



Kresta Holdings Limited

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18 January 2019

ASX Compliance Pty Ltd
20 Bridge Street
SYDNEY, NSW, 2000

Further to your letter of 9 January 2018, the Company provides the following responses to the queries raised therein.

Regards

A handwritten signature in black ink, consisting of stylized Chinese characters, likely representing the name Xianfeng Lu.

Xianfeng Lu
Chairman

	Query	Response
1	<p>Is the Company able to confirm that in the Directors' opinion, the Financial Report:</p> <p>(a) complies with the relevant Accounting Standards; and</p> <p>(b) gives a true and fair view of the financial performance and financial position of the Company?</p>	<p>We refer to the Directors' declaration of 20 December 2018 contained within the Financial Report.</p> <p>This declaration was resolved unanimously by the Board and confirms the Directors' view that the Company's Financial Report complies with the relevant Accounting Standards and gives a true and fair view of the financial performance and financial position of the Company.</p>
2	<p>ASX understands that the Company has recorded an inventory balance amounting to \$7.302 million at 30 June 2018:</p> <p>(a) What were the inaccuracies in the recording of inventory?</p> <p>(b) Why were stock counts not performed as at 30 June 2018?</p> <p>(c) Why were the Company's auditors unable to conduct alternative procedures so as to obtain sufficient appropriate audit evidence to support the existence and valuation of the reported \$7.30 million of inventory?</p> <p>(d) Were stock counts performed as at 31 December 2018? If not, please explain why not.</p> <p>(e) What additional steps does the Company propose to take to ensure in future periods it is able to provide its auditor with sufficient and accurate evidence of inventory recording?</p>	<p>(a) The inaccuracies with the recording of inventory relate to just 70 out of 8,000 items and amount to a total value (which is not material in nature) of approximately AUD \$16,000. The inaccuracies arose from delays with the recording of inventory and the presence of negative sale stock. The Company regards the value of these inaccuracies as immaterial from a quantitative perspective. However, the identification of these inaccuracies have caused the Company to review its inventory processes (see the answer to Question 2(e) for further details).</p> <p>(b) Stock counts were not performed as at 30 June 2018 as the Company has not historically performed stock counts for its half year Financial Reports. Instead stock counts are undertaken throughout the year. The Company confirms that stock counts were performed in September 2018 and December 2018 for the Company's financial year end audit.</p> <p>(c) There was a high turnover of staff during the relevant period the established process for entering inventory purchases in Kresta's Curtin Wonderland (CW) stores was not followed resulting in incorrect quantities of inventory being reported CW for 30 June 2018.</p> <p>Management conducted a full stock count and then roll back to 30 June 2018, a process that was complicated by there being 32 stores and a warehouse, the time between the 30 June 2018 and the date of the stock takes, which could not all be conducted simultaneously due to limited resources and the turnover of staff. The roll back procedure resulted in some negative quantities at 30 June 2018.</p> <p>This also resulted in the need for management to recalculate the cost of inventory on hand at 30 June 2018, using the latest purchase price of inventory items acquired in the six months to 30 June 2018.</p> <p>For the half year ended 30 June 2018, the management also adopted a new basis for calculating the provision for</p>

	<p>inventory obsolescence which increased the provision significantly and factored in a decision not to currently enforce an agreement with a major supplier to purchase inventory under an agreement signed in January 2018. The Company's auditor was not able to conclude whether or not management's assessment was reasonable.</p> <p>(d) As mentioned in the answer to question 2(b), stock counts were conducted in all stores during December 2018.</p> <p>(e) Since this issue has been identified, Kresta's management have taken this matter very seriously, and have conducted a detailed review into the cause of these discrepancies. The review identified 4 main areas of improvement, and possible solutions for these issues. Most of these issues arose due to the presence of large numbers of new staff who were not familiar with the Company's proper procedures and processes.</p> <p>The inventory issues that require attention are summarised below:</p> <ul style="list-style-type: none"> i. Delays in reporting the receipt of stock on the system; ii. the recognition of negative stock sales due to: <ul style="list-style-type: none"> a. miscounts during stock counts; b. delays in recognising stock transferred between stores, particularly for lay by orders; and c. use of the wrong barcode. <p>To address the above, the Company's systems were updated to generate alerts when negative stock sales arise which will require store staff to report the discrepancy to store management who must then send a discrepancy report to the Company's head office. The Company also emphasised the need for prompt updates from the Company's warehouse in relation to the despatch, receipt and transfer of stock to stores and, between stores for the recognition of stock transfers. New processes were implemented to ensure that stores report delays with the entry of deliveries into their systems to head office. The Company also confirmed that reference numbers need to be inputted for layby orders. For transfers the system was also updated to generate a layby transfer report which each store is to follow up.</p> <p>A circular was provided to the managers of each Curtain Wonderland store with instructions that store management ensure that all store staff comply with the above procedures.</p>
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3	<p>Commenting specifically on the Auditor's Review and Disclaimer, in particular the inaccuracies in the recording of inventory and stock counts not being performed as at 30 June 2018, on what basis did the Company include the value of the inventory in the Financial Report at \$7.302 million?</p>	<p>The Company values its inventory (which comprises of raw materials and finished goods) at the lower of cost and net realisable value in accordance with the relevant accounting standards.</p> <p>An item's cost is accounted for as follows:</p> <ul style="list-style-type: none"> • Raw materials – are recognised at their purchase cost on a first-in, first-out basis. The purchase cost is comprised of the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), transport, handling and other costs directly attributable to the acquisition of raw materials. • Finished goods – are recognised as the cost of direct materials and labour and a proportion of variable and fixed manufacturing overheads based on normal operating capacity. Costs are assigned on the basis of weighted average costs. <p>Net realisable value is calculated by the Company as the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.</p> <p>A provision must also be recognised where the inventory cannot be sold above its carrying amount. Management have confirmed that they have prepared the provision with reference to the turnover of each item of inventory.</p>
4	<p>Why were invoices paid by the Company on behalf of entities owned by the Executive Chairman Xianfeng Lu ("Xianfeng Lu Entities"). As set out in the Related Party Note Disclosures.</p>	<p>The invoices paid on behalf of the Xianfeng Lu Entities were solely for business related expenses (i.e. travel and telephone costs) incurred by members of the Company's former key management personnel during the period in which they transitioned to other positions within the Xianfeng Lu Entities.</p>
5	<p>When were the amounts paid on behalf of the Xianfeng Lu Entities repaid?</p>	<p>All expenses were re-charged by the Company to the Xianfeng Lu Entities and repaid before 30 June 2018.</p>
6	<p>Which Board members comprise the Company's audit committee?</p>	<p>Li Ding (Chair - Non-Executive Director), Yongjiu Xu (Non-Executive Director) and Mingming Zhang (Executive Director) comprise the Company's audit committee.</p>
7	<p>In relation to the Financial Review, did the Board receive the CFO and Executive Chairman declaration, as described in the Managing Director and chief financial officer declaration section (page 20) of the Company's Annual Financial Report, that in the opinion of the CFO and Executive Chairman, the financial records of the Company have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the Company and that the opinion has been</p>	<p>As noted in the Directors' declaration accompanying the financial statements, a declaration from the Company's Executive Chairman was received by the Board. At the time the Company's half year Financial Report was prepared, the Company did not have a CFO. The Company has subsequently appointed a Financial Controller who together with the Company's finance department performs the role of CFO.</p>

	formed on the basis of a sound system of risk management and internal control which is operating effectively?	
8	If the answer to Question 7 is 'no', why did the Board not receive the CFO and Executive Chairman declaration as described on page 20 of the Company's Annual Financial Report?	N/A
9	What enquiries did the Board make of management to satisfy itself that the financial records of the Company have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the Company? In answering this question, please comment specifically on the matters raised in relation to inventory in the Disclaimer and the Related Party Note Disclosures.	<p>The Board held 2 Board meetings to review and discuss the financial statements. Both the operational team of Curtain Wonderland and the Company's finance department were present to answer the Board's questions at these meetings. During these meetings it became apparent to the Board that the main cause of the inventory issues was due to the presence of large numbers of new staff who were not familiar with the Company's proper procedures and processes.</p> <p>To address this issue the measures noted in the answer to Question 2(e) were adopted by the Company. The Company's response to Question 4 and 5 deal with the Related Party Note Disclosures.</p>
10	Commenting specifically on the Disclaimer, does the Board consider the Company has a sound system of risk management and internal control which is operating effectively?	<p>Subject to the implementation of the measures described in the answer to Question 2(e), the Board continues to hold the view that the Company has a sound system of risk management and internal control, which is operating effectively.</p> <p>As mentioned above, the cause of the inaccuracies in the recording of inventory were identified and the Company has taken measures to ensure that its new staff are familiar with the Company's proper procedures and processes with improvements also made to its systems and, new processes added to further mitigate the risk of errors occurring.</p>
11	Does the Company consider that the financial condition of the Company is sufficient to warrant continued listing on ASX in accordance with the requirements of listing rule 12.2? In answering this question, please explain the basis for this conclusion.	<p>The Directors have reviewed the Company's financial condition and believe it is sufficient to warrant continued listing on ASX in accordance with Listing Rule 12.2.</p> <p>In making this determination, the Directors have considered the followings factors which were also noted in the Company's half year Financial Report:</p> <ul style="list-style-type: none"> • The loan agreement for RMB 16,000,000 and RMB 50,000,000 with Suntarget (Hong Kong) Trading Co., Limited (Suntarget), a related party of the Group, was amended to extend the term of the loan until 31 December 2019 (Loan); • On 22 November 2018 the Group entered into a Deed of Parent Company Support effective until 31 December 2019 with Ningbo Xianfeng New Material Company and its subsidiary, Suntarget, to subordinate all of the debt owed by the Group to them and to provide additional financial support in the form of a

		<p>subordinated, unsecured, interest free loan of up to RMB\$10,000,000, repayable within 18 months of draw down (Parent Company Support).</p> <ul style="list-style-type: none"> On 23 November 2018, the Group entered into a Payment Deferral Agreement with its major supplier to defer the payment of all invoices issued from May 2018 to May 2019, by one year on the current trading terms. As announced on 31 August 2018 and 20 December 2018, the Company undertook a strategic review and identified a number of initiatives to improve the future operating performance of the Group, including its individual stores and showrooms. The Directors consider that the implementation of these initiatives will improve the future performance and cash flows of the Company. Details of the results of this review are contained in the Company's Strategic Review Update announcement released on 20 December 2018.
12	If the answer to questions 11 is "No", please explain what steps the Company has taken, or proposes to take, to warrant continued listing on ASX in accordance with the requirements of listing rules 12.1 and 12.2.	N/A
13	Please confirm that the Company is in compliance with the listing rules and, in particular, listing rule 3.1 and 12.2.	We confirm that the Company remains in compliance with Listing Rules 3.1 and 12.2. We are not aware of any further information which would require disclosure under Listing Rule 3.1. As outlined in the Company's answer to Question 11, the Board believes that the company's financial condition remains adequate to satisfy ASX Listing Rule 12.2.
14	Please confirm that the Company's responses to the questions above have been authorised and approved in accordance with its published continuous disclosure policy or otherwise by its Board or an officer of the Company with delegated authority from the Board to respond to ASX on disclosure matters.	The Company's responses to the questions above were authorised and approved by the Company's Directors.



9 January 2019

Mr Mingming Zhang
Company Secretary
Kresta Holdings Limited

By email:

Dear Mr Zhang

Kresta Holdings Limited (the “Company”) – Financial Condition Query

ASX Limited (“ASX”) refer to the following:

1. The Company’s 2018 Half-Year Financial Report lodged with the ASX on 20 December 2018 (“Financial Report”) which included an Independent Audit Review from Ernst Young on pages 22 to 23 (“Auditor’s Review”).
2. Note 14, the related party transaction note in the Financial Report (page 19) which reads as follows (“Related Party Note Disclosures”):

“During the half year the following transactions and total outstanding balances have been entered into with related parties:

- *Moon Lake Investments Pty Ltd (“Moon Lake Investments”) is ultimately owned by Mr Xianfeng Lu. During the period Kresta Holdings Limited paid invoices on behalf of Moon Lake Investments amounting to \$5,961 which were repaid during the period.*
- *Kresta Holdings has paid invoices amounting to \$1,272 during the period on behalf of Van Milk Pty Ltd, a company ultimately owned by Mr Xianfeng Lu which were repaid during the period.”*

3. The Disclaimer of Conclusion in the Auditor’s Review (page 22) which reads as follows (“Disclaimer”):

“We have reviewed the accompanying half-year financial report of Kresta Holdings Limited (the Company) and its subsidiaries (collectively the Group), which comprises the consolidated statement of financial position as at 30 June 2018, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the half-year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, and the directors’ declaration.

Because of the significance of the matters described in the Basis for Disclaimer of Conclusion paragraphs, we do not express a conclusion on the financial report for the half-year ended 30 June 2018.

Basis for disclaimer of conclusion

As outlined in note 2(b), subsequent to 30 June 2018 the Group undertook a strategic review of its operations which identified initiatives to improve the future performance of the Group, including individual stores and showrooms. The Directors’ assessment of the provision for onerous leases and the recoverable amount of assets as at 30 June 2018 is based upon their expectations of improved performance and resulting cash flows. The implementation of these initiatives is ongoing and the extrapolation and sustainability of improvements in performance to date is uncertain. Consequently, it has not [sic] practicable for us to obtain sufficient evidence to conclude on the accuracy or sustainability of the improved performance assumptions supporting these judgemental accounting positions.

In the conduct of our review, it came to our attention that during the six months ended 30 June 2018, there were inaccuracies in the recording of inventory and stock counts were not performed as at 30 June 2018. We were unable to conduct sufficient alternative procedures in relation to the existence and valuation of the inventory balance, amounting to \$7.302 million, at 30 June 2018.

Emphasis of matter – Material uncertainty related to going concern

We draw attention to Note 2(b) in the half-year financial report which describes the principal conditions that raised doubt about the Group's ability to continue as a going concern. These events or conditions indicate that a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern."

4. The Company's net liability position of \$6.877 million as recorded in its Financial Report.
5. The Company's 2017 Corporate Governance Disclosure, included within the Company's Annual Financial Report for year ending 31 December 2017, lodged with the ASX on 29 March 2018 ("Annual Financial Report") ("Corporate Governance Disclosure"), which, on page 20 states that:

"In accordance with section 295A of the Corporations Act 2001, the Executive Chairman and CFO have provided a written statement to the Board that:

 - *Their view provided on the Company's financial report is founded on a sound system of risk management and internal compliance and control which implements the financial policies adopted by the Board.*
 - *The Company's risk management and internal compliance and control system is operating effectively in all material respects."*
6. ASX Listing Rules 12.1, 12.2 and 19.11A:

Financial condition

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| Listing Rule 12.1 | <i>The level of an entity's operations must, in ASX's opinion, be sufficient to warrant the continued quotation of the entity's securities and its continued listing.</i> |
| Listing Rule 12.2 | <i>An entity's financial condition (including operating results) must, in ASX's opinion, be adequate to warrant the continued quotation of its securities and its continued listing.</i> |
| Listing Rule 19.11A | <i>If a listing rule requires an entity to give ASX accounts, the following rules apply</i>
<i>...</i>
<i>(b) The accounts must be prepared to Australian accounting standards. If the entity is a foreign entity the accounts may be prepared to other standards agreed by ASX.</i> |

Questions for response

In light of the Auditor's Review, the Disclaimer, the information contained in the Financial Report, Corporate Governance Disclosure, and the application of the listing rules stated above, please respond to each of the following questions:

1. Is the Company able to confirm that in the Directors' opinion, the Financial Report:
 - (a) complies with the relevant Accounting Standards; and
 - (b) gives a true and fair view of the financial performance and financial position of the Company?

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2. ASX understands that the Company has recorded an inventory balance amounting to \$7.302 million at 30 June 2018:
 - (a) What were the inaccuracies in the recording of inventory?
 - (b) Why were stock counts not performed as at 30 June 2018?
 - (c) Why were the Company's auditors unable to conduct alternative procedures so as to obtain sufficient appropriate audit evidence to support the existence and valuation of the reported \$7.30 million of inventory?
 - (d) Were stock counts performed as at 31 December 2018? If not, please explain why not.
 - (e) What additional steps does the Company propose to take to ensure in future periods it is able to provide its auditor with sufficient and accurate evidence of inventory recording?
 3. Commenting specifically on the Auditor's Review and Disclaimer, in particular the inaccuracies in the recording of inventory and stock counts not being performed as at 30 June 2018, on what basis did the Company include the value of the inventory in the Financial Report at \$7.302 million?
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 5. When were the amounts paid on behalf of the Xianfeng Lu Entities repaid?
 6. Which board members comprise the Company's audit committee?
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 8. If the answer to Question 7 is 'no', why did the Board not receive the CFO and Executive Chairman declaration as described on page 20 of the Company's Annual Financial Report?
 9. What enquiries did the Board make of management to satisfy itself that the financial records of the Company have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the Company? In answering this question, please comment specifically on the matters raised in relation to inventory in the Disclaimer and the Related Party Note Disclosures.
 10. Commenting specifically on the Disclaimer, does the Board consider the Company has a sound system of risk management and internal control which is operating effectively?
 11. Does the Company consider that the financial condition of the Company is sufficient to warrant continued listing on ASX in accordance with the requirements of listing rule 12.2? In answering this question, please explain the basis for this conclusion.
 12. If the answer to questions 11 is "No", please explain what steps the Company has taken, or proposes to take, to warrant continued listing on ASX in accordance with the requirements of listing rules 12.1 and 12.2.

13. Please confirm that the Company is in compliance with the listing rules and, in particular, listing rule 3.1 and 12.2.

14. Please confirm that the Company's responses to the questions above have been authorised and approved in accordance with its published continuous disclosure policy or otherwise by its board or an officer of the Company with delegated authority from the board to respond to ASX on disclosure matters.

Please note ASX reserves its right under listing rule 18.7A to release this letter and the Company's response to the market. Accordingly, the Company's response should address each question separately and be in a format suitable for release to the market.

Unless the information is required immediately under listing rule 3.1, a response is requested as soon as possible and, in any event by 9:00am WST, Friday 18 January 2019.

Any response should be sent to ListingsCompliancePerth@asx.com.au. It should not be sent to the ASX Market Announcements Office.

If you have any queries regarding any of the above, please let me know.

Kind regards

Isabelle Andrews
Adviser, Listings Compliance (Perth)