QIAN HU CORPORATION LIMITED
(Company Registration No. : 199806124N)

RESPONSES TO QUESTIONS FROM SHAREHOLDERS AND SECURITIES INVESTORS ASSOCIATION (SINGAPORE)

The Board of Directors of Qian Hu Corporation Limited ("**Qian Hu**" or the "**Company**" and together with its subsidiaries, the "**Group**") would like to thank shareholders for submitting their questions in advance of the Company's 22nd Annual General Meeting ("**AGM**") to be held on 29 March 2021 at 11.00 a.m. by electronic means in accordance with the Notice of AGM published earlier.

Please refer to the questions received from the shareholders and the responses as set out below:-

Q1. Will you be monetising any of the current assets in the short term?

As inventory and trade receivables balances constituted approximately 32% and 25% of the Group's total current assets respectively, it is always the Group's working capital management function to monitor and to work on releasing the cash trapped in inventory and trade receivables so as to improve the efficiency of its balance sheet.

Nonetheless, the Group will not be engaging in complex factoring or securitisation of trade receivables, nor off-balance sheet inventory financing while monetising its current assets. It will continue to escalate its revenue generating capabilities, review its inventory management system and monitor its trade receivables collection conscientiously, with the aim of lowering the inventory and trade receivables turnover days, which would result in the improved generation of operating cash flow in the years to come.

Q2. Is there any plan to increase dividend to shareholders?

As disclosed on page 38 of the Annual Report 2020, it has been the Company's priority to achieve long-term capital growth for the benefit of its shareholders. The bulk of its profits, when made, shall therefore be retained for investment into the future. Nevertheless, the Company recognises the desire of some of its shareholders to receive income from their investments in the Company. Therefore, the Company strives to distribute, annually or when its cash flow permits, an appropriate sum of dividends to reward its shareholders for their loyalty and support for the Company.

Qian Hu has formalised its dividend policy to provide a return to shareholders at least once a year through the payment of dividends. It aims to pay sustainable and growing dividends over time, consistent with its long-term growth prospects. The form, frequency and amount of dividends declared each year will take into consideration the Group's financial performance, cash flow generation, projected capital requirements for business growth, general global economic conditions and other relevant factors as the Directors may deem appropriate, so as to ensure that the best interests of the Company are served.

In addition, the Company had received questions raised by the Securities Investors Association (Singapore) ("**SIAS**") through email with reference to the Annual Report 2020 ("**Annual Report**") for the financial year ended 31 December 2020 ("**FY 2020**"). Below were the responses from the management on the various areas of concerns and clarifications sought by SIAS.

Q1

(i) Can management help shareholders understand the changes on the ground that led the Group to acquire the non-controlling interests in the subsidiaries in Hainan? What were the roles expected to be played by the former partners, if any?

In FY 2017, Qian Hu ventured into the aquaculture business to farm antibiotic-free fingerings in Hainan Province, China. A 51% owned subsidiary ("**Qian Hu Aquaculture**") was formed with a business partner whose expertise in herbal medications was essential in the farming of antibiotic-free fingerlings. In November 2017, the Group, with another business partner, set up a 60% owned subsidiary ("**Tian Tian Fisheries**") that focus on the import and export of edible fish and seafood products. The two different China business partners possessed different kinds of capability and knowledge in the aquaculture business while running the two separate farms.

In late FY 2018, the Group acquired the additional 49% interest in Qian Hu Aquaculture to make it a wholly-owned subsidiary after it secured the herbal medication formulations from the business partner. Qian Hu Aquaculture has since reared antibiotic-free fingerings for the China domestic market, as well as exported them to Singapore, Malaysia, Thailand, Taiwan, Vietnam and Indonesia.

In FY 2020, the Group went on to acquire the additional 40% interest in Tian Tian Fisheries as the former business partner was a Shanghai-based import and exporter, while the focus of Tian Tian Fisheries had shifted to the farming and distribution of edible fish and seafood products for the China domestic market instead of importing these items into China.

The management reckoned that having full control of these two companies in Hainan would enable the Group to integrate, align and implement its planned strategies going forward, explore new synergistic tie-up to extend its involvement in the supply value chain unreservedly, as well as to consolidate its resources in Hainan to further enhance the efficiency of its aquaculture operations in China.

(ii) Does the Group have the necessary network, support and expertise in Hainan to operate the farms efficiently?

Qian Hu has been operating two aquaculture farms in Hainan since FY 2017. Over the past four years, other than rearing fingerlings for sale, it has focused on driving higher yield in the aquaculture business in a few ways, such as expanding into new areas of the aquaculture value chain, as well as conducting trials on new edible products. Undeniably, the Group has the necessary network, support and expertise to run its aquaculture operations resourcefully to meet the demand of the sector.

(iii) Can management confirm that the Group's focus has now shifted to farming shrimps in Singapore and Malaysia?

Aquaculture business remains a major driver in Qian Hu's future growth as it is expected to eventually surpass the current core ornamental fish segments, if executed appropriately. Leveraging on its knowledge and experience in Hainan, the farming of the mono-sex giant freshwater shrimp in Singapore and Malaysia is an <u>expansion</u> to the Group's aquaculture business, focusing on the supply of seafood products closer to the local market. The Group has also started an intensive farming system for Vannamei shrimps in Singapore which has yielded promising results. In the coming years, it will be looking at the R&D behind breeding more consistent stocks of Vannamei shrimps in Singapore and Malaysia. This is in line with the Singapore government's aim to produce 30% of the country's nutritional needs by 2030, as mentioned on page 12 of the Annual Report.

(iv) Please also provide a comprehensive update on the current status and the future plans for the two farms in Hainan.

As mentioned on page 25 of the Annual Report, the Group's aquaculture business in Hainan Province was impacted by the extensive reduction of air cargo capacity and flight frequencies in FY 2020. The business has since focused on supplying edible fish fingerlings and other seafood products to the China domestic farmers for local consumption, which constituted substantially the aquaculture revenue for that year. It is envisaged that with the lifting of border restrictions and the gradual resumption of air traffic, the revenue and profits from this business segment would recuperate with more export activities in the coming months.

Other than continuing with the rearing of the various types of edible fish fingerlings for sale, the Group is actively working on expanding its aquaculture export markets beyond its current network. The Hainan farms have also started their penetration into new areas within the aquaculture value chain, such as the hatchery and grow-out stages. These processes will enable the farms to gain control over the quality, production timing and the consistency of fish fry available. More details will be provided as and when the Group make progress in these areas.

(v) With the current contract farming of freshwater shrimp in Desaru, how does management protect its intellectual property (including its technical know-how)? What is the level of oversight and control by management under the contract farming arrangement?

The Group has signed a Collaboration Agreement (the "**Collaboration**") with a third-party farm for the contract farming arrangements of giant freshwater shrimp in Desaru, West Malaysia. Under the Collaboration, Qian Hu has seconded an employee to the third-party farm to carry out and keep track of the activities of the ponds assigned for contract farming purposes. Perpetual inventory checks and audits are carried out to ascertain the accuracy of the inventory movement records. Irregularities and discrepancies, if any, will have to be investigated and reported promptly to the management in Singapore.

Q2

(i) Can management disclose the species of Dragon Fish that is faced with falling production yield and declining selling prices?

(ii) Of the estimated 3,500+ pieces of brooder stock, how many pieces are of the particular species?

(iii) Did the particular species of Dragon Fish show a significant decline in its production yield in FY2020? If so, what was the decrease? Has management investigated the reason(s) for the declining production yield?

(iv) Can the audit committee help shareholders understand in detail and reconcile the $9.6 million/54% drop in the recoverable value of its brooder stock?

The Group acknowledged the challenging operating environment faced by its Dragon Fish business. The significant reduction in the recoverable value of the brooder stocks was largely due to the plunge in production yield across all brooder stocks species, coupled with the downward pressure on the selling prices.

As at 31 December 2020, the management carried out an annual impairment test on the brooder stocks by comparing the carrying amount of the brooder stocks to the recoverable value determined based on the value-in-use ("**VIU**") method. It involved making assumptions on production yield, growth rate and determining the appropriate discount rate, as well as taking into consideration other qualitative factors such as weather conditions and economic outlook relating to the brooder stocks. In projecting the production yield of these brooder stocks, the actual production quantity of the year was used, as it was difficult to justify any deviation due to the unpredictable production patterns of the brooder stocks each year, which to a certain extent, is dependent on many natural factors. In this regard, the production yield of the brooder stocks may vary year to year.

Of the various brooder stocks species held by the Group, the carrying amount of the Golden Crossback Arowana was in excess of the recoverable value, which resulted in an impairment loss of $2 million in FY 2020. This species constituted approximately one-third of the brooder stocks quantity.

The management would like to highlight that in FY 2020, the Group had started a selective breeding initiative with a brooder stock pairing exercise for the Golden Crossback Arowana to further enhance the quality of the species. During the process, it affected the production yield of that species in the short-term.

(v) Separately, revenue from the plastics segment decreased by 30% in FY 2020 due to the loss of a major customer. Has management reviewed the reason(s) for the loss of the major customer?

As set out on page 35 of the Annual Report, despite the reduction of plastic revenue due to the loss of a major customer in FY 2020, the profit from the plastic segment improved by approximately 11.7% year-on-year. It is the intention of the Group to diversify its customer base and to focus on generating revenue through selling products with sustainable margins, instead of entering in a price war with its competitors.

Q3

(i) Can management provide shareholders with an update on the operational and financial progress made by GZQH since the acquisition?

The acquisition of Guangzhou Qian Hu Aquarium and Pets Accessories Manufacturing Co., Ltd ("**GZQH**") was completed in December 2019 (the "**Acquisition**"). As previously announced, the Acquisition was part of the Group's strategic plan to streamline its accessories operations in China. It was a meaningful backward integration for the Group with the intention to enhance the Group's ability to grow the market position of its China accessories business. Following the Acquisition, the Group had since taken over the management of GZQH and managed to turnaround the manufacturing operation in FY 2020. In addition, with vigilant cash flow management in place and prioritising the necessary payments to be made, the amount due from GZQH to the Company was reduced by approximately $0.8 million during the financial year.

(ii) Can the audit committee help shareholders understand the reasonableness of using a net profit margin of 6% in the VIU calculation when the Group achieved an average net profit margin of 0.725% from FY2016 - FY2019 (prior to the pandemic)?

(iii) Can the independent auditors elaborate further on how it had challenged management on the key assumptions used, especially in assuming a net profit margin of 6% based on the Group's historical performance?

The ***average net profit margin*** of the Group reported from FY 2016 to FY 2019 related to the Group's business activities in <u>three business segments</u> and <u>five locations</u>. It was inevitable that certain business operations and locations were faced with their own sets of operational challenges over the years, and hence, the net profit margins registered by each business segment and location would differ. It was also evident that the established entities would deliver more resilient and stable profit margins, while the profits of the entities which underwent transformation and consolidation would be affected.

The business of GZQH is in the manufacturing of aquarium accessories, which is grouped under the accessories business segment that also include the wholesale trading and distribution of aquarium and pet accessories, as well as a small portion of retail store operations. When carrying out the impairment test for the goodwill in GZQH, while estimating the recoverable amount of the cash-generating-unit ("**CGU**"), the management had applied a net profit margin of 6% in the VIU calculation to determine the recoverable amount of the CGU.

As documented in the Independent Auditors' Report on page 98 of the Annual Report, the external auditors, KPMG LLP, had challenged the key assumptions underlying the VIU calculation (including budgeted revenue growth, net profit margin and terminal growth) by <u>comparing the assumptions against the Group's historical performance in similar business segment, future business plans and consideration of other external and internal factors</u>. The valuation specialists from KPMG LLP were also engaged in assessing the reasonableness of the discount rate used. In this regard, the management would like to highlight that the historical Group's ***average net profit margin*** as stipulated in the question was an **average** number comprising numerous business variables, which was not a fair representation of the net profit margin of GZQH. The net profit margin applied of 6% was pertaining to GZQH's own financial performance since the Acquisition, as well as taking into consideration the entity's relevant future business plan.

On page 75 of the Annual Report, it was disclosed that the Audit Committee ("**AC**") had discussed with the external auditors on the robustness of the methodology used and reviewed the VIU computations, incorporating reasonably possible changes to the key assumptions, and evaluated the outcome of the sensitivity analysis prepared by management. The AC had also deliberated the management's view on the prospects and business outlook of GZQH. As a result of the above procedures, the AC concurred with the management's conclusion that no impairment charge was required as at 31 December 2020 and that the valuation of goodwill and the disclosures in the financial statements were appropriate.

(iv) Can the audit committee clarify if they had reviewed the minutes of the last AGM and followed up with management to ensure that the guarantee fees would be stopped?

The management commented at the Company's AGM held in March 2019 that the Company had entered into a Sale and Purchas Agreement to acquire the entire equity interest in GZQH that year. With GZQH becoming a wholly-owned subsidiary of the Group, the guarantee on the outstanding receivables due from GZQH to the Company would be discharged and there would be no guarantee fee payable by the Company to a major shareholder of the Company and a director of the Company, who were acting as guarantors for the outstanding receivables.

The acquisition of GZQH was completed in December 2019. The guarantee was not discharged instantaneously as GZQH needed to demonstrate its ability to regain profitability and to generate sufficient cash flow to gradually reduce the outstanding receivables. Accordingly, there were still payments for guarantee fee made in FY 2019 and FY 2020.

The guarantee is continued into FY 2021 as GZQH, despite making good progress, has yet to fully achieve the expected operational results in FY 2020 due to the unforeseen effect of the COVID-19 outbreak. Nonetheless, the Company has negotiated with the guarantors to waive the guarantee fee payable from FY 2021 till the discharge of the guarantee.

By Order of the Board

Kenny Yap Kim Lee
Executive Chairman
26 March 2021