



DARCO WATER TECHNOLOGIES LIMITED
(Incorporated in the Republic of Singapore)
(Company Registration No. 200106732C)

ANNUAL GENERAL MEETING (AGM) TO BE HELD ON 26 JUNE 2020 RESPONSES TO QUESTIONS RECEIVED FROM SHAREHOLDERS

Darco Water Technologies Limited (“**Darco**” or the “**Company**”) refers to its announcement of 4 June 2020 on the alternative arrangements for the AGM, and in particular to the invitation to shareholders to submit questions in advance of the AGM. The Company would like to thank shareholders for the questions submitted.

The Company’s response to the questions received from the shareholders that are relevant to the AGM resolutions and the business of the Company are set out below. The questions which are similar in nature and pertain to the same subject matter are grouped together for ease of reference:

1. **Placement and General Mandate:**

- (a) **With regards to the recent placement fiasco, can the Board reassure the shareholders, that Mr Wang Zhi who was on record a director of Yunnan Water subsidiary Company in Singapore, did not facilitate Yunnan Sidu to be a placee of the Placement? Did the Board take any steps such as getting a statutory declaration of his non-involvement in the placement process?**

Response: The Company has previously received confirmation in writing from Mr. Wang Zhi that there was no relationship between Yunnan Sidu and him.

- (b) It is common practice in AGM to give the Management the general mandate to carry out placement shares to raise capital. In view of the fact Management has arguably abused the process. We would like to suggest that the Board explain the true reasons why the recent placement was allowed to lapse. In order to safe guard any possible abuse, such unfettered power should not be granted during the coming AGM. **Would the Board state clearly their decision and reasons to support such a resolution? The written rationale should be prepared and presented during the coming AGM.**

Response: The Board wishes to state categorically that there is no basis to say that the Management had abused the placement process (whether in the past or otherwise).

The reason why the recent placement had lapsed is contained in the Company’s announcement dated 25 March 2020. As at the Cut-Off Date, the condition precedents as set out in the Placement Agreement have not yet been satisfied. As a result, the Company and the Placees have decided not to proceed with the Placement.

A general share issue mandate enables directors of a company to be nimble when it comes to having to raise funds (through share issuance) at short notice or using new shares to trade for or acquire assets quickly as long as any of the aforesaid falls within the approved limits. This would also enable the company to minimise costs as it would not be required to go to the shareholders for approval in light of the size and the impact that such share issuance or

acquisition would have on the Company as a whole. In light of the foregoing, the Board is of the view that it would be in the best interest of the Company to have available the ability to proceed with new share issuance at short notice and at minimum costs.

- (c) **Are there any other services provided by Qarah Consultancy Pte Ltd to Darco besides the Placement Agreement?**

Response: Qarah Consultancy had in 2019 provided consultancy services to the Company over a period of three months.

- (d) **Are there any services provided by either Ms. Joanna Ong or Qarah Consultant Pte Ltd to controlling shareholders, Mr Wang Zhi, or organization related to Mr Wang Zhi, directly or indirectly, prior to Joanna Ong being appointed as an Independent Director on 2 May 2019 and/or after her appointment to Darco?**

Response: In her reply to the Company, Ms Ong has confirmed that she has not provided any services to Mr Wang Zhi or organizations related to him. Separately, the Company has also received confirmation from Mr Wang Zhi that Qarah Consultancy has not provided any services to him or organizations related to him (other than the Company).

2. **Nambo Project:**

- (a) We refer to section 2 of the 8 June Announcement. We note that JBL is required to commence operations by 12 June 2020 (“**Deadline**”), failing which liquidated damages of approximately US\$46,000 per day of delay, up to 180 days (i.e. up to an amount of US\$8,280,000) (“**Damages**”) would be chargeable to JBL, in the event the West Java Government decides not to grant an extension of the Deadline (“**Extension**”). As at the date of this letter being 11 June 2020, there has been no further updates by the Company to the shareholders, as to the Extension or the exercise of the reversal option.

We wish to seek the following clarification / confirmation:

- (i) **the Board’s reasons / rationale for not deciding to exercise the Reversal Option, particularly in view that the Company does not appear to have sufficient financial resources to pay the maximum amount of Damages and that there is no certainty whatsoever that the West Java Government will grant the Extension; and**

Response: The Board has deliberated on and weighed the pros and cons of choosing to exercise the Reversal Option immediately, on the one hand, against choosing to work with the West Java Government with the goal of securing improved terms and conditions for the Cooperative Agreement so as to render the Project viable and earnings accretive. After much deliberation, the Board determined that it remains in the interest of the Company to give another shot at making the Nambo Project work as such a project, if rendered viable and earnings accretive, would be strategic for the expansion and growth of the Group. In this regard, the Board has also taken into account the fact that the Reversal Option remains exercisable even if the Company is unable to reach an agreement with the West Java Government on the renegotiation of the terms and conditions of the Cooperative Agreement.

In any case, regardless of when the Reversal Option is exercised, and as explained in the Company’s announcement on 11 June 2020, the maximum exposure to the Company’s books is as follows:

“Purely for illustration purposes and assuming that the Reversal Option was exercised and completed on 31 December 2019, the impact the Reversal Option on the Group’s audited consolidated financial statements for the financial year ended 31 December 2019 would have been as follows:

- (a) a reduction of the net liabilities of the Group by an amount of S\$566,000, being the net liabilities of the PEI Group;*
- (b) a de-recognition of other payables of S\$270,000 (or USD\$200,000) in relation to the outstanding purchase consideration amount;*
- (c) a de-recognition of the intangible assets (goodwill) of S\$2,535,000) which was recognised when the business of the PEI Group was combined with that of the Group; and*
- (d) a reversal of the non-controlling interest of S\$84,000.*

In addition, the purchase consideration for the acquisition of the PEI Group paid by the Company to the Seller of S\$1,783,000 (or USD\$1,300,000) will be recorded in the Company’s books as other receivables. This outstanding amount is to be recovered from the Seller and will be subject to Expected Credit Losses (ECL) assessment per SFRS(I) 9.

Based on the above, the period of consolidation of the PEI Group with the Group is from 12 December 2019 to 31 December 2019. Due to the short duration of consolidation, the impact on the profit and loss accounts of the Group would have been minimal and immaterial.”

- (ii) confirmation on whether the Audit Committee has duly and fully deliberated on the risk exposure to the Company before making the 8 June Announcement; and**

Response: The Audit Committee confirms that it had had the opportunity to duly and fully deliberate on the risk exposure to the Company and had done so before the 8 June Announcement was made by the Company.

The Audit Committee would like to further note that it has been informed by the Investment Committee that the Nambo Project is a priority and of importance to the West Java Government. The Business Partner is of the view that, notwithstanding the recent reply from the West Java Government indicating that it is not prepared to re-negotiate the terms and conditions of the Cooperative Agreement (see the Company’s announcement dated 25 June 2020), there remains room for JBL to continue to engage with the West Java Government to find an acceptable solution with a view towards rendering the Nambo Project viable from a financial perspective.

- (iii) the Board’s proposition to ensure that the Company will not be required to pay the Damages.**

Response: The Board would like to reiterate that the Damages, if suffered, are payable by JBL, that is, at the project company level. Other than possible accounting impact on the Company’s financial position (on a consolidated basis), there is no actual payment required to be made by the Company. The Board would like to further reiterate that upon exercise of the Reversal Option, the PEI Group (including JBL) would be recorded as discontinued business of the Group and the impact on the financial position of the

Company (on a consolidated basis) would be significantly reduced as the Damages would cease to be accounted for at the Company level.

- (b) We further refer to section 3(i) of the 11 November Announcement, pursuant to which the Company stated that Mr Wang Zhi had recommended that the Company considers the proposed Acquisition, and in the event, for any reason whatsoever, the Company declines, elects not to or otherwise is **unable** to proceed with and/or complete the Proposed Acquisition, Mr. Wang Zhi will reimburse the Company in full any and all of the costs, including but not limited to the costs and expenses in undertaking business, financial, legal and technical due diligence and feasibility studies, as well as to negotiate and finalise the transaction documents, incurred and paid for by the Company in excess of the initial S\$100,000 (the “Costs”).

We wish to seek the Board’s confirmation that, in the event the Company chooses to exercise the Reversal Option:

- (i) **Mr. Wang Zhi will reimburse all costs as set out in section 3(i) of the 11 November Announcement; and**

Response: Mr. Wang Zhi has previously given the Company an undertaking in writing to reimburse the Costs. Mr Wang Zhi has also, as a gesture of goodwill, offered to take over the project should the Company elect not to proceed with the Proposed Acquisition.

- (ii) **the foregoing undertaking by Mr. Wang Zhi is validly set out in writing, legally binding and enforceable. Please consider publishing such undertaking and/or allowing shareholders to inspect the relevant document at its registered office at specified time in accordance with the safe distancing measures implemented due to COVID-19; and**

Response: The Board would like to inform Shareholders that the written undertaking from Mr. Wang Zhi was drafted with assistance from the legal counsel to the Company.

- (iii) **the Company is satisfied that it will be able to recover the amount of US\$1,300,000, consisting of the Advance Payment, First Payment and Second Payment, which had been paid to Esmus Co. Ltd. within 14 days, as we note that it is stated in the CSPA that the completion date of the Reversal Option shall be 14 days from the date of written notice from the Company to exercise the Reversal Option.**

Response: As announced by the Company on 11 June 2020:

“Should the Company eventually choose to exercise the Reversal Option, the Company will have direct recourse against the Seller for the refund of the purchase consideration paid by the Company for the acquisition of the PEI Group in accordance with the terms and conditions set out in the CSPA. In the event that there might be, at any relevant time, any concern relating to the recoverability of the purchase consideration from the Seller, the Company will in tandem seek to dispose of its shares in PEI or its interest in the Project to a another party who will be able to better manage the risks associated with the Project, while still continuing to seek recovery of the purchase consideration from the Seller.”

- (c) We have seen from the announcement dated 11 Nov 2019 that this Waste to Energy project in Indonesia was recommended and spearheaded by, Mr Wang Zhi, deputy chairman and director of Darco. **Could the Board ensure that Mr. Wang Zhi recuse himself from participating in**

any further discussion and decisions on this project to avoid getting into potential conflict of interest?

Response: The Board is of the view that there is no reason to consider Mr Wang Zhi as having a potential conflict of interest, as none of Mr Wang Zhi, his family and associates is interested in the Project (other than through shareholding interests in the Company). Mr Wang Zhi is also not a director in the company which currently holds the Project.

- (d) **Could the Board share its Business Plan of the Company as to how it would fund this US\$46.0M project?** The Board should have a concrete plan as we note that the original operation date of the plant is said to be 12th June 2020, which has already passed.

Response: The current focus of the Company is have JBL engage with the West Java Government to re-negotiate the terms and conditions governing the Nambo Project so as to render it viable and earnings accretive. In doing so, the Company will also include an extension of time to ensure that there is sufficient time for JBL to implement, launch and commence operations of the Nambo Project. When negotiating for the extension of time, the Company will ensure that there is sufficient time to raise any additional funds (be it conventional borrowing or project financing, capital markets fund raising, or joint venture arrangements) that may be required to implement, launch and commence operations of the project.

3. **Wuhan Kaidi Water Services Co., Ltd.**

- (a) We note from Page 159 of the FY2019 Annual Report that significant impairment has been made to the accounts receivables in China, due to what appears to be technical adjustment.

In this regard, we wish to seek the Board's clarification on the following matters:

- (i) **the circumstances or reasons which led the management of the Company and / or Wuhan Kaidi Water Services Co., Ltd. ("WHKD") to make such impairments in the FY2019 Annual Report and not in earlier financial statements;**

Response: All financial assets are subject to impairment testing at the end of each financial year. The Group applies impairment model in SFRS(I) 9 to measure the Expected Credit Losses ("ECL").

The Group applies simplified approach to all trade receivables and contract assets. Impairment loss allowance is measured at life time ECL, which represents ECLs that result from all possible default events over the expected life of a financial instrument ('Life-time ECL').

The Group have established a provision matrix that is based on historical credit loss experience, adjusted for forward-looking factors specific to those customers and the economic environment. By considering the historical credit loss and the economic condition in China, the ECL rate has been adjusted upward. This has caused higher loss allowance recognised in FY2019.

A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. After considering below events/incidents which occurred during the year 2019, we have

assessed and concluded that these receivables and contracts assets need to be credit impaired:

- One of our customers and the project owner have reached agreement on the final project claim, but the agreed settlement sum falls markedly short of the original contract price.
- We have a project owner who is faced with difficulties that has rendered the project halted since 2017. To date, we have no visibility on the timing nor the possibility on the resumption of the project.
- There is also a project that has stalled for a period of time and we further notice that the customer is in financial difficulties.

- (ii) **whether there is a fundamental issue in the business model of WHKD or inherent business risks involved in such engineering, procurement and construction (“EPC”) business, and if to the sudden crystallisation of all impairments in the FY2019 Annual Report is appropriate. Please also clarify whether the impairments reflected in the financial reports for the preceding 5 financial years, prior to the impairment reflected in FY2019 Annual Reports, were true and fair; and**

Response: WHKD has been operating for more than 20 years, and it has been in a profitable position since its acquisition in FY 2016, up until the loss shown in FY 2019. It is the stiff competition in the China market which has caused the drop in revenue and Gross Profit Margin in the recent years, as well as the loss position in FY 2019. At the same time, as explained in 3(a)(i) above, higher impairment losses were recognized in FY 2019. We are, therefore, not aware of any fundamental issues in the business model of WHKD.

Financial assets of the Group is carried at amortised costs less impairment losses. All financial assets are subject to impairment testing at the end of each financial year. The Group applies impairment model in SFRS(I) 9 to measure the Expected Credit Losses (“ECL”).

As explained above, the impairment losses are taken up in Year 2019, after considering historical credit loss experience, adjusted for forward-looking factors and also events/incidents which occurred during the year 2019.

At the end of each financial year, the management has carried out the necessary impairment testing procedures to assess the recoverability of each financial asset. The amount recognised for impairment losses has further been reviewed and audited by the Group auditors. We would like to confirm that impairment losses have been taken up correctly in the past.

- (iii) **whether there is any lapse of control in meeting the targeted gross profit margin during project implementation, since we note that gross profit margin has decreased over the years.**

Response: Management, with guidance from the Internal Auditor, has been strengthening the monitoring process of targeted Gross Profit Margins. Additionally, the decrease in GPM is subject to various factors, and could be more related to market conditions rather than a lapse of control.

- (b) As we are concerned that there may be more serious lapses in the Company's financial reporting, **we also urge the Board to carry out a special audit to provide an independent review and to advise the Board on internal controls, credit risks and business modelling of WHKD.**

Response: There is ongoing internal audit on WHKD, and WHKD has been included in the Internal Audit plans for the past few years. Some areas of concern were highlighted from the past review and a follow up has been scheduled in October 2020. Subject to the outcome of this review, the Board will consider the necessity for an independent review.

- (c) WHKD under the stewardship of Mr. Wang Yao Yu has performed dismally. **Would the Board review the performance and replace Mr. Wang and appoint a better suited executive to take the Company forward?**

Response: FY2019 is the first financial year in which WHKD had recorded losses since its acquisition in 2016. The Board is of the view that there had been multiple factors that had contributed to less than ideal performance including local regulatory environment, macro-economic environment and, more recently, the COVID-19 impact. Mr Wang Yao Yu has been key to the operations of WHKD given that he, together with the management of WHKD, has been intimately involved with such operations – even prior to the acquisition by the Company of WHKD. The Board would like to note that the Nominating Committee has put in place an annual assessment of the members of the Board at the beginning of each calendar year. The Nominating Committee will deliberate on the Shareholders' feedback in relation to Mr Wang Yao Yu and his role within the Group in its next annual assessment and will make its recommendations to the Board as appropriate.

- (i) Currently, all the directors in WHKD are members of Wuhan Liankai, who were previously substantial shareholders of Darco. Now that they have sold their shares. We can no longer rely on them to look after 72% of Darco equity interest. **Have the NC considered nominating 3 of the 5 board members from Singapore to sit on Wuhan Kaidi board which the Group is entitled?**

Response: The Board is alive to this issue and has requested the Nominating Committee to make its recommendations at the next board meeting.

- (ii) WHKD has defaulted on more than S\$6.5M in loans plus interest (S\$4.0M of which was payable to Mr Wang Zhi) payable to the Group. What concrete action is the Board taking to recover the outstanding debts from this subsidiary?

Response: The Board would like to clarify that WHKD is currently not in breach of its payment obligations under the loan arrangements. The agreed date for next tranche of repayment is 31 December 2020. The Board has directed the Management to keep close tab on the cash position of WHKD and to the extent that there is any operating surplus, such operating surplus shall be prioritised for the repayment of loans and interest accrued.

- (d) Could the Board also disclose the cash balance of the Group after the WHKD defaulted on the S\$4.0M loan repayment to Wang Zhi and the Company had paid Wang Zhi from the Group's own coffers?

Response: As noted above, WHKD is not in breach of its payment obligations under the loan agreements. The Management confirms that the repayment of the S\$4.0 million loan to Mr

Wang Zhi was made using available internal resources. The Company will disclose the cash balance of the Group as well as provide a statement of cash flows for the Group when it announces its next half-year financial results in mid-August 2020.

4. Mandatory General Offer:

(a) Notwithstanding the foregoing, it is noted that Mr Wang Yaoyu (“**Chairman**”) disagreed with the opinion of the IFA and the recommendation of the remaining Independent Directors, and had, instead, recommended that Shareholders accept the Offer, for the following reasons:

- (i) the Offer Price represents a premium of approximately 30.8%, 33.3% and 30.6% over the VWAP of the Shares on the last traded day prior to the release of the Offer Announcement, for the one-month and three-month periods prior to the release of the Offer Announcement respectively;
- (ii) the Shares have insufficient liquidity in the open market, having been traded for only 33 days out of a total of 261 market days during the one-year period prior to the release of the Offer Announcement; and
- (iii) due to the current market situation, the industry in which the Group is operating in faces significant challenges.

(b) It is noted that the reasons set forth in Paragraph 4(a) and 4(b) herein appear to be similar reasons for IFA’s advice for the Independent Directors to recommend Shareholders to reject the Offer, as set forth in Paragraphs 3(a) and 3(f) herein. Furthermore, in respect of the reason set forth in Paragraph 4(c) above, it is noted that the IFA has stated that the Group has sufficient assets to cover its current liabilities and the Group’s net cash outflow from operating activities has decreased significantly in FY2019 as compared to FY2018, which appear to suggest that prospects are improving for the Company. As such, in our view, the basis and reasons provided by the Chairman for his differing recommendation to Shareholders to accept the Offer is unclear and / or weak.

More pertinently, it is observed that the Chairman is a controlling shareholder and director of the Seller, holding the entire deemed interest on behalf of the Seller, which sold 13,387,118 Shares to the Offeror, thereby triggering the obligation of the Offeror to make a mandatory general offer under Rule 14 of the Takeover Code.

As such, we are concerned whether there may be any conflicts of interests and/or failure by the Board to ensure good corporate governance, in the course of making recommendations on the Offer. We are also concerned if the Chairman was indeed acting in the best interest of the Company and the shareholders as a whole, by providing a recommendation to the independent Shareholders to accept the Offer contrary to the IFA’s advice and the remaining Independent Directors’ recommendation, without clear and strong reasons. In this regard, we wish to highlight that Principle 4 of the Takeover Code states that the rights of control must be exercised in good faith and oppression of the minority is wholly unacceptable. Additionally, Rule 103 of the Listing Rules states the underlying principle that directors of an issuer shall act in the interests of shareholders as a whole, particularly where a director or substantial shareholder has a material interest in a transaction entered into by the issuer.

Accordingly, we wish to seek the following confirmations / clarifications:

- (i) **the Board’s confirmation on whether there are any conflicts of interest in allowing the Chairman to make a recommendation to the Shareholders in respect**

of the Offer, and the basis of such confirmation. Please highlight the steps taken by the Board to mitigate or manage such conflict of interest, if any; and

Response: Pursuant to Rule 24.1(a) of the Singapore Code on Take-overs and Mergers (the “Code”), the offeree board circular should indicate whether or not the board of directors of the offeree company recommends to shareholders the acceptance or rejection of take-over offer(s) made, or to be made, by the offeror. For the purposes of making a recommendation on an offer, all directors of the offeree company are regarded as independent unless there is an irreconcilable conflict of interest in the context of the offer, in which case, an exemption from the Securities Industry Council (the “SIC”) would have to be sought. Therefore, unless specifically exempted by the SIC from assuming responsibility for any recommendations on the Offer, all members of the Board must make a recommendation on the Offer.

In determining whether Mr. Wang Yaoyu should be exempt from making a recommendation on the Offer under the Code, the management of the Company and the Board took into consideration Paragraph 3 of Note 1 to Rule 8.3 of the Code, which states as follows:

“Directors of the offeree company who have sold offeree company shares to the offeror or persons acting in concert with the offeror are not deemed to have an irreconcilable conflict of interests. The same holds true for directors of the offeree company who are directors, employees or nominees of the vendor company which has sold offeree company shares to the offeror or persons acting in concert with the offeror. The Council will not normally exempt these directors from assuming responsibility for any recommendations on the offer that the offeree board may make to shareholders.”

The Company has also received a confirmation from Mr. Wang Yaoyu that save for the sale of 13,387,118 Shares by the Seller to the Offeror, there are no other arrangements or understandings entered into between him and the Offeror, or between the Seller and the Offeror. The Board and the management of the Company are also not aware of any other matters or relationships between Mr. Wang Yaoyu and the Offeror which would suggest that there is an irreconcilable conflict of interests in the context of the Offer. Accordingly, Mr. Wang Yaoyu is regarded as independent for the purposes of the Offer and is not exempted from making a recommendation on the Offer to the Shareholders.

- (ii) the Chairman’s clarification on and explanation / substantiation of the reasons for making a recommendation to Shareholders to accept the Offer, to all the Shareholders.**

Response: The Company had reached out to the Chairman to request for his clarification on and explanation / substantiation as requested. In reply, the Chairman noted as follows: (i) as a Director of the Company, he understood and respected the IFA’s opinion, and shareholders should decide whether or not to accept the Offer based on their own situations; and (ii) his reasons as stated in the offeree board circular are clear and he has nothing further to add.

BY ORDER OF THE BOARD

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