SOLUTIONS TO WATER & WASTE

Darco Water Technologies Limited

(Incorporated in the Republic of Singapore)
(Company Registration Number 200106732C)

ANNUAL REPORT FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2019
RESPONSES TO QUERIES RAISED BY THE SGX-ST

The Board of Directors (the "**Board**") of Darco Water Technologies Limited (the "**Company**" and together with its subsidiaries, the "**Group**") refers to the Company's annual report for the financial year ended 31 December 2019 ("**Annual Report 2019**") released on the SGXNET 4 June 2020 and sets out below the Company's responses to queries raised by the Singapore Exchange Securities Trading Limited (the "**SGX-ST**") regarding the Results Announcement.

Query (a): With reference to the audited consolidated statement of cash flows on page 75 of the Company's Annual Report 2019, please provide an explanation for the material difference in

(i) the amount of the net cash from/(used in) operating activities of approximately $(1,460,000), as compared to the unaudited financial results announcement of the Company of $2,039,000 for the financial year ended 31 December 2019;

(ii) the amount of the net cash used in investing activities of approximately $3,641,000, as compared to the unaudited financial results announcement of the Company of $1,993,000 for the financial year ended 31 December 2019; and

(iii) the amount of the net cash from financing activities of approximately $2,832,000, as compared to the unaudited financial results announcement of the Company of $80,000 for the financial year ended 31 December 2019; and

Please also explain whether and how the Company has complied with Listing Rule 704(6).

Company's Response:

(i) the changes in net cash from/(used in) operating activities is mainly due to:-
- the fixed deposits pledged and fixed deposits with tenure more than 3 months has been excluded in the cash and cash equivalent in Annual Report 2019, amounting to $2,350,000; and
- audit reclassification of cash and bank, borrowing and income tax payables from payables, amounting to $767,000

(ii) the changes in net cash used in investing activities is mainly due to:-
- net cash inflow amounting to $1,000,000 for the disposal of subsidiary without a change in control been classified under financing activities in Annual Report 2019
- term loan drawdown of $1,010,000 for the purchase of freehold land is classified under financing activities in Annual Report 2019.

(iii) the changes in net cash from financing activities is mainly due to:-

- net cash inflow amounting to $1,000,000 for the disposal of subsidiary without a change in control been classified under financing activities in Annual Report 2019
- loan drawdown of $1,010,000 for the purchase of freehold land is classified under financing activities in Annual Report 2019; and
- audit reclassification of borrowing from payables, amounting to $595,000

In compliance with Listing Rule 704(6), the Company has made the announcement on 4 June 2020, explaining the material variances between the audited financial statements and the Preliminary Unaudited Results 2019.

Query (b): Provision 8.1 of the Code states that "The company discloses in its annual report the policy and criteria for setting remuneration, as well as names, amounts and breakdown of remuneration of:

(a) each individual director and the CEO; and

(b) at least the top five key management personnel (who are not directors or the CEO) in bands no wider than S$250,000 and in aggregate the total remuneration paid to these key management personnel." (emphasis added)

Listing Rule 710 requires issuers to explicitly state, when deviating from the provisions prescribed in the Code, the provision from which it has varied, explain the reason for variation and provide an explanation on how the practices it had adopted are consistent with the intent of the relevant principle. We note that the Company had not complied with Provision 8.1 of the Code with regard to the disclosure of the amounts of remuneration of each individual director and the CEO, and at least the top five key management personnel (who are not directors or the CEO) in bands no wider than S$250,000. Please clarify how the practices the Company had adopted are consistent with the intent of Principle 8 of the Code, which requires transparency on the Company's remuneration policies, level and mix of remuneration, the procedure for setting remuneration, and the relationships between remuneration, performance and value creation.

Company's Response:

The Company has disclosed in its annual report for the financial year ended 31 December 2019 (the "Annual Report 2019"):

(a) the remuneration of each individual director and the CEO in bands of S$250,000 (instead of the exact amount of remuneration as stated in Provision 8.1 of the Code);

(b) the remuneration of the top two (instead of the top five as stated in Provision 8.1 of the Code) key management personnel (who are not directors or the CEO) in bands of S$250,000 (as stated in Provision 8.1 of the Code);

(c) the breakdown of the remuneration of each individual director and the CEO into four components comprising (i) base/fixed salaries, including CPF; (ii) variable or performance related income or bonuses; (iii) benefits in kind; and (iv) director's fees; and

(d) the breakdown of the remuneration of each key management personnel into three components comprising (i) base/fixed salaries, including CPF; (ii) variable or performance related income or bonuses; and (iii) benefits in kind.

The Company has provided an explanation for its deviation from Provision 8.1 of the Code on page 35 of the Annual Report 2019. An extract of the relevant portion of the Company's Corporate Governance Report for FY2019 is set out below.

"The Board has considered Provision 8.1 of the Code, and after careful deliberation, has decided that as remuneration matters are confidential and commercially sensitive and full disclosure would be prejudicial to the Company's interest given the highly competitive environment. The Board is of the opinion that it is in the best interests of the Group not to disclose the exact remuneration of each individual Director, CEO, and the top five (5) key management personnel (who are not Directors nor CEO) in the Annual Report. The Board is of the opinion that the information disclosed in the Annual Report strikes an appropriate balance between detailed disclosure and confidentiality.

The Company ensures that the remuneration of key management is consistent and comparable with market practice by periodically reviewing and considering such remuneration components against those of comparable companies."

The Annual Report 2019 only disclosed the remuneration of the top two (instead of the top five as stated in Provision 8.1 of the Code) key management personnel as the Company only has two key management personnel.

The Company also has disclosed the Company's remuneration policies and the relationships between remuneration, performance and value creation on pages 32 and 33 of the Annual Report 2019 under the section titled "Principle 7: Level and Mix of Remuneration" of the Company's Corporate Governance Report for FY2019.

For the abovementioned reasons, the Board of Directors of the Company is of the view that the current disclosure of the remuneration of each individual director, the CEO and key management personnel is not prejudicial to the interests of shareholders and believes that the disclosure in the Company's Corporate Governance Report for FY2019 is consistent with the intent of Principle 8 of the Code as the level of remuneration has been disclosed in bands and the mix of remuneration has been disclosed in percentage terms. The reasons for deviating from Provision 8.1 of the Code has also been explained on page 35 of the Annual Report 2019.

Query (c): It is disclosed on page 107 of the Annual Report that an amount of $2,920,000 was recognised as impairment loss on intangible assets for the year ended 31 December 2019. In this regard, please disclose the following information.

(i) how the amount of impairment was determined;

(ii) the Board's confirmation as to whether it is satisfied with the reasonableness of the methodologies and estimates used to determine amount of impairment;

(iii) the reasons for the impairment losses for FY2019; and

(iv) whether any impairment losses should have been recognised in prior years, details of such impairment losses and the Board's bases of assessment.

Company's Response:

(i) Full impairment losses amounting to $2,920,000 have been recognised for intangible assets including trade name, trademarks, patented technologies and licenses.

These intangible assets were recognised as a result of the acquisition of Wuhan Kaidi Water Services Co., Ltd. (“WHKD”) in 2016 through a Purchase Price Allocation process carried out by the Group.

These Intangible assets are assessed for impairment whenever there is an indication that the intangible asset may be impaired.

The impairment amount was determined in accordance to Paragraph 8 of SFRS(I) 1-36 which states an asset is impaired when its carrying amount exceeds its recoverable amount”.

As the intangible assets cannot be assessed individually, it was determined that the they are assessed at the cash generating unit (“CGU”) level. The recoverable amount of the CGU was then determined based on its value in use, using DCF with a pre-tax discount rate of 11.06%. Our conclusion from the impairment assessment is a full impairment for intangible assets related to WHKD.

(ii) The Company has carried out the impairment testing with the assistant from external valuation specialist in determining the recoverable amount.

As explained above, the recoverable amount of the CGU was then determined based on its value in use, using DCF with a pre-tax discount rate of 11.06%.

The Board has assessed and satisfied that the above methodologies and estimates used to determine the amount of impairment is reasonable.

(iii) Impairment losses has been recognised for intangible assets including trade name, trademarks, patented technologies and license. These intangible assets are recognised in Year 2016, as a result of the acquisition of Wuhan Kaidi Water Services Co., Ltd. (“WHKD”).

Intangible assets with finite lives are amortised on a straight-line basis over the estimated economic useful lives and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

During the financial year, WHKD has recorded a net loss and this has been an indication that the intangible asset may be impaired. Therefore, the Group has carried out the impairment review, by assessing the recoverable amount of the above intangible assets.

(iv) WHKD is operating at profit in Year 2016 and Year 2017. When come to Year 2018, WHKD has shown a net profit in its standalone entity report. With the modification for the fair value adjustment on acquisition and corresponding group consolidation entries, WHKD has shown a net loss position in Year 2018.

With the drop in revenue and widening losses in 2019, Management has determined that there is an indication for impairment and therefore, impairment testing been carried out.

By Order of the Board of
Darco Water Technologies Limited

Poh Kok Hong
Executive Director and Chief Executive Officer
19 June 2020