CHINA STAR FOOD GROUP
中国之星食品集团

(Incorporated in the Republic of Singapore with Unique Entity No.: 200718683N)
Website: www.zixinshuye.com
SGX Stock Code: **42W**

RESPONSE TO QUESTIONS FROM A SHAREHOLDER AND THE SECURITIES INVESTORS ASSOCIATION (SINGAPORE) IN RESPECT OF THE COMPANY'S ANNUAL REPORT FOR THE FINANCIAL YEAR ENDED 31 MARCH 2020

The board of directors (the "**Board**" or the "**Directors**") of China Star Food Group Limited (the "**Company**" and together with its subsidiaries, the "**Group**") refers to the questions raised by a shareholder and the Securities Investors Association (Singapore) ("**SIAS**") in respect of the Company's annual report for the financial year ended 31 March 2020 (the "**Annual Report 2020**"). In this regard, the Company has made some editorial amendments to the question received from one of its shareholders to ensure that the question is clear. For the avoidance of doubt, the editorial amendments do not change the meaning of the question from the shareholder.

The Company wishes to provide its responses to the question from the shareholder below:

Q1. **Please provide an update on the status of the paid-up capital of Fujian Zixin.**

Company's response

As disclosed in paragraph 12 of the Company's full year results announcement, as announced on 30 July 2020, the Company had intended to fulfill the capital commitment of Fujian Zixin's registered share capital through additional capital raising exercises (the "**Fund-Raising Plans**") in FY2020. Unfortunately, the Fund-Raising Plans have been delayed due to the outbreak of COVID-19 as well as the difficult global market conditions. Accordingly, the Fund-Raising Plans have been put on hold as Management has had to devote all of its attention to the Group's operational and business needs. The Company will provide further updates on Fund-Raising Plans as and when necessary.

The Company wishes to provide its responses to the questions from SIAS below:

Q1. **SIAS:** As noted in the chairman's letter to shareholders, revenue for the financial year slipped by 9.5% RMB 323.1 million, partly due to the COVID-19 pandemic that saw the group offer a one-off discount to their distributors. In addition, the group incurred marketing and distribution costs which increased by 81.1% to RMB 40.4 million to support the new distribution channel management strategy.

As can be seen from the consolidated statement of profit or loss and other comprehensive income (page 73), the group achieved a gross profit of RMB70.2 million but incurred marketing and distribution costs of RMB(40.4) million and administrative expenses of RMB(39.6) million.

Loss before income for the year was RMB(10.6) million.

	Notes	2020 RMB'000	2019 RMB'000 (Restated) (Note 27)
Revenue	5	323,141	357,001
Cost of sales		(252,982)	(254,701)
Gross profit		70,159	102,300
Finance income	6	376	621
Other income	7	713	1,027
Marketing and distribution costs	8	(40,402)	(22,311)
Administrative expenses	9	(39,571)	(40,282)
Other losses	10	(34)	(391)
Finance costs	6	(1,831)	(1,326)
(Loss)/Profit before income tax		(10,590)	39,638
Income tax credit/(expense)	12	4,123	(15,963)
(Loss)/Profit for the year, net of tax		(6,467)	23,675
Other comprehensive (loss)/income:			
Items that may be reclassified subsequently to profit or loss:			
Exchange differences on translating foreign operations		(372)	301
Total comprehensive (loss)/income for the year		(6,839)	23,976

(Source: Annual Report 2020)

In Note 8 (page 96), it was further disclosed that advertisement costs increased from RMB4.49 million in FY2019 to RMB18.73 million in FY2020 and publicity expenses increased from RMB3.68 million to RMB6.65 million.

(i) **Can management provide greater clarity on the RMB18.73 million spent in advertisement costs and the RMB6.65 million spent in publicity expenses in FY2020? Please elaborate further on the advertising and publicity channels used by the group and provide greater clarity on the scaling up of its marketing efforts. For instance, was there a huge national campaign? Did the group buy more airtime or sponsored a major event/show? Was there increased outreach on certain e-commerce platforms?**

Company's response:

During FY2020, the Group had sponsored several sporting events (such as the international half marathon and international cycling event in Longyan Province, China) and had also participated in several national fairs and campaigns focused in the food and beverage sector in China (such as the Spring and Autumn China Food & Drinks Fair). The Company's rationale for undertaking the aforementioned marketing events is to increase consumers' awareness of the Group's brands and products in a highly competitive snack food industry in the Chinese market.

The advertisements costs were mainly spent on renting booths at the aforementioned national fairs, designing the appropriate advertisements to be displayed on large billboards located on expressways connecting to airports and on expressways that have good traffic (such as but not limited to Changting Expressway, Beijing Nanyuan Airport Expressway, Hefei Xinqiao International Airport Expressway, Longyan Expressway) as well as the associated rental expenses in connection with leasing of such large billboards. In addition, the Group had also incurred advertising and publicity expenses in relation to the placement of advertisements for the Group's brands and products in selected airports and train stations which the Group has assessed to have exposure to heavy commuter traffic.

Further to this, the Group had also engaged a marketing agent, based in China, to advise the Group on the appropriate brand management strategies in order to deploy digital marketing strategies and applications suitable for the Group's snack food products.

(ii) What were the results of the increased marketing spend?

Company's response:

As with all advertising and publicity campaigns, the Group will only be able to ascertain the results of its efforts in the medium to long term and it is of the view that it is premature to provide any immediate indication on the results of the increased marketing spend.

Notwithstanding the above, the Group is of the view that, in order to achieve sustainable growth in the long term, increased efforts in advertising and publicity to enhance brand and product awareness amongst the highly competitive snack food sector are of high importance to the Group.

(iii) In approving the marketing budget, what was management's expected return on investment (prior to the pandemic)?

Company's response:

The purpose of the advertising and publicity campaigns undertaken by the Group is to create brand awareness and to ensure that the Group's brands continue to stay in the forefront of consumers' minds. In this regard, the Group is unable to provide an indication on the expected return on investment at this point of time as there are many variable factors that could affect the effectiveness of the advertising and publicity campaigns. The Board would, however, continually assess the effectiveness of the Group's advertisement and publicity efforts. The effectiveness of the Group's marketing efforts is mainly ascertained by garnering feedback from customers, suppliers and the general public.

(iv) Can management also elaborate further on the "new distribution channel management strategy"?

Company's response:

As set out in the Chairman's Letter to Shareholders in the Annual Report, in light of the COVID-19 pandemic, there has been a shift from the conventional way consumers make purchases at physical stores and supermarkets to online purchases. This has prompted the Group to accelerate its e-commerce development and "live streaming" online sales platform to market and sell its fresh sweet potatoes and proprietary branded snack food.

These online sales channels complement the Group's entrenched traditional marketing and distribution channels by offering alternative options to distributors and consumers. Moving forward, the Group will explore how best to utilise e-commerce and online sales to meet the growing push for digitialisation.

(v) **Will the group be scaling back its advertisement and publicity efforts in the new financial year?**

Company's response:

The advertisement and publicity efforts of the Group are continuously monitored by the management and the Board. If necessary, appropriate adjustments and/or changes will be made based on the needs of the Group's operations.

Q2. **SIAS:** The "Advance payments for supplies of sweet potatoes" is a key audit matter (KAM) highlighted by the Independent Auditor in their Report on the Audit of the Financial Statements (pages 42 to 46). Key audit matters are those matters that, in the professional judgement of the Independent Auditor, were of most significance in the audit of the financial statements of the current period.

As mentioned in the KAM, the carrying amount of the advance payments to six sweet potatoes suppliers amounted to RMB120,657,000 as at 31 March 2020. This represented 25.5% of total assets as at 31 March 2020 and was a significant balance during the year.

The group's outstanding purchase contracts are as follows:

- In FY2018: five years upfront payments amounting to an aggregate of RMB 131,715,000 with 3 suppliers who are to supply an aggregate of 12,190 tons of raw sweet potatoes yearly
- In FY2019: RMB 46,500,000 for an agreement with a supplier for at least 4,600 tonnes of sweet potatoes per year and RMB 25,000,000 for an agreement with another supplier for at least 2,300 tons of sweet potatoes per year
- In FY2020: a new purchase contract in March 2020 with a supplier for a total of 6,000 tons of sweet potatoes from March to August 2020, of which an advance payment of RMB 3,592,800 was made for approximately 1,800 tons of sweet potatoes

In FY2020, the group purchased 20,193 tonnes of fresh sweet potato, up 40% from 14,431 tonnes in the previous year.

(i) **How much of the group's purchase of sweet potato came from the six suppliers with whom the group has made advance payments to?**

Company's response:

In light of the highly competitive nature of the sweet potato snack industry, the Board is of the view that this is confidential information which may have a material impact on the Group's existing relationship with its key suppliers as well as its position in securing / negotiating terms with new suppliers. Accordingly, the Company is of the view that such a disclosure would not be in the interest of the Group's business and operations.

(ii) **What was the average price obtained during the year as a result of the purchase contracts?**

Company's response:

Please see our response to Question 3(i) above.

(iii) **How much oversight and/or influence does management have in the operational and financial matters of the 6 suppliers?**

Company's response:

Management does not have oversight and/or influence in the operational and financial matters of the six (6) suppliers as these suppliers are not employees of the Group and there are contractual obligations in place in these supply agreements. In addition, the commercial realities are that sweet potatoes as a food resource is high in demand. The reason for such high demand is attributed to the fact that the cultivation of sweet potatoes is a seasonal process and is also subject to certain external factors such as weather conditions, vis-à-vis the growing global demand for sweet potatoes on the back of increasing awareness of the health benefits of sweet potatoes and an increase in consumer awareness of health- and wellness-consciousness.

Notwithstanding the above, the Group wishes to assure Shareholders that as part of its daily operations, it maintains a consistent and stringent monitoring and reviewing process to assess the quantity and quality of sweet potatos against the agreed contractual terms (further details are set out below). In the event that any of the suppliers did not perform up to their contractual obligations, the Group will be entitled to enforce its rights in accordance with the terms of the supply contracts.

(iv) **What are the safeguards put in place to protect the group's interests given that the group has made significant amounts of upfront payment to the suppliers?**

Company's response:

In the event of a default in the suppliers' delivery obligations, a breach of contract or any other default on the part of the suppliers, the Group has the right, pursuant to the terms of the supply contracts, to legally take over the land involved and hand it over to a third party or directly appoint a professional to manage it. In addition, should the Group incur additional significant costs / losses in the event of a breach of contract, the Group will be able to take legal action against the supplier on the basis of the contracts entered into with the suppliers, which are governed under the laws of the People's Republic of China.

Separately, the Group is continually seeking to increase the number of suppliers so as to reduce its reliance on any one supplier. This is part of the Group's risk mitigation plans.

(v) **In addition, how does the group ensure that the quality of the sweet potato from the 6 suppliers meets the requirements of the group?**

Company's response:

The Group has put in place a process whereby it continuously monitors and reviews the quantity and quality of sweet potatoes provided by the respective supplies against the agreed contractual terms.

In addition, the Group had also undertaken soil improvement projects for the purposes of enriching the soil conditions to improve the harvest yield as well as maintain a consistent supply of good and satisfactory quality sweet potatoes for the Group.

(vi) **How does management manage the risk of crop failure (due to weather, pests etc) of its suppliers and the potential financial difficulties faced by its 6 suppliers following a crop failure?**

Company's response:

The quality of fresh sweet potatoes is a prerequisite for the Group to produce high quality sweet potato snacks. In this regard, supplies of such quality fresh sweet potatoes for making sweet potato snacks are generally only found in Liancheng County where the Group operates. Liancheng County is famous for its sweet potato produces, with most of the farmers there specializing in farming sweet potatoes and are able to develop and improve the seedlings to grow specific breed of sweet potato variants for various kind of food preparations. Furthermore, given the ideal weather conditions in Liancheng County, the sweet potatoes are generally sweeter than sweet potatoes grown in other parts of China.

In addition, any reason for why the Group sources its fresh sweet potatoes supplies in the Liancheng Country is due to the costs savings that it is able to enjoy as the cost of transporting the fresh sweet potatoes is lower as compared to the Group obtaining its supplies from other regions and provinces.

Accordingly, these are the key reasons for why the Group sources its fresh sweet potatoes supplies in the Liancheng County.

As part of the Group's existing risk mitigation plans, the Group will seek to enforce its contractual rights in the event the contractual obligations of the suppliers are not fulfilled. Pursuant to the terms of the supply contracts, the Group is entitled to receive a minimum quantity of sweet potatoes and in the event that the suppliers are unable to perform its contractual obligations, the Group will enforce its contractual rights to have the suppliers acquire the stipulated quantity and quality of sweet potatoes from open market. In addition, the Group has the right to legally take over the land involved and hand it over to a third party or directly appoint a professional to manage it. This would enable the Group to continue receiving the necessary supplies, where possible.

Notwithstanding the above, the Group is continually exploring the feasibility of diversifying its supply of quality fresh sweet potatoes from other local provinces.

Q3. **SIAS:** As noted on page 59, the board has stated that, after much deliberation and consideration, it did not recommend the company to declare dividends for FY2020. The board is of the view that it should conserve the financial resources of the group for the purposes of funding the group's operations and that it is a commercially prudent approach. In addition, the company does not have a formal dividend policy and that the form, frequency and amount of dividends will depend on the company's earnings, general financial condition, results of operations, capital requirements, cash flow, general business conditions, development plans and other factors as the directors may deem appropriate.

Since the reverse take-over in 2015, the company has not declared a dividend.

As shown on page 15 (Financial highlights), the group is in net cash position as at the end of the last three financial years. As at 31 March 2020, the group has net cash and cash equivalents amounting to RMB71.1 million, up from RMB60.0 million.

(i) Has the board evaluated the capital structure of the group and determined its optimal capital structure?

Company's response:

When necessary, the Board will review and evaluate the capital structure of the Group. With regard to the question on the optimal capital structure of the Group, the Board is of the view that the optimal capital structure of the Group should be guided by its long-term growth plans. In this regard, the Board constantly reviews any potential capital financing plans (whether debt or equity) to ensure that is able to efficiently utilise its capital in a manner that will ultimately benefit all its shareholders.

(ii) Is management able to obtain cheaper sources of funding to fund the business?

Company's response:

Please refer to the responses set out in Question 3(i).

(iii) What is the amount of working capital required to support the group's operations and its growth plans?

Company's response:

The Board is of the view that the amount of working capital required to support the Group's operations and its growth plans is dependent on several forward-looking external factors (such as but not limited to the industry outlook and market dynamics). As such, it is not appropriate for the Board to provide any specific amount which may be deemed to be a forecast or projection of the Group's operations.

The Board is continuously monitoring and ensuring that the level of working capital available to the Group capital is sufficient for its operations and expansion plans.

(iv) Would the board consider a review of how the group could balance the need to provide returns to its capital providers (dividends for shareholders) and the need to support its operations and growth?

Company's response:

The Board wishes to highlight that, as and when necessary, it will review the operations and long-term plans of the Group in order to ensure that it is able to provide returns to its capital providers (such as Shareholders) while ensuring that it can support the necessary operations and growth plans.

Further to this, as disclosed in paragraph 12 of the Company's full year results announcement, as announced on 30 July 2020, the Company had intended to fulfill the capital commitment of Fujian Zixin's registered share capital through additional capital raising exercises (the "**Fund-Raising Plans**") in FY2020 before deciding on whether dividends should be declared. Unfortunately, the Fund-Raising Plans have been delayed due to the outbreak of COVID-19 as well as the difficult global market conditions. Accordingly, the Fund-Raising Plans have been put on hold as Management has had to devote all of its attention to the Group's operational and business needs. The Company will provide further updates on Fund-Raising Plans as and when necessary.

By Order of the Board

Liang Chengwang
Executive Chairman and Chief Executive Officer

28 September 2020

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*This announcement has been prepared by the Company and reviewed by the Company's sponsor, Novus Corporate Finance Pte. Ltd. (the "**Sponsor**"), in compliance with Rule 226(2)(b) of the Singapore Exchange Securities Trading Limited (the "**SGX-ST**") Listing Manual Section B: Rules of Catalist.*

This announcement has not been examined or approved by 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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