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世茂集團

SHIMAO GROUP HOLDINGS LIMITED

世茂集團控股有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock code: 813)

KEY FINDINGS OF THE INDEPENDENT INVESTIGATION

INTRODUCTION

Reference is made to the announcement of the Company dated 25 March 2022 in relation to, among others, the change of auditors. Reference is also made to the announcement of the Company dated 19 July 2022 on the resumption guidance for the Company.

As set out in the announcement of the Company dated 19 July 2022, one of the resumption conditions is that the Company must conduct an appropriate independent investigation into the issues raised by PwC, the previous auditor of the Company, in the Resignation Letter, announce the findings and take appropriate remedial measures.

This announcement sets out the key findings of the Independent Investigation.

BACKGROUND

PwC stated in the Resignation Letter that in the conduct of its audit of the financial statements of the Company for the year ended 31 December 2021, it became aware of information from media reports and other public sources that the Group was in default on certain trust loan arrangements and was in discussions with the trust loan providers for repayment extension. The media reports indicated that the Trust Loans were borrowed by joint ventures/associated companies of the Group for the financing of the Group, with full/partial collateral in the form of pledge of the Group's assets and guarantees of the Company and certain of its subsidiaries. PwC has noted that four such trust loan arrangements were entered into in 2020 or before and alleged that the Trust Loans, including certain pledges/guarantees provided by the Group, had not been previously disclosed to it.

PwC requested the Company to provide, without limitation, the following explanations and documents in relation to the trust loans identified:

- whether the trust loan arrangements reported by the media are factually correct;
- whether there exist any such other similar arrangements which have neither been provided/disclosed to them nor recorded in the Group's financial statements;
- commercial substance and business rationale for the arrangements;
- management's assessment of the respective obligations of the companies where the Group has an interest in each of the arrangements;
- the internal control for approval for entering into such arrangements; and
- the reassessment and basis for accounting for such companies as joint ventures/associated companies or subsidiaries and the related implication to the Group's consolidated financial statements.

Owing to the then outbreak of COVID-19 and the various pandemic control measures that were in place, the Company was unable to provide to PwC the information requested in a timely manner. PwC tendered its resignation as auditor of the Company on 24 March 2022.

SCOPE OF THE INDEPENDENT INVESTIGATION

The Company has engaged RSM to conduct the Independent Investigation on the issues raised by PwC in the Resignation Letter as set out above.

RSM, in conducting the Independent Investigation, has reviewed the relevant documentations and public documents in relation to the Trust Loans, conducted forensic review on the records of the Group and interviewed the management personnel of the Group.

KEY FINDINGS

(A) The Trust Loans

PwC mentioned four trust loan arrangements in the Resignation Letter. In respect of the issue raised by PwC in the Resignation Letter on whether the statements related to the Trust Loans reported by the media were accurate, RSM has reviewed public records and documents for the Trust Loans arrangements and confirmed with the Company that the trust loan arrangements reported by the media were accurate on the date of the media report. Set out below is a summary of the trust loan arrangements.

Trust Loan 1

On 8 September 2020, an associated company of the Group, as borrower, entered into a trust loan agreement with Trust Corporation 1 for a loan in the aggregate amount of RMB1.4 billion. Two subsidiaries of the Group provided joint guarantees for the loan, where the 100% equity interest of a subsidiary and the land use rights and the construction in progress of a project owned by that subsidiary were also pledged/charged to Trust Corporation 1 as credit enhancement.

The proceeds from Trust Loan 1 in the amount of RMB1.4 billion were finally transferred by the associated company to a subsidiary of the Group, and were applied by the Group for the development and construction of its property development projects to avoid having idle funds.

Trust Loan 2

First facility

In April 2018, Trust Corporation 2 provided a comprehensive facility of RMB15 billion to a subsidiary of the Group for engagement in the development of the Group's major real estate project in Shenzhen.

Under the first facility, Trust Corporation 2, through its related company, injected capital contribution of RMB4.94 billion to the shareholder company of the aforementioned project subsidiary of the Group to acquire 30% equity interest in such shareholder company of the Group's subsidiary, and provided a shareholder's loan in the aggregate amount of approximately RMB3.76 billion to that shareholder company in the name of a shareholder. Trust Corporation 2 also provided a facility fund of RMB4.5 billion to such project subsidiary by way of assigning usufruct of specified assets.

In 2018, with regard to the first facility, two subsidiaries of the Group provided joint guarantees to Trust Corporation 2, and the equity interest in the project subsidiary and the land use rights of the project in Shenzhen were also pledged/charged to Trust Corporation 2.

The relevant transaction amount and charges on assets under the first facility have been included in the Group's consolidated financial statements since 2018, and such guarantees and charges were disclosed to PwC in the same year.

Pursuant to the first facility, the Group's subsidiary obtained a fund totaling RMB13.2 billion in 2018. In 2020, the Group's subsidiary repaid RMB4.5 billion to Trust Corporation 2. Meanwhile, from May to July 2020, a joint venture of the Group transferred RMB8.7 billion to the aforementioned related company of Trust Corporation 2, while the related company of Trust Corporation 2 retained its 30% equity interest in the Group's subsidiary.

Second facility

In July 2020, Trust Corporation 2 granted a comprehensive facility of RMB11 billion to the aforementioned project subsidiary of the Group as an extension of the first facility granted in 2018, following which Trust Corporation 2 provided a loan of RMB8.7 billion to a joint venture of the Group.

As the related company of Trust Corporation 2 still held 30% equity interest in the Group's subsidiary and remained as its shareholder after the grant of the second facility by Trust Corporation 2 in 2020, the Group's subsidiary kept recognising the funds contributed by the related company of Trust Corporation 2 under the first facility as paid-in capital and shareholder's loan in its accounting records in 2020 with no change made.

Trust Loan 3

On 18 June 2020, an associated company of the Group, as borrower, entered into a trust loan agreement (as subsequently amended) with Trust Corporation 3, with the loan in the aggregate amount of RMB600 million as of 2021. A subsidiary of the Group provided a joint guarantee for such trust loan arrangement and the Company provided a top-up undertaking. Three project subsidiaries of the Group also charged their properties to Trust Corporation 3 as credit enhancement.

The proceeds from Trust Loan 3 were finally transferred by the associated company to the Group's subsidiary as prepayment, and were applied by the Group for the development and construction of its property development projects to avoid having idle funds.

Trust Loan 4

In 2019 and 2020, a joint venture of the Group, as borrower, entered into a trust loan arrangement with Trust Corporation 4, and the aggregate loan amounted to RMB1.908 billion in accumulation. A subsidiary of the Group provided a joint guarantee for the loan and the Company provided a top-up undertaking. A subsidiary and a joint venture of the Group charged the land use rights of the relevant property development projects held by them to Trust Corporation 4 as credit enhancement.

The proceeds from the loan were finally transferred to the Group's subsidiary and then were transferred back to the joint venture (the borrower) for the development and construction of its projects.

(B) Issues Raised by PwC in the Resignation Letter

(1) *Internal control for approval*

RSM, through review of physical records and computer forensic review procedures, has noted that there are clear records for each of the Trust Loans arrangements from initiation to approval. Essentially, each of the Trust Loans arrangements was initiated by the financial staff of the relevant project companies, and approved by the legal, financing, risk control and financial functional departments at the Group headquarters, and finally approved by an Executive Director and the head of the Group's financial management center.

The Company has never attempted to conceal the existence of the Trust Loans arrangements to PwC.

(2) *Disclosure on credit enhancement measures*

Given the overall difficulties faced by the real estate industry in the Mainland since 2022, which inevitably resulted in voluntary or passive departure of personnel in the industry, the Group also underwent similar significant changes in staffing with the departure of a large number of staff including the financial management personnel. The management is currently of the view that the reason why the credit enhancement measures of the Trust Loans were not disclosed to PwC is that the then financial management personnel was of the view that the notes to the financial statements of the annual report would only require disclosure on the pledges and guarantees provided for the borrowings of the Group's subsidiaries, and as such, did not include the pledges and guarantees provided to joint ventures and associated companies.

In addition, as the development and construction progress and sales of the relevant projects were relatively satisfactory in 2020 or before, the management is currently of the view that the then project financial personnel was of the view that the possibility of default was remote and the probability for triggering the performance of the guarantees was relatively low, so no disclosure was made.

According to the lists of pledges and guarantees provided by the Company to PwC in 2020 and mid-2021, they did not include the credit enhancement arrangements in relation to Trust Loan 1, Trust Loan 3 and Trust Loan 4.

Owing to the departure of the then financial staff responsible for the liaison with PwC on audit work, the Group is currently unable to confirm the reason why the records on the charges and pledges in relation to Trust Loan 2 have been missing in the working papers since 2020.

(3) *Commercial rationale for the Trust Loans*

In order to avoid having idle funds, the borrower of each of Trust Loan 1, Trust Loan 3 and Trust Loan 4 transferred the funds to the Group and the funds were applied for the development and construction of the property development projects of the Group and for daily operations.

With respect to Trust Loan 2, the subject company in cooperation with Trust Corporation 2 under each of the first facility and the second facility is a subsidiary of the Group.

Given that the proceeds from the Trust Loans were used by the Group, the Group considered that the provision of credit enhancements for the Trust Loans was not detrimental to the interests of the Group.

(4) *Accounting treatment for the Trust Loans*

Each of Trust Loan 1, Trust Loan 3 and Trust Loan 4 was recorded as a liability on the balance sheet of the borrower for the corresponding financial period, and consolidated on the proportion of equity investment under equity method in the consolidated balance sheet of the Group for 2020.

In November 2021, Trust Corporation 1 entered into a supplemental agreement with, among others, the relevant subsidiary of the Group, under which the subsidiary of the Group became a co-obligor under Trust Loan 1 and assumed repayment responsibility. As such, the Group has included Trust Loan 1 in the consolidated financial statements for the year ended 31 December 2021.

In early 2022, Trust Corporation 3 entered into a memorandum of understanding with, among others, the relevant subsidiary of the Group, under which the relevant subsidiary of the Group became a co-borrower under Trust Loan 3 and such subsidiary successively repaid parts of the loan to Trust Corporation 3. As such, the Group has included Trust Loan 3 in the consolidated financial statement for the year ended 31 December 2021.

As for Trust Loan 4, due to the poor operating conditions of the relevant joint venture of the Group, the partner of the corporate shareholder of the joint venture in that project negotiated to withdraw from such joint venture in the second half of 2022. Such joint venture has become a subsidiary of the Company. The Group has incorporated Trust Loan 4 in the Group's consolidated financial statements for the year ended 31 December 2022.

As for Trust Loan 2, with regards to the reason why no adjustment was made to the corresponding accounting items after the completion of the replacement of the second facility in 2020, the Group is of the view that such replacement was a continuation of the first facility arrangement. Meanwhile, the related company of Trust Corporation 2 did not return the 30% equity interest it held in the relevant subsidiary to the Group and remained as its shareholder, and thus the Group did not make accounting adjustment to the consolidated statements for the financial year following the completion of the replacement.

After that, considering: (a) the two successive facilities in 2018 and 2020 and the capital investments of Trust Corporation 2 were the replacement or continuation of the original arrangement, and the investment amount has not changed; (b) Trust Corporation 2 and the Group reached a consensus in early March 2022 on the “observation period”, renegotiated a temporary repayment plan to treat the entire arrangement under the second facility as a fixed-term debt; and (c) in 2022, Trust Corporation 2 elected to claim its rights and interests as a creditor. As of the end of 2022, the Group adjusted such equity contribution and shareholder’s loan as interest-bearing liabilities.

(C) Other Trust Loan Arrangements

RSM’s findings

One of the concerns raised by PwC in the Resignation Letter was whether the Group has other undisclosed trust loan arrangements. RSM has conducted review of the Group’s loan records and noted that 14 trading and procurement joint ventures/associated companies and 13 development joint ventures/associated companies of the Group had trust loan arrangements similar to the arrangements under the Trust Loans (other than Trust Loan 2) as of 31 December 2021. These other trust loan arrangements were entered into between the relevant joint ventures/associated companies of the Group and other independent trust corporations in 2021 or before.

The majority of the trust loans of the 14 trading and procurement joint ventures/associated companies and the 13 development joint ventures/associated companies were secured by guarantees or assets of the Group. RSM has reviewed the lists of pledges and guarantees provided by the Company to PwC and noted that none of the guarantees or assets pledges associated with these other trust loans were included in the lists.

The principal balances of the trust loans for these joint ventures/associated companies as of 31 December 2021 and 31 December 2022 were RMB42.98 billion and RMB34.01 billion, respectively.

Accounting treatment

Since some of the trust loans were actually used, and the repayment responsibility of which was assumed, by the subsidiaries of the Group, the Group has included a total of RMB11.62 billion of the principal balance of the trust loans in the consolidated financial statements of the Group for the year ended 31 December 2021.

In the financial year 2022, due to the withdrawal or intention to withdraw by the shareholders of these joint ventures/associated companies from the cooperation arrangements, the Group decided to include a total of RMB24.34 billion of the above principal balance of the trust loans in the consolidated financial statements of the Group for the year ended 31 December 2022.

In addition, the balance of the trust loans that has been consolidated in 2021 from the start dropped to RMB9.67 billion in the financial year 2022, the aggregate total amount of the trust loans for the 14 trading and procurement joint ventures/associated companies and the 13 development joint ventures/associated companies in the amount of RMB34.01 billion were fully consolidated in the financial statements of the Group as of 31 December 2022.

With regard to the accounting treatment of the trust loans of the 14 trading and procurement joint ventures/associated companies and the 13 development joint ventures/associated companies from 2021 to 2022, the relevant loans have been recorded in the then financial statements of the joint ventures/associated companies when incurred, and then consolidated on the proportion of equity investment under equity method in the Group's consolidated financial statements. Therefore, in the Group's consolidated financial statements as of 31 December 2021, except for the 3 trading joint ventures/associated companies and the 7 development joint ventures/associated companies where the principal balance of the trust loans amounting to RMB11.62 billion was consolidated into the Company's consolidated financial statements as a result of utilization and assumption of repayment responsibility by the Group's subsidiaries, the principal balance of other trust loans of the 14 trading and procurement joint ventures/associated companies and the 13 development joint ventures/associated companies in the aggregate amount of RMB31.36 billion was accounted for on the proportion of equity investment under equity method in the consolidated financial statement of the Group. However, as the shareholders of these joint ventures/associated companies completed their withdrawal or expressed their willingness to withdraw in 2022, the Group has decided to consolidate all the trust loans of these 14 trading and procurement joint ventures/associated companies and 13 development joint ventures/associated companies with an aggregate amount of RMB34.01 billion with the financial statements of the Group for the year ended 31 December 2022.

As noted above, all such trust loans are now accounted for in the consolidated financial statements of the Group and details of such trust loans have been provided to Zhonghui Anda, the current auditor of the Company, for its audit of the financial statements of the Group.

Commercial rationale

Similar to the Trust Loans, the proceeds from the trust loans from the 14 trading and procurement joint ventures/associated companies and 13 development joint ventures/associated companies were transferred and finally remitted to a subsidiary of the Group as advance payments or other receivables. The proceeds would then be handled by the subsidiary as a whole or used for the development and construction of projects of the development-type joint ventures/associated companies.

For the majority of the trust loans of the 14 trading and procurement joint ventures/associated companies and 13 development joint ventures/associated companies, the relevant subsidiaries of the Group provided guarantees or charges on assets to trust institutions as credit enhancement. RSM has reviewed the lists of pledges and guarantees provided by the Company to PwC and noted that none of the guarantees or assets pledges associated with these other trust loans were included in the lists. Similar to the Trust Loans arrangement, the Group is of the view that the then financial management personnel interpreted that only guarantees or pledges provided in connection with debts of the subsidiaries of the Group would need to be disclosed in notes to the financial statements of the Group.

THE BOARD'S ASSESSMENT

The Board is satisfied that the issue on the Trust Loans has been addressed as the nature of the loans has been clarified. The Board considered that the Independent Investigation is adequate for the following reasons:

- (1) the Independent Investigation has covered every contract under the Trust Loans;
- (2) the fund flow for the Trust Loans can be clearly traced and all amounts can be accounted for;
- (3) RSM has conducted background checks on all the entities involved in the arrangement and none of them are connected persons of the Company; and
- (4) the other trust loan arrangements of the Group have been identified.

The Board also considered that no additional investigative procedures would be required for the following reasons:

- (1) as noted in the report of the Independent Investigation, information about the Trust Loans and the credit enhancements was not disclosed to PwC due to the interpretation by the financial management personnel that only guarantees or pledges provided in connection with debts of subsidiaries of the Group would need to be disclosed to PwC. It did not involve any dishonest or fraudulent practice of personnel of the Group; and
- (2) all of the trust loans have now been included in the consolidated financial statements of the Group.

The Company has engaged an internal control consultant to perform a review on the Group's internal control. Based on the recommendations made by the internal control consultant, the Group has gradually adopted the internal control measures to complement the internal control measures in place and to address the findings from the Independent Investigation.

LISTING RULES IMPLICATIONS

To the best of the Board's knowledge, information and belief, having made all reasonable enquiries, the trust corporations, the partners of the joint ventures and associated companies referred to in the section headed "(A) The Trust Loans" and their respective ultimate beneficial owners are third parties independent of the Company and its connected persons.

The provision of credit enhancements in the form of guarantees, pledge of equities or assets to the trust corporations for the borrowings of joint ventures or associated companies of the Group constituted financial assistance under Rule 14.04(1)(e) of the Listing Rules. As the highest applicable percentage ratio in respect of each of the Trust Loans is below 5% of the applicable percentage ratios at the relevant time, the credit enhancements provided by the Group did not constitute a notifiable transaction under Chapter 14 of the Listing Rules.

In addition, given that the Trust Loans have now been included in the consolidated financial statements of the Group, the Company takes the view that the Trust Loans are financing facilities of the Group and the financial assistance provision under Chapter 14 should not apply to the credit enhancements for the Trust Loans.

INTERNAL CONTROL

During its independent forensic accounting review process for the Independent Investigation, RSM noted that it would be difficult for the staff of the Group's headquarters to directly confirm the details of the trust loan arrangements due to the resignation of some relevant employees of the subsidiaries and at the Group's headquarters. There are also situations where the staff of the Group's headquarters need to make enquiries with various parties due to the records of the relevant trust loans are kept at the project companies. RSM recommended the audit committee to engage an internal control consultant to review the internal procedures of the Group, and on measures for maintaining documents of the Group at the Group's headquarters, in particular agreements, contracts, letters of guarantee, confirmation letters and other legally binding documents signed by subsidiaries.

The credit enhancement measures, including the pledges and guarantees provided by the Group for the loans of the joint ventures/associated companies, have not been disclosed to PwC nor disclosed in the notes to the financial statements of the Company's annual report for the 2021 audit. The Group attributed this to the misunderstanding by the staff of the Group's financial management center of the disclosure requirements for pledge and guarantee information to be included in the notes to the financial statements of the annual report. In this regard, RSM suggested that the Company should engage internal control or compliance consultants to provide training to the Group's management, the person in charge of the Group's financial management center and the financial management personnel, as well as the financial management personnel of each subsidiary of the Group, so as to ensure that the Group's financial management personnel could correctly understand the disclosure requirements and standards of the notes to the financial statements of listed companies.

The Group has engaged an internal control consultant to carry out a review on the internal control measures of the Company. The internal control review is expected to be completed in July 2023. The Company will publish an announcement separately on the results of the internal control review.

CONTINUED SUSPENSION OF TRADING

At the request of the Company, the trading in the shares of the Company on the Stock Exchange was suspended with effect from 9:00 a.m. on 1 April 2022. Trading in the shares of the Company will remain suspended until further notice.

Holders of the Company’s securities and potential investors are advised to exercise caution when dealing in the securities of the Company.

DEFINITIONS

Unless the context requires otherwise, capitalized terms in this announcement shall have the meanings set out below:

“Board”	the board of directors of the Company;
“Company”	Shimao Group Holdings Limited, a company incorporated in the Cayman Islands with limited liability, the shares of which are listed on the main board of the Stock Exchange (Stock Code: 813);
“connected person”	has the meaning ascribed to it under the Listing Rules;
“Director(s)”	the director(s) of the Company;
“Group”	the Company and its subsidiaries;
“Independent Investigation”	the independent investigation carried out on the issues raised by PwC in the Resignation Letter;
“Listing Rules”	The Rules Governing the Listing of Securities on the Stock Exchange;
“PRC”	the People’s Republic of China;
“PwC”	PricewaterhouseCoopers, the previous auditor of the Company;
“Resignation Letter”	the resignation letter of PwC dated 24 March 2022;
“RMB”	Renminbi, the lawful currency of the PRC;

“RSM”	RSM Corporate Advisory (Hong Kong) Limited, the independent investigator engaged by the Company to conduct the Independent Investigation;
“Stock Exchange”	The Stock Exchange of Hong Kong Limited;
“subsidiaries”	has the meaning ascribed to it under the Listing Rules;
“Trust Corporation 1” to “Trust Corporation 4”	four independent commercial trust corporations established in the PRC;
“Trust Loan 1” to “Trust Loan 4”	the trust loan arrangements entered into with Trust Corporation 1 to Trust Corporation 4, respectively;
“Trust Loans”	the four trust loans identified by PwC in the Resignation Letter, namely Trust Loan 1, Trust Loan 2, Trust Loan 3 and Trust Loan 4;
“Zhonghui Anda”	Zhonghui Anda CPA Limited, the current auditor of the Company; and
“%”	per cent.

On behalf of the Board
Shimao Group Holdings Limited
Hui Sai Tan, Jason
Vice Chairman and President

Hong Kong, 23 June 2023

As at the date of this announcement, the Board comprises five Executive Directors, namely, Mr. Hui Wing Mau (Chairman), Mr. Hui Sai Tan, Jason (Vice Chairman and President), Ms. Tang Fei, Mr. Lu Yi (Executive President) and Mr. Xie Kun; one Non-executive Director, namely, Mr. Ye Mingjie; and three Independent Non-executive Directors, namely, Mr. Lyu Hong Bing, Mr. Lam Ching Kam and Mr. Fung Tze Wa.