# HSIN CHONG GROUP HOLDINGS LIMITED
# 新昌集團控股有限公司

*(Incorporated in Bermuda with limited liability)*

**(Stock Code: 00404)**

## US$300 MILLION 8.75% SENIOR NOTES DUE 2018

**(Stock Code: 5513)**

## US$150 MILLION 8.50% SENIOR NOTES DUE 2019

**(Stock Code: 5607)**

## UPDATE ON RECENT DEVELOPMENT OF SUSPENSION – INTERNAL INVESTIGATION REPORT

This announcement is made by Hsin Chong Group Holdings Limited (the "**Company**" and together with its subsidiaries, collectively the "**Group**" or "**HCGH**") pursuant to Rule 13.09 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "**Listing Rules**") and the Inside Information Provisions under Part XIVA of the Securities and Futures Ordinance (Chapter 571, Law of Hong Kong).

References are made to the announcements of the Company dated 29 December 2017, 29 November 2017, 31 October 2017, 29 September 2017, 14 August 2017, 12 June 2017, 29 May 2017, 17 May 2017, 5 April 2017 and 3 April 2017, and the 2016 annual results announcement published on 19 April 2017 and the annual report of the Company for the year ended 31 December 2016 (together "**2016 Annual Report**").

Further to the updates included in the above mentioned announcements, the Company provides further information on its recent development. Unless otherwise specified, capitalised terms used herein shall have the same meanings as those defined in 2016 Annual Report.

## A. BACKGROUND

As stated in the announcement of the Company dated 29 September 2017 relating to the update on recent development of suspension, on 25 July 2017, Deloitte Advisory (Hong Kong) Limited ("**Deloitte**") has been engaged by P. C. Woo & Co., the legal advisor representing the Independent Investigation Committee, as the independent consultant to conduct independent forensic review on certain audit issues raised by the former auditor of the Company, PricewaterhouseCoopers ("**PwC**") in its 2016 independent auditor's report. The fieldwork of the forensic review has commenced in September 2017.

As of the date of this announcement, the Company has received the draft version of the investigation report issued by Deloitte on 29 December 2017 (the "**Investigation Report**"). The highlights of the Investigation Report are set out herein as follows.

As the Investigation Report is still in the draft form, the following highlights of the Investigation Report may be subject to addition, reduction or modification.

## B. HIGHLIGHTS OF ALLEGED MATTERS

Trading in shares of the Company on the Stock Exchange has been suspended with effect from 3 April 2017. Pursuant to 2016 Annual Report, the then auditor of the Group, PwC, has not expressed an audit opinion on the consolidated financial statements for the year ended 31 December 2016. The disclosure of "Basis for Disclaimer of Opinion" by PwC is attributable to PwC's lack of sufficient appropriate evidence in respect of the following matters:

i. multiple uncertainties relating to going concern;

ii. transactions and balances relating to Mr. Zhou Wei and his related entities (hereinafter referred to as "**Identified Issue I**");

iii. payments made to a construction company (hereinafter referred to as "**Identified Issue II**"); and

iv. payments made to certain financial consultancy companies (hereinafter referred to as "**Identified Issue III**", together with Identified Issue I and Identified Issue II, the "**Identified Issues**").

Given the abovementioned, the Board has established the Independent Investigation Committee in late March 2017 and authorised it to conduct independent investigations on Identified Issues I, II and III. The Independent Investigation Committee comprises three independent non-executive Directors and it engages P. C. Woo & Co. to provide the independent non-executive Directors with relevant legal advice in respect of the independent investigations. Also, Deloitte is engaged by P. C. Woo & Co. to conduct independent investigations on each of the Identified Issues.

## C. SUMMARY OF THE INVESTIGATION REPORT

A summary of the main findings and the corresponding recommendations in the draft Investigation Report based on the text whereof is set out below:

### 1 Identified Issue I: Transactions and Balances Relating to Mr. Zhou Wei (Former Executive Director of the Company) and His Related Entities

1.1 In July 2016, Beijing Zhong Wu Xin He Property Development Company Limited* (北京中物信和房地產開發有限公司, hereinafter referred to as "**Zhong Wu Xin He**"), a related company of the Company's former executive director, Mr. Zhou Wei ("**Mr. Zhou**") and a third party company established in the PRC (the "**Original Vendor**") entered into an agreement pursuant to which Zhong Wu Xin He agrees to sell two of its properties in Beijing (the "**BJ Properties**") to the Original Vendor at a consideration of RMB1,070,000,000. On 2 August 2016, Hsin Chong Finance Lease (China) Company Limited* (新昌融資租賃(中國)有限公司, hereinafter referred to as "**HCFL**"), a subsidiary of the Company, and the Original Vendor entered into a cooperation agreement pursuant to which HCFL agreed to finance of not less than RMB500 million to assist the Original Vendor in paying its property transfer amount to Zhong Wu Xin He. On 24 August 2016, the Original Vendor, HCFL and Zhong Wu Xin He entered into a Sale and Leaseback Agreement and the first instalment of RMB129,000,000 was settled as agreed thereunder. It is known that the sale and leaseback transaction was approved by the then executive Director, Mr. Zhou (as the head of HCFL), without submitting to the Group for examination and approval. As no adequate business approval procedures has been set up by the Company to guide its subsidiaries, Deloitte was not able to evaluate whether such approval conformed with the Group's internal policy. Due to various reasons of the parties, the sale and leaseback transaction was therefore revoked on 15 December 2016 with the agreement of all parties whom agreed to assign the rights over the first instalment of the property transfer amount of RMB129,000,000 provided to Zhong Wu Xin He by HCFL, to Hsin Chong Holdings (China) Limited* (新昌控股(中國)有限公司, hereinafter referred to as "**Hsin Chong China**"), a subsidiary of HCGH. Subsequently, on 28 December 2016, a trust loans company established in Tianjin (hereinafter referred to as "**Trust Company A**") entered into a Loan Agreement with Hsin Chong China pursuant to which Trust Company A agreed to advance a loan to Hsin Chong China in the sum of RMB420,000,000. The loan was secured by the BJ Properties owned by Zhong Wu Xin He and guaranteed by HCGH. The loan has been considered and approved on the board meetings held by Hsin Chong China and HCGH on 9 December 2016 and 12 December 2016 respectively. The loan was extended to Hsin Chong China according to the terms of the Loan Agreement.

1.2 On the day before the signing of the Loan Agreement with Trust Company A, Tianjin Xiesheng Commercial Management Company Limited* (天津協盛商業管理有限公司, "**Tianjin Xiesheng**"), another subsidiary of HCGH, and Beijing Xuan He Jia Mei Property Management Company Limited* (北京宣和嘉美物業管理有限公司, "**Xuan He Jia Mei**"), another associated company of Mr. Zhou, entered into a Cooperation Agreement. Pursuant to which, the management company Xuan He Jia Mei agreed to carry out decoration works for BJ Properties at an amount of RMB247,500,000. However, it is claimed that the Cooperation Agreement was revoked on the same day by the reason of lack of due consideration and was replaced by Xuan He Jia Mei borrowing an amount of RMB247,500,000 from Tianjin Xiesheng. The loan was guaranteed by Zhong Wu Xin He. Deloitte learned from the interview that Hsin Chong China agreed the loan terms with Xuan He Jia Mei for the reason of facilitating itself in applying loans from Trust Company A. However, the agreement was revoked and replaced by a loan agreement of a completely different nature with the same transaction value on the same day when Tianjin Xiesheng and Xuan He Jia Mei entering into the BJ Properties Decoration Agreement. Deloitte is of the view that the Company did not give a satisfactory explanation in this regard.

1.3 As mentioned above, the agreements entered into by the Group with Zhong Wu Xin He and Xuan He Jia Mei respectively were not announced on a timely basis. Deloitte is of the view that the transactions thereunder may constitute a discloseable and connected transaction under the Listing Rules of the Stock Exchange. Deloitte recommends the Independent Investigation Committee to seek legal advice on potential violations of the Listing Rules in order to assess the impact on the compliance of the Company and, if required, demand the management of HCGH to appoint an independent financial adviser to advice whether the terms of the connected transaction are fair and reasonable. It is understood that no active reporting mechanism, policy or other approval procedures was set up within HCGH concerning connected transaction or relationship of the connected persons.

1.4 PwC has challenged the reasons of the management of the Company (other than Mr. Zhou) for lack of knowledge of certain major connected transactions between its subsidiaries and Zhong Wu Xin He and Xuan He Jia Mei. As regard to the report and approval for specific issues submitted to the management of the Company by HCGH's subsidiaries, Deloitte noticed that no corporate governance policy or control process concerning such specific issues that must be submitted to the management of the Company for reporting and approving was executed within both domestic real estate projects and leasing business segments of the Company. Based on the fact that the Company did not clearly define material transactions, some of the interviewees considered that the aforesaid sale and leaseback and property management business fell within the scope of the subsidiaries' daily operations and therefore did not report such transactions to the management of the Company in time.

1.5 In addition, PwC has referred to the management of the Company providing certain agreements and contracts that had not yet completely or fully implemented or signed to them during the audit. Deloitte conducted interviews with the former staff members of HCFL responsible for recording such documents and found that due to the internal reorganisation and insufficient manpower of HCFL, no proper handover of work was arranged to the former staff and thus mistakenly provided the unstamped or unsigned drafts to PwC without due understanding.

1.6 As to whether the above transactions will pose potential economic and financial risks to HCGH, Deloitte recommends the management of the Company to consider seeking legal advice from domestic practicing solicitors to determine the legal enforcement of the collateral under the loan transaction between Trust Company A and Hsin Chong China and to assess the potential economic and financial losses to HCGH.

## 2 Identified Issue II: Payments to a Construction Company

2.1 The contractor responsible for the shop renovation of Foshan Outlet Project of the Group (the "**Construction Company**") was entrusted by Outlets Property Guangdong Company Limited*（奧特萊斯置業廣東有限公司）("**Property Guangdong**"), a subsidiary of the Group, to pay renovation compensations of RMB8,500 per square metre to the tenants of shops of commercial phase 1 with a total sum of RMB765,000,000. It is understood that RMB765,000,000 was the cap for the total contract fee, including the renovation compensations, fees for land and water system works, coordination of demolition and relocation work and interior decoration work, and such fees would be apportioned and used according to the actual needs for construction works by the Construction Company. Based on the financial documents and contracts reviewed by Deloitte, the Group has paid part of the agreed amount of RMB589,835,900 to the Construction Company as of 17 October 2017, and RMB286,480,000 of which were related to the total cost of investment attraction while the remaining was construction fee, soft decoration costs and interior decoration costs. In addition, on 1 July 2016, Jiali Xiesheng (Tai'an) Property Limited* (嘉勵協盛（泰安）置業有限公司, "**Jiali Xiesheng**"), another subsidiary of the Group, and the Construction Company entered into a contract in relation to another Outlet Project situated at Tai'an City pursuant to which the Construction Company was engaged to provide exquisite renovations for its shops. The total project budget was RMB500,000,000 and the Group has paid RMB272,000,000 in total as required in the contract.

2.2 At the request of Deloitte, the Company commissioned a professional firm in the PRC which engaged in commercial real estate marketing management to provide an independent industry expert assessment report for Outlet Project of Hsin Chong China. Industry professionals are of the view that the renovation compensations invested by Foshan Project Companies were fair and reasonable with reference to other outlet projects engaged in by their team in the past.

2.3 As Foshan Project and Tai'an Outlet Project are long-term investment in the domestic real estate market of the Group, Deloitte is unable to calculate the financial return and commercial value of the project based on known facts to further assess the business reasons for the project fund spending and its rationality. However, the management of the Company indicated that the land price of Foshan Outlet Project has been increasing by reason of economic performance since its commencement of business. It is estimated that the current land price of Foshan Outlet Project has far exceeded the purchase price when the project was acquired by the Group.

## 3. Identified Issue III: Payments to Certain Financial Consultancy Companies

3.1 In May 2016, Property Guangdong obtained a short-term entrusted loan of RMB750,000,000 from an entrusted loan company established in the PRC (the "**Trust Company B**"). The loan with a term from 25 May 2016 to 24 May 2017 and interest at 1% per month was funded by an independent third company (the "**Loan Company**"). At the time of loan negotiation, Property Guangdong and three other subsidiaries involved in the construction of Foshan Outlet Project entered into certain financing advisory services agreements and financial advisory contracts with the Loan Company and three financial consulting firms respectively. The principal, interest and other fees incurred of the abovementioned loan were early repaid on 29 March 2017 and its actual term was about 10 months. The loan interests charged by the Trust Company B and the financial consultancy fees charged by the Loan Company and three financial advisory firms were RMB181,290,000 in aggregate, accounting for 24.17% of the loan in total.

3.2 It is understood that the Group and its subsidiaries was unable to obtain loans at lower costs through the general financial institutions due to various reasons. Therefore, the Group could only obtain market funds by way of entrusted loans to meet its daily operations and repay other loans to be due by the Group. Nevertheless, the loan costs involved would be significantly higher and reflected in the financing consulting fees, financial advisory fees or agency fees upon lending. In assessing the rationality of the loan cost, Deloitte acknowledged that the Loan Company and the three financial consulting firms, though, would provide specific advisory services to lenders, the main consideration for the reasonableness of the fees was that a lender had to utilise its business relationship in the domestic market for introducing lenders and procuring borrowers in obtaining the loans through different intermediaries, namely the brokerage fee to be charged by the Loan Company for providing entrust loans to Property Guangdong. After taking full consideration of the operating environment of the Group under the Identified Issue I and Identified Issue II, Deloitte understood that the Group had tight cash flow in 2016 but was unable to understand the rationale for HCGH making loans at the cost-to-principal ratio up to 24.17% under such circumstances.

## 4. Conclusion

4.1 Deloitte understood that the management were responsible for the commercial considerations of the transactions concerning such Identified Issues and should make business decisions based on its understanding of the market, operating costs and profitability, which might involve long-term development of the Company. Deloitte is not in a position to assess any long-term rewards or risks (such as the future value of the land and property, loan repayments, development and gains of Outlet Projects) that may arise from the transactions involved in the identified issues. Thus, Deloitte is unable to assess the reasonableness of the management's explanation for their commercial considerations of such transactions. However, during its assessment, Deloitte did not find any clear evidence that some individuals misappropriated funds or did other commercial frauds by virtue of the transactions involved in the identified issues. Limited by aforesaid commercial and unknown factors, Deloitte is not able to prove that such transactions currently cause apparent and significant economic or financial losses to the Group.

4.2 However, based on Deloitte's findings, there are weaknesses in group management and certain internal control systems inside the Group. For example, the management of the Company had no knowledge of the transactions with its subsidiaries and related parties and had no sound and effective management mechanism. Meanwhile, there was clearly a lack of understanding among some of the management members in recognising notifiable transactions and connected transactions under the Listing Rules. In respect of corporate governance, the Company did not clearly define material transactions and clarify the reporting requirements for subsidiaries on major issues. In terms of operations, the Group lacked a sound fund transfer and management plan as a whole. On the one hand, senior management explained that due to various negative factors, the Group failed to obtain loans through general financial institutions and thus needed to raise money at a very high cost by entrusted loan; while on the other hand, its subsidiaries provided large amounts of loans to associated entities of Mr. Zhou without the knowledge of the Board within a relatively close period of time, which highlights the potential conflicts in management.

## D. OPINIONS FROM THE INDEPENDENT INVESTIGATION COMMITTEE

The Independent Investigation Committee is further reviewing the draft of the Investigation Report issued by Deloitte, and will provide views, opinions and relevant advice in respect of the findings of the Investigation Report to the Board, so as to procure the Board to take appropriate actions to settle each Identified Issues and promote the corporate governance of the Company. For the advice provided by the Independent Investigation Committee to the Board, the Company will disclose to its shareholders and potential investors as and when appropriate.

## CONTINUED SUSPENSION OF TRADING IN THE SHARES AND DEBT SECURITIES

Trading in the ordinary shares and debt securities of the Company has been suspended since 3 April 2017 and will continue to be suspended until further notice. Conditions of the resumption of trading have been set out in the Company's announcement dated 12 June 2017.

Shareholders of the Company and potential investors are advised to exercise caution when dealing in the shares and other securities of the Company.

By order of the Board of
**Hsin Chong Group Holdings Limited**
**LIN Zhuo Yan**
*Non-executive Chairman and Non-executive Director*

Hong Kong, 9 January 2018

*As at the date of this announcement, the Board comprises Mr. LIN Zhuo Yan as the Non-executive Chairman and Non-executive Director; Ir Dr Joseph CHOI Kin Hung (Chief Executive Officer), Mr. Wilfred WU Shek Chun (Chief Risk Officer) and Mr. Eric TODD as Executive Directors; Mr. YAN Jie, Mr. CHEN Lei, Mr. CHUI Kwong Kau and Mr. LUI Chun Pong as Non-executive Directors; and Mr. CHENG Sui Sang, Ms. LEE Jai Ying, Mr. George YUEN Kam Ho and Mr. LAI Chik Fan as Independent Non-executive Directors.*

* *For identification purpose only*