KAI YUAN HOLDINGS LIMITED
開源控股有限公司

(incorporated in Bermuda with limited liability)

(Stock Code: 1215)

SUPPLEMENTAL ANNOUNCEMENT IN RELATION TO THE ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2021

Reference is made to the annual report of Kai Yuan Holdings Limited (the "**Company**", which together with its subsidiaries, the "**Group**") dated 28 March 2022 for the year ended 31 December 2021 (the "**Annual Report**"). Reference is also made to (i) the circular of the Company dated 26 November 2019 in relation to the acquisition of the Associate (as defined below) and the provision of the Loan (as defined below) (the "**Circular**"); (ii) the business update announcement of the Company dated 29 November 2021 (the "**Business Update Announcement**") and (iii) the profit warning announcement dated 14 March 2022. Unless otherwise stated, capitalised terms used herein shall have the same meaning as those used in the Annual Report.

As disclosed in the Annual Report, the Company recognised the provision for impairment on the loan to an associate and interest receivable in aggregate of approximately HK$103.6 million for the year ended 31 December 2021.

The Company would like to supplement further information as regards such provision for impairment. The Company would like to state that nil provision for expected credit loss (the "**ECL**") had been made as regards the loan to an associate and interest receivable for the corresponding period in 2020. For the year ended 31 December 2021, such provision for impairment had been made after a firm of independent valuers (the "**Valuer**") had been engaged by the Company to perform assessment as regards the ECL relating to such loan and interest receivable. The amount of ECL will be updated at each reporting date to reflect changes in credit risk since initial recognition.

REASONS FOR AND CIRCUMSTANCES LEADING TO THE PROVISION OF IMPAIRMENT

Since March 2020, the Group has become interested in 37.125% equity interests in 北京凱瑞英科技有限公司 (Beijing Chemical Reaction Engineering Science & Technology Co., Ltd.) (the "**Associate**", together with its subsidiaries, "**Associate Group**") following completion of the acquisition set out in the Circular. The principal activity of the Associate Group is the production and sale of chemical products. Major products ("**Products**") of the first phase of production originally intended to include (a) dimethyl sulfate (硫酸二甲酯); (b) nitromethane (硝基甲烷); and (c) hydroxylamine hydrochloride (鹽酸羥胺) as set out in the Circular.

The Group also provided a 3-year RMB180.0 million (equivalent to approximately HK$214.5 million) loan (the "**Loan**") to the Associate in April 2020 in accordance with the terms of the shareholders' agreement entered into among the shareholders of the Associate and the Associate, and as disclosed in the Circular. The Loan and interest receivable thereon (the "**Financial Assets**") were secured by the Associate Group's land parcel and construction-in-progress (the "**Pledged Assets**").

As set out in the Circular, commercial production of the production project of the Associate Group was expected to commence in second quarter of 2020. However, as set out in subsequent annual and interim reports of the Company, construction of first phase of the production project was delayed a few times due to the COVID-19 outbreak and extreme bad weather, leading to delay in commercial production commencement of the Products as well. Construction of the first phase facilities was ultimately completed in July 2021 and approval for production of Products obtained thereafter.

As disclosed in the Business Update Announcement, the Company was informed by the general manager of a major subsidiary (the "**Associate Subsidiary**") of the Associate that, (i) the COVID-19 pandemic as well as the then current socio-economic environment in the People's Republic of China had rendered the Associate Subsidiary's development progress as well as business and financial performance being less than satisfactory; (ii) due to competitors' production technology breakthrough regarding hydroxylamine hydrochloride (鹽酸羥胺), re-adjustments would need to be made to the original product mix of medical intermediary products offered by the Associate Subsidiary; and (iii) the Associate Subsidiary had been involved in certain cases of litigation regarding outstanding balance on construction of its production plant.

In the first quarter of 2022, the Group received the Associate Group's audit report with a qualified opinion for the year ended 31 December 2021. The Group understood a qualified opinion was issued due to the significant losses and outstanding debts incurred by the Associate Group, causing concerns as to whether the Associate Group could continue as going concern. The Associate Group also recorded net current liabilities as at 31 December 2021.

In light of the above, the Company carried out an assessment on whether an allowance for ECL is required on the Financial Assets in accordance with the Hong Kong Financial Reporting Standard 9 ("**HKFRS 9**"). Pursuant to HKFRS 9, credit loss is the difference between all contractual cash flows that are due to an entity in accordance with the contract and all cash flows that the entity expects to receive, discounted at the original effective interest rate or credit-adjusted effective interest rate on purchased or originated credit-impaired financial assets. The method used for the measurement of ECL should reflect: an unbiased weighted amount, the time value of money and the reasonable and supportable information about past events, current conditions and forecasts of future economic conditions available at the reporting date without undue cost or effort. The Company had engaged the Valuer to carry out a valuation on the ECL of the Financial Assets as at 31 December 2021 (the "**Valuation Report**").

THE ECL VALUATION

According to the Valuation Report, the ECL model divides financial assets into three stages according to the credit risk status to ensure the appropriate and timely recognition of ECL:

- Stage 1, i.e. the stage of high-quality assets, which applies to assets or portfolios with low credit risk and no significant increase in risk since their initial recognition. Provision shall be made for credit losses that may occur within 12 months after the reporting date, i.e. 12-month ECL. Interest income is calculated by multiplying the effective interest rate by the amount of assets.

- Stage 2, i.e. the stage of decline in asset quality, which applies to financial assets or portfolios with a significant expected increase in credit risk but no objective impairment events since their initial recognition. Provision shall be made for ECL over the assets' lifetime, i.e., lifetime ECL. Interest income is calculated by multiplying the effective interest rate by the amount of assets.

- Stage 3, i.e. the stage of deterioration of asset quality to "non-performing", which applies to financial assets under Stage 2 that suffer from credit impairment (i.e. loss events). Lifetime ECL shall be continuously recognised. Interest income is calculated based on amortised cost, i.e. the gross carrying amount less the net impairment allowance.

Upon analysis and discussions with the Company's management on the borrower's credit risk profile, the Valuer consider the Financial Assets conformed with the characteristics of Stage 3 above. Accordingly, the Valuer had used the following formula in making the ECL assessment:

ECL = value of the Pledged Assets – outstanding amount relating to the construction-in-progress as regards the Pledged Assets – default debt exposure position

(i) Value of the Pledged Asset

The Valuer valued the Pledged Assets on the basis of the Group's recovery in the event of liquidation of the Associate Group member holding the Pledged Assets, being the "orderly liquidation value" (**有序清算價值**) (the "**OLV**"). An OLV refers to an estimate of the gross amount that the tangible assets would fetch in an auction-style liquidation with the seller needing to sell the assets on an "as-is, where-is" basis. Pursuant to the Valuation Report, the OLV of the Pledged Assets was RMB150,600,000 (equivalent to approximately HK$179.5 million) as at 31 December 2021.

In calculating the OLV of the Pledged Assets, the Valuer had (i) assessed the fair value of the land parcel primarily by making reference to certain comparable transactions available in the area where the assessed object is located by referring to the land transactions disclosed by the local land reserve centre and public domain; and (ii) assessed the fair value of construction-in-progress by analysing the value of the new built assets and adjusting factors based on market data and their useful life.

(ii) Outstanding amount relating to the construction-in-progress as regards the Pledged Assets

The outstanding amount relating to the construction-in-progress as regards the Pledged Assets amounted to RMB38,893,506.90 (equivalent to approximately HK$46.4 million) as at 31 December 2021.

(iii) Default debt exposure position

As at 31 December 2021, the Group's default debt exposure position was equivalent to the outstanding principal amount and interest under the Loan, being RMB198,670,684.93 (equivalent to approximately HK$236.7 million).

By applying the above formula, the ECL had come to the amount of RMB86,964,000 (rounded down to nearest thousand) (equivalent to approximately HK$103.6 million). Accordingly as set out in the Annual Report, the Company provided for impairment of approximately HK$103.6 million to the Financial Assets as at 31 December 2021.

This supplemental announcement is supplemental to and should be read in conjunction with the Annual Report.

For the purpose of this announcement, the conversion rate of RMB to HK$ is set at the rate of RMB1.00 for HK$1.1918.

By order of the Board
Kai Yuan Holdings Limited
Law Wing Chi, Stephen
Executive Director

Hong Kong, 15 September 2022

As at the date of this announcement, the Board comprises Mr. Xue Jian and Mr. Law Wing Chi, Stephen (both being executive Directors), and Mr. Tam Sun Wing, Mr. Ng Ge Bun and Mr. He Yi (all being independent non-executive Directors).