform fair value valuation for film investments. Such valuation was reported to the Group in June 2022 and indicated the recoverable amount based on the value-in-use calculation of one film was much lower than the carrying amount. Below are details of the valuation methodology and major assumptions of the valuation:–

1. VALUATION METHODOLOG

We have adopted the Income-Based Approach in arriving at the value in use of the Film Investment as at the Date of Valuation. Under the Income-Based Approach, we have adopted the discounted cash flow ("**DCF**") method, which is based on a simple reversal calculation to restate all future cash flows in present terms. The expected free cash flow for each year was determined as follows:

Expected Free Cash Flow = Net Profit + Depreciation – Change in Net Working Capital – Capital Expenditure

The present value of the expected free cash flows was calculated as follows:

$$PVCF = CF_1/(1+r)^1 + CF_2/(1+r)^2 + \ldots + CF_n/(1+r)^n$$

In which
PVCF = Present value of the expected free cash flows;
CF = Expected free cash flow;
r = Discount rate; and
n = Number of years.

To adopt this method, we estimated the weighted average cost of capital ("**WACC**") of the Film Investment as a basic discount rate. WACC of the Film Investment is the minimum required return that the Film Investment must earn to satisfy its various capital providers including shareholders and debt holders. WACC calculation takes into account the relative weights of debt and equity. It is computed using the formula below:

$$WACC = W_e \ x \ R_e + W_d \ x \ R_d \ x \ (1 - T_c)$$

In which
R_e *= Cost of equity;*
R_d *= Cost of debt;*
W_e *= Weight of equity value to enterprise value;*
W_d *= Weight of debt value to enterprise value; and*
T_c *= Corporate tax rate.*

2. MAJOR ASSUMPTIONS

The valuer had adopted certain specific assumptions in the valuation and the major ones are as follows:

- In the process of valuation, no receivables and payables for the Film Investment as at the Date of Valuation was considered;

- The box office of Film Investment would be performed as planned by the Management throughout the forecasted period, and the development would be in line with the financial projection;

- The valuation was mainly based on the projections of the future cash flows. The projections outlined in the financial information provided are assumed to be capable of reflecting future market conditions and economic fundamentals, and are assumed to be materialized;

- All relevant legal approvals and business certificates or licenses to operate the business in the localities in which the Company operates or intends to operate were assumed to be successfully obtained and renewable upon expiry with minimal costs;

- There will be sufficient supply of technical staff in the industry in which the Company operates, and the Company will retain competent management, key personnel and technical staff to support its ongoing operations and developments;

- There will be no major change in the current taxation laws in the localities in which the Company operates or intends to operate and that the rates of tax payable shall remain unchanged and that all applicable laws and regulations will be complied with;

- There will be no major change in the political, legal, economic or financial conditions in the localities in which the Company operates or intends to operate, which would adversely affect the revenues attributable to and profitability of the Company; and

- Interest rates and exchange rates in the localities for the operation of the Company will not differ materially from those presently prevailing;

It is also noted that, while gross loss and impairment loss of a film investment were recognised, the reduction in recoverable amount of the film investment mentioned above would also reduce the amounts payable by the Company to its film investors, which was reflected in the reduction in the amounts of financial liabilities at fair value through profit or loss and derivative financial liabilities in relation to the film, contributing to the recognition of a gain in the amount of HK$83,751,000 on changes in fair values of financial and derivative financial liabilities under the Consolidated Statement of Profit or Loss.

c. Impairment losses on prepayments, other receivables and other assets

This comprised impairment loss on film prepayments of HK$127,237,000 and impairment loss on prepayment, other receivables and other assets of HK$25,947,000.

Upon recognition of impairment on film investment, the Group then reassessed the recoverability of prepayments, other receivables and other assets and recognised impairments due to the doubtful recoverability of these assets which are unlikely to generate future economic benefits.

The Directors have undergone a detailed review of recoverability of the Group's prepayments to film directors taking into account the current situation. Where an indication of impairment exists, the asset's recoverable amount is estimated based on a value-in-use calculation. It is highly judgmental when the film industry will recover so that reasonable profit will be available for allocation through the recoupment corridor. Based on information available to the Directors when the consolidated financial statements are prepared, an impairment provision of HKD127,237,000 was made for film prepayments during the year ended 31 December 2021. The impairment was individually assessed, taking into account of the length of time for the investment made, and taking into consideration of the details of production plans of the underlying IPs, the recent stages and status of their development, recent cooperation and production between the film directors and the Company, and current film investment market environment. Impairment was made where the recoverability of the film prepayment was remote (where recovered through the recoupment corridor is doubtful, or/and when the film will start production is also uncertain). The provision of impairment on film prepayment as at 31 December 2021 was HK$129,637,000.

Impairment loss on prepayment, other receivables and other assets of HK$25,947,000 comprises a full provision of impairment of input value-added tax of approximately HK$19,000,000, the probability of collection of the invoices of which was considered low, and impairments of HK$6,947,000 of other prepayments and receivables, the recoverable amount of which were estimated based on value-in-use calculation.

It is noted that the recognition of impairment loss was based on the best assessments and estimates made by the Company under current film market (which is overall the worst film market ever seen by the Company's management). When a turnaround of the film market appears, the Company could opt to realize the film prepayments by producing more film investments and/or by assignment of the Company's interests to potential film investors.

Please also refer to the disclosure in relation to the impairment analysis of prepayments, other receivables and other assets is set out in "Notes to Financial Statements-18. Prepayments, Other Receivables and Other Assets" in the 2021 Annual Report.

Discussions on the Company's Going Concern

Reference is made to pages 31 of the 2021 Annual Report. The Board would like to provide further information on the section headed "Material uncertainties relating to events or conditions that may cast significant doubt on the issuer's ability to continue as a going concern".

The auditors of the Group issued the Audit Modification over the Group's ability to continue as a going concern due to multiple uncertainties relating to going concern that may cast doubt on the Group's ability to continue as a going concern and therefore it may be unable to realise its assets and discharge its liabilities in the normal course of business. Such material uncertainties are: (i) a net loss of over HK$400 million for the year ended 31 December 2021; (ii) net current liabilities and total deficiency in net assets of over HK$400 million and HK$190 million respectively as at 31 December 2021; (iii) default on the repayment of overdue borrowings and film investment loans; and (iv) other borrowings and film investment loans which will be due for repayment in less than one years' time, while the Group's cash and cash equivalents amounted to approximately HK$157 million only.

The Board has adopted and considered different measures to further improve its cash flows, which includes (i) closely monitoring the development of the COVID-19 pandemic in major markets of the Group's business; (ii) actively negotiating with all the lenders for renewal and extension for repayments of the overdue borrowings; (iii) negotiating with financiers of the film industry to secure new sources of financing; (iv) taking active measures to control administrative costs and prioritise film investment expenditures; and (v) taking actions to refinance the other borrowings and film investment loans. For details, please refer to the section headed "Directors' Report – The Board response to the basis for disclaimer of opinion" on page 54 of the 2021 Annual Report (the "**Measures**"). Further, subject to the condition of the capital market and availability of investors, the Company also plans to conduct equity financing to reduce financial liabilities and improve liquidity.

The audit committee of the Company (the "**Audit Committee**") has critically reviewed the Audit Modification, the management's position concerning the Audit Modification and the Measures. The Audit Committee has enquired management of their basis to prepare the consolidated financial statements on a going concern basis and the Company's proposals to address the Audit Modification, as well as discussing with the auditors to understand the reasoning and consideration in arriving the Audit Modification. After careful consideration, the Audit Committee agreed with the management's position and basis concerning major judgmental areas including the going concern basis, and acknowledged the Measures to address the Audit Modification after a review of the Measures to address the Audit Modification (with assumption and continued implementation) and the Group's cash flow forecast prepared by the management; and discussions among the Audit Committee, the auditor and the board of the Company at the Audit Committee meetings and the board meeting.

The Audit Committee is of the view that the management should continue its efforts in implementing the Measures with the intention of mitigating the Group's liquidity pressure.

By order of the Board
Starlight Culture Entertainment Group Limited
Tang Liang
Chairman

Hong Kong, 8 August 2022

As at the date of this announcement, the Board comprises six executive Directors, namely Mr. Tang Liang, Mr. Chau Chit, Mr. Luo Lei, Mr. Zhou Jingbo, Mr. Sang Kangqiao and Ms. Wu Xiaoli; and three independent non-executive Directors, namely Mr. Wong Wai Kwan, Mr. Michael Ngai Ming Tak, and Mr. Jing Xufeng.