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HARMONY AUTO

**和諧汽車**

**China Harmony Auto Holding Limited**

**中國和諧汽車控股有限公司**

*(Incorporated in the Cayman Islands with limited liability)*

**(Stock Code: 03836)**

**(A) DISCLOSEABLE TRANSACTION IN RELATION TO  
DEEMED DISPOSAL OF INTEREST IN IAC;  
(B) DISCLOSEABLE TRANSACTION IN RELATION TO  
DISPOSAL OF 29% INTEREST IN IAC;  
AND  
(C) DISCLOSEABLE AND CONNECTED TRANSACTION  
IN RELATION TO THE TAX NOVATION ARRANGEMENT**

**(A) DISCLOSEABLE TRANSACTION IN RELATION TO DEEMED  
DISPOSAL OF INTEREST IN IAC**

On 28 December 2017, the 2017 December IAC Capital Increase Agreement was entered into among Hexie Trading, IAC, the Aftersales Management Company, the IAC Key Management and the 2017 December IAC Investor to raise the same amount of new capital for IAC as originally contemplated under the 2017 June IAC Capital Increase Agreement.

Prior to the 2017 December IAC Capital Increase Agreement, IAC was an indirect wholly-owned subsidiary of the Company. Following completion of the 2017 December IAC Capital Increase Agreement, IAC was owned as to 49.28% by Hexie Trading, 25.36% by the 2017 December IAC Investor, 1.73% by Tibet Runyin and 23.63% by Lancherui respectively.

As all of the relevant percentage ratios (as defined under the Listing Rules) of the transactions contemplated under the 2017 December IAC Capital Increase Agreement were more than 5% but less than 25%, the transactions contemplated under the 2017 December IAC Capital Increase Agreement constituted a discloseable transaction of the Company under Chapter 14 of the Listing Rules and was subject to the reporting and announcement requirements under the Listing Rules.

The Company admits that it has breached Rule 14.34 of the Listing Rules for not timely making announcement in relation to the 2017 December IAC Capital Increase Agreement.

**(B) DISCLOSEABLE TRANSACTION IN RELATION TO DISPOSAL OF 29% INTEREST IN IAC**

On 5 April 2019, Hexie Trading as vendor and Wanyin as purchaser entered into the IAC Disposal Agreement, pursuant to which Hexie Trading agreed to sell and Wanyin agreed to purchase the IAC Sale Interest, representing 29% equity interest in IAC, at a cash consideration of RMB192.0 million.

As one or more of the relevant percentage ratios (as defined under the Listing Rules) of the transactions contemplated under the IAC Disposal Agreement exceeded 5% but were all less than 25%, the IAC Disposal constituted a discloseable transaction of the Company, and was subject to the reporting and announcement requirements under Chapter 14 of the Listing Rules.

The Company admits that it has breached Rule 14.34 of the Listing Rules for not timely making an announcement in relation to the IAC Disposal in a timely manner due to an inadvertent oversight.

**(C) DISCLOSEABLE AND CONNECTED TRANSACTION IN RELATION TO THE TAX NOVATION ARRANGEMENT**

On 1 June 2017, Hexie Trading (an indirect wholly-owned subsidiary of the Company), Hexie Industrial and IAC (a then indirect wholly-owned subsidiary of the Company) entered into the Tax Novation Agreement, pursuant to which Hexie Trading novated all the payment obligations in relation to the Tax Liabilities amounting to RMB1,021,716,000 to Hexie Industrial. In consideration of Hexie Industrial agreeing to the Tax Novation Arrangement, Hexie Trading agreed to pay a sum equivalent to the Tax Liabilities to Hexie Industrial in cash via IAC.

As all of the relevant percentage ratios (as defined under the Listing Rules) of the transactions contemplated under the Tax Novation Agreement were more than 5% but less than 25%, the transactions contemplated under the Tax Novation Agreement constituted a discloseable transaction of the Company under Chapter 14 of the Listing Rules and was subject to the reporting and announcement requirements under the Listing Rules. Hexie Industrial was majority-controlled by Mr. Feng, being the chairman of the Board, an executive Director and the controlling shareholder of Company who was indirectly interested in 690,066,160 Shares representing approximately 43.79% of the issued share capital of the Company. Hexie Industrial is an associate of Mr. Feng and hence a connected person of the Company under Chapter 14A of the Listing Rules. Hence, the transactions contemplated under the Tax Novation Agreement also constituted a connected transaction of the Company subject to the reporting, announcement, circular and independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

Due to inadvertent oversight, the Company had not timely made announcement and sought independent Shareholders' approval in respect of the Tax Novation Arrangement in accordance with the Listing Rules. The Company admits that it has breached Rules 14.34, 14A.35 and 14A.36 of the Listing Rules.

Please refer to a separate announcement of the Company of even date regarding actions of the Company to enhance its internal control policies and measures to ensure future compliance with the Listing Rules.

#### **(A) DISCLOSEABLE TRANSACTION IN RELATION TO DEEMED DISPOSAL OF INTEREST IN IAC**

Reference is made to the announcement of the Company dated 29 June 2017 in relation to the proposed introduction of strategic investors to IAC (a then indirect wholly-owned subsidiary of the Company) and the proposed deemed disposal by the Group of interest in IAC pursuant to the 2017 June IAC Capital Increase Agreement entered into among Hexie Trading, IAC, the Aftersales Management Company, the IAC Key Management and two strategic investors who were Independent Third Parties.

The Board would like to provide updates on the aforesaid proposed transaction that (i) subsequent to the signing of the 2017 June IAC Capital Increase Agreement, the two strategic investors decided not to proceed with the transactions thereunder and accordingly the 2017 June IAC Capital Increase Agreement did not proceed to completion; and (ii) on 28 December 2017, the 2017 December IAC Capital Increase Agreement was entered into among Hexie Trading, IAC, the Aftersales Management

Company, the IAC Key Management and the 2017 December IAC Investor to raise the same amount of new capital for IAC as originally contemplated under the 2017 June IAC Capital Increase Agreement. Details of the 2017 December IAC Capital Increase Agreement are set out below.

## **1. The 2017 December IAC Capital Increase Agreement**

### **Date**

28 December 2017

### **Parties**

- (i) Hexie Trading;
- (ii) IAC;
- (iii) the Aftersales Management Company;
- (iv) Tibet Runyin;
- (v) Lancherui; and
- (vi) the 2017 December IAC Investor.

### **Subject matter**

Pursuant to the 2017 December IAC Capital Increase Agreement, the parties agreed that:

- (i) Tibet Runyin would make cash contribution of RMB4,776,500 (equivalent to approximately HK\$5.5 million) to subscribe for the registered capital of IAC in the amount of RMB4,776,500;
- (ii) Lancherui would make cash contribution of RMB65,223,500 (equivalent to approximately HK\$74.6 million) to subscribe for the registered capital of IAC in the amount of RMB65,223,500;
- (iii) the 2017 December IAC Investor would make cash contribution of RMB210,000,000 (equivalent to approximately HK\$240.3 million) to subscribe for the registered capital of IAC in the amount of RMB70,000,000 (equivalent to approximately HK\$80.1 million); and

- (iv) Hexie Trading would subscribe for the registered capital of IAC in the amount of RMB116,000,000 (equivalent to approximately HK\$132.7 million) by way of capitalising part of the Operation Advances in the sum of RMB630,000,000 (equivalent to approximately HK\$720.9 million).

The capital contribution of Hexie Trading by way of capitalisation of the Operation Advances at a premium was determined with a view to offsetting part of the outstanding debts owed by IAC to Hexie Trading and attracting new capital for IAC's development. The cash contribution from the IAC Key Management and the 2017 December IAC Investor were intended to be applied for IAC's business development, capital expenditure and general working capital purposes, and was determined based on arm's length negotiations having taken into account the capital needs and prospects of the IAC Group. The consideration paid by the IAC Key Management was at a discount to that paid by the 2017 December IAC Investor in order to incentivise the IAC Key Management. It was further agreed among the parties that the payment of cash contribution and capitalisation of the Operation Advances would be in accordance with the schedule below:

- (i) the IAC Key Management would make cash contribution of RMB51,000,000 in aggregate within 30 days from the signing of the 2017 December IAC Capital Increase Agreement, and Hexie Trading would capitalise RMB29,000,000 of the Operation Advances upon receipt by IAC of the aforesaid cash contribution from the IAC Key Management;
- (ii) the IAC Key Management would make cash contribution for the remaining balance of RMB19,000,000 in aggregate on 1 April 2018, and Hexie Trading would capitalise RMB601,000,000 of the Operation Advances on the same date; and
- (iii) the 2017 December IAC Investor would make cash contribution of RMB210,000,000 to IAC on or before 15 March 2018.

As at the date of the 2017 December IAC Capital Increase Agreement, the total principal amount of the Operation Advances owed by the IAC Group amounted to approximately RMB1,020,000,000 (equivalent to approximately HK\$1,167.2 million). Following completion of the loan capitalisation contemplated under the 2017 December IAC Capital Increase Agreement, the remaining balance of the Operation Advances in the amount of RMB390,000,000 had become a 5-year term loan which bears interest at the rate in accordance with the benchmark loan interest rate stipulated by the People's Bank of China.

## Completion

Completion of the 2017 December IAC Capital Increase Agreement took place after the signing thereof on 28 December 2017.

## 2. Information about parties to the 2017 December IAC Capital Increase Agreement

Hexie Trading is an indirect wholly-owned subsidiary of the Company principally engaged in automobile sales, services, investment and investment holding. IAC was a wholly-owned subsidiary of Hexie Trading before the 2017 December IAC Capital Increase Agreement.

To the best of the knowledge, information and belief of the Directors having made all reasonable enquiries, as at the date of the 2017 December IAC Capital Increase Agreement,

- (i) Tibet Runyin was a partnership owned as to 20% by the Aftersales Management Company (as general partner), and as to 45% by Mr. Gao Zhongjian (高中建) and 35% by Mr. Zhao Yaowen (趙耀文) as limited partners respectively who were the senior management members of the IAC Group;
- (ii) Lancherui was a partnership owned as to 1.68% by the Aftersales Management Company (as general partner), and 39.46% by Mr. Feng Changjin (馮長進), 18.56% by Mr. Yang Lei (楊磊), 39.98% by Mr. Chen Yi (陳翼) and 0.32% by Mr. Wang Chang Sheng (王長生) (as limited partners). Mr. Feng Changjin is the elder brother of Mr. Feng, Mr. Yang Lei was the chairman and chief executive office of IAC and an executive Director who resigned as a Director on 28 December 2017 and was the sole director and authorised representative of the Aftersales Management Company, while Mr. Chen Yi and Mr. Wang Chang Sheng were the director of insurance matters (保險事故總監) and the finance manager (財務經理) of IAC respectively;
- (iii) the Aftersales Management Company is the general partner of Tibet Runyin and Lancherui and was owned as to 28% by Mr. Yang Lei, 24% by Mr. Qu Shao Hui (瞿韶輝), 24% by Mr. Chen Yi and 24% by Mr. Hu Lei (胡磊). Mr. Qu Shao Hui and Mr. Hu Lei were the chief operations officer (營運總監) and sales director (銷售總監) of IAC respectively; and

- (iv) the 2017 December IAC Investor was beneficially owned by Mr. Li Tu Jin (李土金) and was principally engaged in equity investment.

Save as aforesaid, the parties to the 2017 December IAC Capital Increase Agreement and their respective ultimate beneficial owners are Independent Third Parties.

### 3. Information about IAC

IAC is a company established in the PRC in 2011 with limited liability. Prior to 2016, there was no operations conducted by IAC. In 2016, the Company implemented a reorganisation involving grouping all its 65 subsidiaries engaging in the provision of independent aftersales services under IAC (the “**Reorganisation**”). Since then, IAC became the holding company of the Group companies engaging in the provision of independent aftersales services.

Set out below is a summary of the financial information of IAC based on the financial statements prepared in accordance with the PRC accounting standards for each of the four years ended 31 December 2015, 2016, 2017 and 2018:

	Year ended 31 December			
	2015	2016	2017	2018
	(note 1)	(note 1)	(Note 2)	(Note 2)
	(RMB)	(RMB)	(RMB)	(RMB)
Loss before tax	5,124	6,626	215,069,830	197,367,553
Loss after tax	5,124	6,262	215,769,538	189,307,459

*Notes:*

1. Being unaudited financial information of IAC before the Reorganisation.
2. Being audited consolidated financial information of the IAC Group after the Reorganisation.



The unaudited net asset value of IAC as at 31 December 2016 (before the Reorganisation) was approximately RMB18.8 million, and the audited consolidated net asset value of the IAC Group as at 31 December 2017 and 2018 were approximately RMB779.8 million and RMB590.9 million respectively.

Following completion of the 2017 December IAC Capital Increase Agreement, IAC was owned as to 49.28% by Hexie Trading, 25.36% by the 2017 December IAC Investor, 1.73% by Tibet Runyin and 23.63% by Lancherui respectively. IAC was no longer a subsidiary of the Company following completion.

#### **4. Reasons for and benefits of the 2017 December IAC Capital Increase Agreement**

The Company is an investment holding company. The Group is principally engaged in the sale of automobiles and provision of aftersales services in the PRC.

It was the plan of the Company since its listing on the Stock Exchange to improve its revenue mix and profit margin by diversifying its revenue source. Apart from its traditional 4S-store operations, the Company was also optimistic about the prospects of the independent automobile aftersales services sector and commenced this business in 2015 by setting up independent aftersales services outlets in various cities in China. The number of outlets grew rapidly when the Company built up the critical mass to weed out small players in the market and seize market share. The expansion of this business however had commanded significant amount of working capital and upfront costs which had seen this business incurring losses from the start. In the meantime, with the development and expansion of the Group's independent aftersales services outlet network, the automobile manufacturers had reservation about the Group's involvement in the independent automobile aftersales services sector which might have certain degree of competition with the aftersales services provided by 4S-stores authorised by the automobile manufacturers. In the circumstances, the Company had wanted to solicit potential investors to provide new capital to support the business and offload part of the Company's interest in IAC in order to address the concerns of the automobile manufacturers on conflicts of interest with the Group's 4S-store operations. The Company also invited the then key management of the IAC Group to have become shareholders of IAC in order to ensure continuity and stability of the management of the IAC Group after the new investors had come in and to provide incentives to the management by aligning their interests with that of IAC.



Following the Reorganisation implemented in 2016 as referred to in the paragraph headed “Information about IAC” above, IAC had also become a treasury centre for the 65 subsidiaries engaged in the independent aftersales services business. IAC would centralise surplus funds from and distribute the required working capital to each of the subsidiaries. The Company would also from time to time make advances and capital injections to IAC for fulfilling the working capital needs of the independent aftersales services outlets. Up to the financial year ended 31 December 2017, the accumulated capital investment and advances made by the Group to IAC reached RMB1.0 billion.

Having considered that the 2017 December IAC Capital Increase Agreement would (i) bring in new investors and new capital to support the capital needs of IAC; (ii) enable the Group to offload partly its interest in IAC to address the concerns of automobile manufacturers and in particular offset part of the outstanding debts owed by IAC to the Group; and (iii) enable IAC to retain its senior management and align their interests with that of IAC, the Directors were of the view that the transactions contemplated under the 2017 December IAC Capital Increase Agreement were in the interests of the Company and the Shareholders as a whole, and the terms of the 2017 December IAC Capital Increase Agreement were on normal commercial terms and fair and reasonable.

## **5. Financial effects of the 2017 December IAC Capital Increase Agreement**

Prior to the 2017 December IAC Capital Increase Agreement, IAC was an indirect wholly-owned subsidiary of the Company. As a result of the completion of the 2017 December IAC Capital Increase Agreement on 28 December 2017, the Company’s equity interest in IAC was diluted to 49.28%, and the Group’s investment in IAC had been accounted for as interest in associate in the consolidated financial statements of the Group for the financial year ended 31 December 2017.

The deemed disposal of a 50.72% interest in IAC as a result of completion of the 2017 December IAC Capital Increase Agreement resulted in a gain of approximately RMB27.9 million, which was disclosed in note 40 to the audited consolidated financial statements of the Group contained in the annual report of the Company for the financial year ended 31 December 2017.

## **6. Listing Rules implications**

As all of the relevant percentage ratios (as defined under the Listing Rules) of the transactions contemplated under the 2017 December IAC Capital Increase Agreement were more than 5% but less than 25%, the transactions contemplated under the 2017 December IAC Capital Increase Agreement constituted a discloseable transaction of the Company and was subject to the reporting and announcement requirements under the Listing Rules.

As both the 2017 June IAC Capital Increase Agreement and the 2017 December IAC Capital Increase Agreement were to raise the same amount of new capital to IAC, with the 2017 December IAC Investor contributing the capital in place of the two strategic investors under the 2017 June IAC Capital Increase Agreement and the resulting percentage of equity interest of the Group in IAC were the same under both agreements, there was a misunderstanding at the relevant time that no announcements would be required regarding the non-completion of the 2017 June IAC Capital Increase Agreement and the entering into of the 2017 December IAC Capital Increase Agreement. The Company admits that it has breached Rule 14.34 of the Listing Rules for not timely making announcement in relation to the 2017 December IAC Capital Increase Agreement.

### **(B) DISCLOSEABLE TRANSACTION IN RELATION TO DISPOSAL OF 29% INTEREST IN IAC**

On 5 April 2019, Hexie Trading as vendor and Wanyin as purchaser entered into the IAC Disposal Agreement, pursuant to which Hexie Trading agreed to sell and Wanyin agreed to purchase the IAC Sale Interest, representing a 29% equity interest in IAC, at a cash consideration of RMB192.0 million. Details of the IAC Disposal Agreement are set out below.

#### **1. The IAC Disposal Agreement**

##### **Date**

5 April 2019 (as supplemented by a supplemental agreement dated 18 April 2019)

##### **Parties**

- (i) Hexie Trading; and
- (ii) Wanyin.

To the best of the knowledge, information and belief of the Directors having made all reasonable enquiries, (i) Wanyin is a company established in the PRC with limited liability, which was principally engaged in corporate asset management, corporate management consulting, investment consulting and property leasing; (ii) the ultimate beneficial owner of Wanyin as at the date of the IAC Disposal Agreement was Mr. Sun Yan Ming (孫彥明); and (iii) each of Wanyin and its ultimate beneficial owner is an Independent Third Party.

### **Assets disposed of**

Pursuant to the IAC Disposal Agreement, Hexie Trading agreed to sell and Wanyin agreed to purchase the IAC Sale Interest, being 29% equity interest in IAC as at the date of the IAC Disposal Agreement.

### **Consideration**

The consideration for the IAC Sale Interest was RMB192.0 million (equivalent to approximately HK\$219.7 million), which would be payable by Wanyin to Hexie Trading (or its nominee(s)) in cash on or before 30 September 2019.

The consideration was determined based on arm's length negotiations between Hexie Trading and Wanyin with reference to the unaudited net assets of the IAC Group as at 31 March 2019 of approximately RMB550.7 million. The consideration represented a premium of approximately 20% over the aforesaid net assets of the IAC Group attributable to the IAC Sale Interest, which reflected Wanyin's view about the prospects of the independent aftersales services business.

### **Completion**

Completion of the IAC Disposal Agreement took place on the date of receipt of the full consideration by Hexie Trading, being 22 October 2019.

Prior to completion of the IAC Disposal Agreement, Hexie Trading was interested in 48.8% equity interest in IAC. Following completion of the IAC Disposal Agreement, Hexie remained to hold 19.8% equity interest in IAC which had been accounted for as equity investment at fair value through other comprehensive income in compliance with applicable accounting standards in the consolidated financial statements of the Group for the financial year ended 31 December 2019.

## **2. Information of IAC**

Please refer to the information disclosed under the sub-section headed “Information about IAC” in the section headed “Discloseable transaction in relation to deemed disposal of interest in IAC” above.

## **3. Reasons for and benefits of the IAC Disposal**

The IAC Disposal was in line with the strategy of the Company to offload its investment in IAC as described in the sub-section headed “Reasons for and benefits of the 2017 December IAC Capital Increase Agreement” in the section headed “Discloseable transaction in relation to deemed disposal of interest in IAC” above.

The Directors considered that the IAC Disposal was in the interests of the Company and the Shareholders as a whole, and the terms of the IAC Disposal Agreement were on normal commercial terms and fair and reasonable.

The net proceeds from the IAC Disposal (after deducting transaction costs and professional expenses) amounted to approximately RMB191 million (equivalent to approximately HK\$218.6 million) which had been applied as general working capital of the Group.

## **4. Financial effects of the IAC Disposal**

Upon completion of the IAC Disposal, the Group had recorded an investment gain of RMB32.3 million (equivalent to approximately HK\$37.0 million), which was calculated with reference to the consideration of RMB192 million paid by Wanyin for the IAC Sale Interest and the unaudited net asset value of the IAC Group as at 31 March 2019 attributable to the IAC Sale Interest of approximately RMB159.7 million.

## **5. Listing Rules implications**

As one or more of the relevant percentage ratios (as defined under the Listing Rules) of the transactions contemplated under the IAC Disposal Agreement exceeded 5% but were all less than 25%, the IAC Disposal constituted a discloseable transaction of the Company, and was subject to the reporting and announcement requirements under Chapter 14 of the Listing Rules.

Due to inadvertent oversight, the Company had not timely made announcement in respect of the IAC Disposal as required under the Listing Rules. The Company admits that it has breached Rule 14.34 of the Listing Rules.

## **(C) DISCLOSEABLE AND CONNECTED TRANSACTION IN RELATION TO THE TAX NOVATION ARRANGEMENT**

On 1 June 2017, Hexie Trading (an indirect wholly-owned subsidiary of the Company), Hexie Industrial and IAC (a then indirect wholly-owned subsidiary of the Company) entered into the Tax Novation Agreement, pursuant to which Hexie Trading novated all the payment obligations in relation to the Tax Liabilities amounting to RMB1,021,716,000 to Hexie Industrial. In consideration of Hexie Industrial agreeing to the Tax Novation Arrangement, Hexie Trading agreed pay a sum equivalent to the Tax Liabilities to Hexie Industrial in cash via IAC. Details of the Tax Novation Agreement are set out below.

### **1. The Tax Novation Agreement**

#### **Date**

1 June 2017 (as supplemented by a supplemental agreement dated 6 December 2019)

#### **Parties**

- (i) Hexie Trading;
- (ii) Hexie Industrial; and
- (iii) IAC.

To the best of the knowledge, information and belief of the Directors having made all reasonable enquiries, (i) as at the date of the Tax Novation Agreement, Hexie Industrial was majority-controlled by Mr. Feng, being the chairman of the Board, an executive Director and the controlling shareholder of Company who was indirectly interested in 690,066,160 Shares representing approximately 43.79% of the issued share capital of the Company. Hexie Industrial is an associate of Mr. Feng and accordingly a connected person of the Company under Chapter 14A of the Listing Rules; and (ii) Hexie Industrial was principally engaged in wholesale and retail of commercial vehicles and auto parts and consulting services, and real estate development and sales.

Hexie Trading is a company established in the PRC with limited liability and an indirect wholly-owned subsidiary of the Company. It is principally engaged in investment holding. IAC was an indirect wholly-owned subsidiary of the Company as at the date of the Tax Novation Agreement and was the intermediate holding company for the members of the Group engaging in independent aftersales services business.

## **Subject matter**

Pursuant to the Tax Novation Agreement, the parties agreed that the payment obligations of the Tax Liabilities in the sum of RMB1,021,716,000 (equivalent to approximately HK\$1,169.1 million, being the estimated outstanding tax liabilities of the Hexie Trading Group as at the date of the Tax Novation Agreement) would be novated to Hexie Industrial. Hexie Industrial would be responsible for liaising with the relevant tax authorities for the settlement and payment schedule of the Tax Liabilities. All the penalties and/or waivers (if any) in relation to the Tax Liabilities would be for the account of Hexie Industrial, and Hexie Trading would not be liable to any payment obligations on the Tax Liabilities and legal consequences relating thereto.

In consideration of Hexie Industrial agreeing to the Tax Novation Arrangement, Hexie Trading agreed to pay a sum of RMB1,021,716,000 (equivalent to approximately HK\$1,169.1 million) to Hexie Industrial and such sum would be paid in cash via IAC within five months from the date of the Tax Novation Agreement.

In a supplemental agreement dated 6 December 2019, the parties thereto further agreed and confirmed:

- (i) the breakdown of the Tax Liabilities owed by the relevant members of the Hexie Trading Group;
- (ii) that Hexie Trading had made payments to IAC in accordance with the Tax Novation Agreement before 31 December 2017;
- (iii) that completion of the Tax Novation Agreement would take place on 6 December 2019. Upon completion of the Tax Novation Agreement, the obligation to pay the Tax Liabilities lies with Hexie Industrial; and
- (iv) that approval of the Tax Novation Arrangement as referred to in (iii) above had been obtained from the relevant tax authorities.

The consideration for the Tax Novation Arrangement was determined based on arm's length negotiations between Hexie Trading and Hexie Industrial after taking into account (i) the sum of the Tax Liabilities; (ii) the potential costs and resources which might be incurred by the Group in settling the Tax Liabilities with the relevant tax authorities; and (iii) the benefits to the Group which may be derived from the Tax Novation Arrangement as described below. The Group utilised its internal resources for payment of the cash consideration for the Tax Novation Arrangement.



## 2. Reasons for and benefits of the Tax Novation Agreement

The Group has been engaging in operating 4S automobile dealership outlets in the PRC since 2005. It sells luxury and ultra-luxury cars as an authorised dealer of a number of luxury or ultra-luxury automobile manufacturers.

The Tax Liabilities arose from income generated from (i) incentive rebates receivable from automobile manufacturers (the “**Manufacturers Rebates**”) and (ii) extra payments offered by car buyers to the dealers as an incentive for the latter to source the hot models for such buyers and quick delivery of goods (the “**Buyers Incentives**”). As a common market practice, the Manufacturers Rebates would be provided by automobile manufacturers to authorised dealers if the dealers meet certain pre-agreed criteria set by the manufacturers. The criteria would relate to sale volume, customer satisfaction, and quality of service provided by the dealers. The Manufacturers Rebates would also be provided to dealers in connection with their promotional events or quarterly sales quota. They were either paid in the form of cash payments or reduction of their sales prices to the Group. The Manufacturers Rebates very often were settled by the automobile manufacturers subsequent to the sales of cars and over a number of years, but the Group nevertheless recorded the Manufacturers Rebates against the cost of sales in the financial year where the sales occurred and made provisions for corresponding tax liabilities arising from such rebates. As the payment obligations of the tax relating to the Manufacturers Rebates only arise when the automobile manufacturers settle the Manufacturers Rebates to the Group, there might be timing difference between the time when the tax liabilities are recorded in the books of the Group and the time when the actual receipts of the Manufacturers Rebates occur.

Apart from the timing difference regarding Manufacturers Rebates as described above, the Tax Liabilities also arose in the past from a then common market practice in the automobile dealers’ business in the PRC, where their customers rewarded the dealers for early delivery of the goods ordered by gratuity payments (i.e. the Buyers Incentives). When the Group established its first 4S dealership outlet in Zhengzhou, Henan Province, the PRC in 2005, it saw the ignition of high-end customers interests in imported luxury car models and the glowing of buying sprees in affluent cities of the PRC. Many customers were willing to make offers for new hot model cars at consideration higher than the suggested selling price released to the dealers by automobile manufacturers (the “**Suggested Retail Prices**”), in order to win the ‘quasi-bid’ for newest car models. It had gradually become an industry norm for fervent car buyers of hot items under limited supply to reward the dealers for early delivery of the goods on top of the Suggested Retail Prices (the “**Industry Norm**”). The then Industry Norm was at the time common market practices to satisfy the



demands of willing customers. As a result of this, the total sum, including the Buyers Incentives, if any, paid by customers might be higher than the invoiced Suggested Retail Prices included in the car sale invoice based on which the value-added tax would be calculated and paid. The then Industry Norm also had it that the customers would ask the Buyers Incentives not to be invoiced as they were given as reward to the dealers, therefore whether the customers would pay any Buyers Incentives or not, the invoiced prices for the vehicles sold would be at the Suggested Retail Prices (or at a discount to the Suggested Retail Prices for certain less popular models). On the other hand, automobile manufacturers also did not generally want to see price competitions between its own dealers in order to maintain price stability for its products, but the Buyers Incentives to dealers were not specifically prohibited. Against this then industry background and market practices, the whole sum of payments paid by the customers, including the Suggested Retail Prices and the Buyers Incentives, if any, was accounted for as revenue in the books of the relevant operating subsidiary of the Group, with provision for applicable tax liabilities made correspondingly on the whole sum of payment. In the circumstances, this had resulted in a difference between the invoiced price filed with the taxation authorities for tax purpose on one hand and the total payment received from the customers and recorded in the books of the relevant operating subsidiaries and in the audited consolidated financial statements of the Group on the other hand.

The accumulation of the Tax Liabilities arising from the then Industry Norm was largely reduced after 2017 given that on 5 April 2017, the Ministry of Commerce of the PRC promulgated an administrative measure (the “**2017 Administrative Measure**”) to govern the sale of passenger vehicles in the PRC, which stipulates that, among other things, car dealers shall not receive from the customers an increased price, or impose additional costs above the stipulated price. Further to the promulgation of the 2017 Administrative Measure, there was investors’ concern raised on the accumulation of the Tax Liabilities at regular investors meetings. The Company believed that considerable time and administrative resources might be required to resolve with the relevant regulatory authorities the terms of the settlement of the Tax Liabilities, given that the Tax Liabilities had been accumulated for years and involved a number of operating subsidiaries in different cities.

Having noted from the market that certain comparable companies in the industry had also accumulated significant amounts of tax liabilities due to the Industry Norm and had made novation arrangements to remove a large part of the accumulated tax liabilities off their balance sheet, and having considered that (i) the reduction of the cumulative long outstanding Tax Liabilities from the Group’s balance sheet would remove the uncertainties about whether any fines or penalties would be imposed on the Group by the authorities upon the

settlement of the Tax Liabilities and on the Group's financial position and performance in future; and (ii) for the purpose of ensuring the transfer of the Tax Liabilities should be to a financially capable party who has the financial resources and knowledge of the market and understanding of the nature of the Tax Liabilities (and the Industry Norm), the Company approached Hexie Industrial on the possible novation arrangement in respect of the Tax Liabilities as well as the tasks to negotiate with the relevant tax authorities. The Company also communicated with the relevant tax authorities on the proposed Tax Novation Arrangement. The Tax Novation Agreement was entered into following in principle approval was obtained from the relevant tax authorities.

The Tax Novation Arrangement was conducted in a commercial manner, and it is in the interests of the Company and the Shareholders as a whole to remove the liabilities relating to the Tax Liabilities and risks and costs that may be associated with settling the Tax Liabilities with the relevant tax authorities by way of the Tax Novation Arrangement. Upon completion of the Tax Novation Arrangement, the tax liabilities of the Group as at 31 December 2021 amounted to RMB284.9 million, which was mainly contributed by timing difference arising from the Manufacturers Rebates and the current year profit tax provisions. Taking into account the above, the Directors were of the view that the Tax Novation Arrangement was in the interests of the Company and the Shareholders as a whole, and the terms of the Tax Novation Agreement were on normal commercial terms and fair and reasonable.

For further details relating to the background of and circumstances relating to the Tax Novation Arrangement, please refer to a separate announcement of the Company of even date.

### **3. Listing Rules implications**

As one or more of the relevant percentage ratios (as defined under the Listing Rules) of the transactions contemplated under the Tax Novation Agreement exceeded 5% but were all less than 25%, the Tax Novation Arrangement contemplated under the Tax Novation Agreement constituted a discloseable transaction of the Company, and was subject to the reporting and announcement requirements under Chapter 14 of the Listing Rules.

Hexie Industrial is a connected person of the Company by virtue of it being an associate of Mr. Feng, who is the chairman of the Board, an executive Director and the controlling shareholder of the Company indirectly interested in approximately 43.79% of the issued share capital of the Company as at the date of the Tax Novation Agreement. Accordingly, the transactions contemplated under the Tax Novation Agreement also constituted a connected transaction of the Company subject to the reporting, announcement, circular and independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

Due to inadvertent oversight, the Company had not timely made announcement and sought independent Shareholders' approval in respect of the Tax Novation Arrangement in accordance with the Listing Rules. The Company admits that it has breached Rules 14.34, 14A.35 and 14A.36 of the Listing Rules.

#### **(D) ACTIONS HAVING BEEN OR TO BE TAKEN BY THE COMPANY**

Having considered the suggestions made by the independent Board committee (as detailed in a separate announcement of the Company of even date), the Company has taken or would adopt (as the case may be) the following remedial measures:

1. the Company had engaged an internal control consultant to review the internal control policies and procedures concerning, among other things, financial reporting, compliances and corporate governance. The review was completed in March 2021;
2. based on the review of the internal control consultant, the Company has adopted certain recommendations made by the internal control consultant to improve its financial reporting and corporate governance measures including but not limited to establishing a register of connected persons and interests held by Directors and controlling Shareholder(s) for the purpose of identifying possible connected transactions in future;
3. the Company is in the process of implementing other measures recommended by the internal control consultant on, among other things, procedures for reporting potential notifiable transaction before the relevant transaction is conducted for the purpose of determining whether there is any compliance requirement under the Listing Rules, and providing sufficient and appropriate training to the relevant staff members;

4. the Company is also in the process of hiring a full time qualified in-house company secretary/compliance officer to oversee the secretarial and compliance matters of the Group; and
5. additional and suitable training programs for the Directors will be arranged annually to keep them abreast of the latest developments of the listing regime and continuing obligations of listed companies in Hong Kong.

## **(E) DEFINITIONS**

In this announcement, unless the content otherwise requires, the following expressions have the following meanings:

“Aftersales Management Company”	西藏和進滙創業投資管理有限公司 (Tibet Hejinhui Venture Capital Management Co., Ltd.*)
“associate(s)”	has the meaning ascribed to it under the Listing Rules
“Board”	the board of Directors
“Company”	China Harmony Auto Holding Limited, a company incorporated in the Cayman Islands with limited liability and the issued Shares of which are listed on the Main Board of the Stock Exchange (stock code: 3836)
“connected person(s)”	has the meaning ascribed to it under the Listing Rules
“Director(s)”	the director(s) of the Company
“Group”	the Company and its subsidiaries from time to time
“Hexie Industrial”	河南和諧實業集團有限公司 (Henan Hexie Industrial Group Co., Ltd.*), a company majority-controlled by Mr. Feng
“Hexie Trading”	河南和諧汽車貿易有限公司 (Henan Hexie Automobile Trading Co., Ltd.*), an indirect wholly-owned subsidiary of the Company
“Hexie Trading Group”	Hexie Trading and its subsidiaries from time to time

“Hong Kong”	the Hong Kong Special Administrative Region of the PRC
“IAC”	河南和諧汽車維修服務有限公司 (Henan Hexie Automobile Aftersales Services Co., Ltd.*), an indirect wholly-owned subsidiary of the Company as at the date of the Tax Novation Agreement and the date of the 2017 December IAC Capital Increase Agreement
“IAC Disposal”	the disposal of the IAC Sale Interest by Hexie Trading to Wanyin subject to the terms of the IAC Disposal Agreement
“IAC Disposal Agreement”	the sale and purchase agreement dated 5 April 2019 (as supplemented by a supplemental agreement dated 18 April 2019) entered into between Hexie Trading and Wanyin in relation to the IAC Disposal
“IAC Group”	IAC and its subsidiaries from time to time
“IAC Key Management”	together, Tibet Runyin and Lancherui
“IAC Sale Interest”	the 29% equity interest in IAC as at the date of the IAC Disposal Agreement subject to the IAC Disposal
“Independent Third Party”	a person, or in the case of a company, the company or its ultimate beneficial owner(s), who is/are independent of and not connected with the Company and its connected persons
“Lancherui”	西藏藍徹瑞創業投資合夥企業 (有限合夥) (Tibet Lancherui Venture Capital Partnership (Limited Partnership)*)
“Listing Rules”	the Rules Governing the Listing of Securities on the Stock Exchange
“Mr. Feng”	Mr. Feng Changge (馮長革), the chairman of the Board, an executive Director and the controlling shareholder of the Company
“Operation Advances”	the accumulated capital investment and advances provided by Hexie Trading to the IAC Group for the operation and business expansion uses of the IAC Group

“PRC”	the People’s Republic of China which, for the purposes of this announcement, excludes Hong Kong, the Macao Special Administrative Region and Taiwan
“Share(s)”	ordinary share(s) of HK\$0.01 each in the capital of the Company
“Shareholder(s)”	holder(s) of the Share(s)
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Tax Liabilities”	the estimated tax liabilities in the amount of RMB1,021,716,000 (equivalent to approximately HK\$1,169 million) accumulated by the Hexie Trading Group
“Tax Novation Agreement”	the agreement dated 1 June 2017 (as supplemented by a supplemental agreement dated 6 December 2019) entered into among Hexie Trading, Hexie Industrial and IAC in respect of the Tax Novation Arrangement
“Tax Novation Arrangement”	the novation by Hexie Trading of all the payment obligations relating to the Tax Liabilities to Hexie Industrial pursuant to the Tax Novation Agreement
“Tibet Runyin”	西藏潤銀創業投資合夥企業(有限合夥)(Tibet Runyin Venture Capital Partnership (Limited Partnership)*)
“Wanyin”	鄭州萬銀資產管理有限公司 (Zhengzhou Wanyin Asset Management Co., Ltd.*), a company established in the PRC with limited liability and an Independent Third Party
“2017 June IAC Capital Increase Agreement”	the capital increase agreement dated 29 June 2017 entered into among Hexie Trading, IAC, the Aftersales Management Company, the IAC Key Management and two strategic investors who were Independent Third Parties

“2017 December IAC Capital Increase Agreement”	the agreement dated 28 December 2017 entered into among Hexie Trading, IAC, the Aftersales Management Company, the IAC Key Management and the 2017 December IAC Investor in relation to the capital increase of IAC
“2017 December IAC Investor”	深圳市迪暉投資發展有限公司 (Shenzhen Dihui Investment Development Company Limited*)
“HK\$”	Hong Kong dollar(s), the lawful currency of Hong Kong
“RMB”	Renminbi, the lawful currency of the PRC
“%”	per cent.

By Order of the Board  
**China Harmony Auto Holding Limited**  
**LIU Fenglei**  
*Chief Executive Officer and Executive Director*

Hong Kong, 10 August 2021

*The English transliteration of the Chinese names in this announcement, where indicated with “\*”, is included for information only, and should not be regarded as the official English names of such Chinese names.*

*For the purposes of illustration only, amounts denominated in RMB in this announcement have been translated into HK\$ at the rate of RMB1.00 = HK\$1.14426. Such translation should not be construed as a representation that the amounts in question have been, could have been or could be converted at any particular rate or at all.*

*As of the date of this announcement, the executive Directors are Mr. Feng Changge, Mr. Liu Fenglei, Ms. Ma Lintao, Ms. Feng Guo and Mr. Han Yang; and the independent non-executive Directors are Mr. Wang Nengguang, Mr. Lau Kwok Fan and Mr. Chan Ying Lung.*