Far East Group Limited
(Company Registration No.:196400096C)
(Incorporated in the Republic of Singapore on 18 March 1964)

RESPONSE TO QUERIES FROM SECURITIES INVESTORS ASSOCIATION (SINGAPORE) ON THE ANNUAL REPORT

The Board of Directors (the "**Board**" or the "**Directors**") of Far East Group Limited (the "**Company**", and together with its subsidiaries, the "**Group**") refers to the queries raised by the Securities Investors Association (Singapore) ("**SIAS**") of the Company in relation to the Group's Annual Report for the financial year ended 31 December 2019 ("**FY2019**") and appends the replies as follows:

<u>Question 1</u>

Would the Board/management provide shareholders with greater clarity on the following operational matters? Specifically:

(i) Manufacturing: The Group manufactures electrical, refrigeration and air-conditioning equipment and parts in China under its "Eden" brand. Revenue increased by 5% to $12.2 million in FY2019, allowing the manufacturing division to report a small profit before tax of $86,115 (page 92 of the annual report). What is the break-even utilisation rate? How much more growth can be achieved by Eden with the current manufacturing site? Can management also help shareholders understand the major products and the breakdown of sales by Eden?

(ii) Coolwerkz Engineering Limited: The Company acquired an additional 20% equity interest in its 40% owned joint venture, Coolwerkz Engineering Limited ("**Coolwerkz**"), on 8 October 2019 and subsequently recognised it as a 60%-owned subsidiary. Coolwerkz is a provider of engineering (design, installation and commissioning) services, consultancy and maintenance works in Myanmar. What is the level of control and oversight by management of the day-to-day operations of Coolwerkz? What is the size and composition of the Coolwerkz team in Myanmar? What are the major opportunities in Myanmar, especially as condominium registrations have started in 2020 under the "Condominium Law" (which was first approved by the parliament in 2016)?

<u>Company's response</u>

(i) The better performance of the manufacturing entities is due to increased sales to new customers as well as to existing ones. Our facilities, Eden Refrigeration Manufacturing (Jiangsu) Co., Ltd. ("**ERM**") and Elite Envirotech Co., Ltd. ("**Elite**") are currently operating at approximately 60% and 70% capacity respectively. There is room to take on future growth of the businesses.

ERM manufactures heat-exchangers which include evaporators, condensers and customised Aluminium and Copper fin coils. Elite manufactures condensing units which include rack systems with multiple compressors for industrial refrigeration, outdoor package units for commercial refrigeration and open frame condensing units both commercial and industrial refrigeration. Both the heat-exchangers and condensing units are branded under our proprietary "Eden" brand and are key components used in the commercial and industrial refrigeration for various industries like food storages, food processing, agriculture, hotels and restaurants, fishery and marine industry.

(ii) The Group's involvement in Coolwerkz includes the implementation of standard operating procedures for management to carry out operational activities, including but not limited to finance, accounting, human resource, technical resources and day-to-day administrative functions. Since the acquisition of the additional 20% shareholding, the Group has hired an experienced general manager who has more than 15 years of experience in the HVAC and Air-Conditioning and Mechanical Ventilation (ACMV) industry to head the local team consisting of management, sales, engineers, technicians, finance and administrative staff.

Coolwerkz currently focuses primarily on refrigeration projects for industries such as food storage, supermarkets, hotels and restaurants, and food processing facilities. We do not rule out the possibility of expanding into ACMV projects in view of the growing demand under the "Condominium Law" introduced in 2016, with additional resources.

<u>Question 2</u>

As disclosed in Note 8, as part of the purchase agreement with the previous owners of M-Tech Air-Con & Security Engineering Pte Ltd ("**M-Tech**"), additional cash payments, recognised as contingent consideration, will be payable to the vendors if certain profit targets are hit. The FY2019 and FY2020 Profit Guarantees were each set at $750,000 of net profit after taxes.

The Company further stated the following:

As of 31 December 2019, the key performance indicators of M-Tech showed that FY2019 Profit Guarantee was not achieved and the achievement of FY2020 Profit Guarantee is not probable as the projected FY2020 NPAT is lower than the difference between $750,000 and its projected FY2020 NPAT.

Management assessed that the probability of the M-Tech achieving FY2020 Profit Guarantee was remote and hence no adjustment was made to the fair value of the contingent consideration as at 31 December 2019.

(i) Can management help shareholders understand if M-Tech has performed up to expectations since the Company's acquisition?

(ii) Was the purchase agreement structured in such a way that the risks are shared with the vendors?

(iii) Has the Board carried out a review of M-Tech and evaluated the reasons for M-Tech not meeting the profit guarantees?

(iv) What experience has management gained from the Company's first major acquisition since it was listed? How will it adjust its acquisition strategy going forward? Did the Company overpay for M-Tech?

<u>Company's response</u>

(i) The management believes M-Tech is a good addition to the Group to diversify from our traditional dependence on the commercial and light industrial (refrigeration) segment to generate revenue, and will continue to add value to the Group in the air-conditioning segment as well as to generate a more sustainable income stream to the Group.

(ii) The vendors of M-Tech have committed to warranties which protect the risks to the Group as well as to our shareholders. The profit guarantee was accepted by the Board after due and careful enquiry, and the Board is of the view that the profit guarantee is reasonable, appropriate and is in the interest of the Company, taking into consideration, *inter alia*, historical revenue generated by M-Tech and its recurrent contracts with key customers.

(iii) The Board has been updated on the performance of M-Tech periodically after the acquisition and is aware of the reasons for M-Tech not meeting the profit guarantees. The main reason, amongst others, for M-Tech not achieving the profit target is due to the impact of new accounting standards applied to the company which required the company to make certain provisions in accordance with the accounting standards.

(iv) The Group is of the view that the acquisition is of a fair value and a win-win for both the vendors of M-Tech as well as for the Group and its shareholders. Accounting standards are constantly being revised and it may not be possible to estimate the impact of each new accounting standard pre-maturely. The Group will take this into considerations in our future acquisition strategy.

<u>Question 3</u>

From Note 39 (pages 130 & 131 – Capital management), it can be seen that the Group's total loans and borrowings amounted to $32.3 million as at 31 December 2019. The Group even utilised bank overdraft amounting to $113,150.

Equity attributable to owners of the Company amounted to $51.3 million. The debt-to equity ratio is approximately 63%.

As seen in Note 11 (page 101 – Investment securities), the Group invested $7.9 million in quoted investment securities held for trading, consisting of $5.3 million in bonds, $1.6 million in money market funds and $1.0 million in fixed income funds.

(i) Would the Board elaborate further on the capital allocation policy?

(ii) What is its cost of capital?

(iii) Would management help shareholders understand the rationale of investing approximately $8 million in quoted securities held for trading when it has loans and borrowings of up to $32.3 million?

(iv) In addition, the Group holds unquoted securities of Guangzhou Fayi Trading Co., Ltd. ("**Fayi**") which is carried at $8.98 million as at 31 December 2019. What is the strategic value of this investment?

<u>Company's response</u>

(i) The capital held by the Group is reported to and reviewed by the Board on a periodic basis. The management is given a mandate by the Board to invest its cash reserves to conserve its value within a stipulated guideline. This is also to generate returns for shareholders which is above the existing fixed deposit rates if the capital is kept in the bank.

(ii) Majority of the total loans and borrowings relates to term loans for properties and acquisition cost. The working capital financing cost amounts to approximately $12.0 million where the average cost of borrowing is lower than the returns from the investment in the securities.

(iii) The investment is to generate returns for shareholders which is above the existing fixed deposit rates if the capital is kept in the bank. The interest rates from the investments are higher than the interest rates on the loans and borrowings. In addition, the capital used in these investments can be readily liquidated to be used for the Group's future mergers and acquisitions which will benefit our shareholders more in value creation.

(iv) Fayi is one of the major wholesalers and distributors of air-conditioner and refrigeration parts to contractors, dealers and OEMs in China and Taiwan, and the Group has held this as a strategic investment with the view of China and Taiwan being economies with strong growth. Fayi's business has grown considerably over the past years and is a consistently profitable business contributing recurring dividend income to the Group.

By Order of the Board

Loh Mun Yew
Chief Executive Officer and Executive Director
12 June 2020

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*This announcement has been reviewed by the Company's sponsor, SAC Capital Private Limited (the "**Sponsor**"). It has not been examined or approved by the Singapore Exchange Securities Trading Limited (the "**SGX-ST**") and the SGX-ST assumes no responsibility for the contents of this announcement, including the correctness of any of the statements or opinions made or reports contained in this announcement.*

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