DUKANG DISTILLERS HOLDINGS LIMITED
(Incorporated in Bermuda)
(Company Registration Number: 41457)

RESPONSES TO QUESTIONS FROM SECURITIES INVESTORS ASSOCIATION (SINGAPORE) ON ANNUAL REPORT FOR FINANCIAL YEAR ENDED 30 JUNE 2016

The board of directors (the "**Board**") of Dukang Distillers Holdings Limited (the "**Company**") refers to the questions raised by Securities Investors Association (Singapore) ("**SIAS**") in respect of the Company's Annual Report for the financial year ended 30 June 2016 (the "**Annual Report**"). The Company's response and the corresponding questions are set out below:

Question 1

In the Chairman's Statement (page 6 of the annual report), the Chairman acknowledged that "Dukang", being a second-tier baijiu brand, faced challenges from first-tier baijiu brands. As a result of the austerity measures implemented by the Chinese government, second-tier brands cannot compete with the first-tier baijiu brands as they lack the brand value recognition. These first-tier brands have carried out aggressive price rationalisation.

Even though the group had carried out aggressive advertising and promotional ("A&P") activities and participated pro-actively in national level trade fair during the financial year, the group witnessed a further decline in sales volume across the premium and regular segments. With selling and distribution expenses increasing by 35.4% year-on-year to RMB216.7 million mainly due to higher A&P expenses, the sales volume still dropped 11.3%.

The group has listed the following measures:

- Increase the fermentation period from 60 days to 90 days to improve quality
- Reposition "Dukang" brand in a more contemporary and trendy approach
- Streamline the distributorships by replacing those non-performing distributors
- Reduce sales channel length and increase service efficiency
- Streamlined organisational structure to improve its operational efficiency and internal cost controls

a) If the measures work, Dukang will still be at best the top tier-two baijiu brand that would capture the residual demand that cannot be met by the tier-one brands. **Is this the best feasible strategy for the group? Are there ways to think outside the box and to create a new niche for Dukang?**

Company's response to 1a)

From a provincial local brand under "Siwu", the Group had replaced it with the current "Dukang" branding, a nation-wide brand, and has successfully made our mark on the national market within a short span of 6, 7 years. The Company agrees that while we are not yet the first-tier brand, the management had implemented the above measures to mitigate the direct impact of the first-tier brands on our premium products and in the meantime focusing on strengthening our presence in the mid-to-low end market segment to maintain our market share.

The management is of the opinion that these are the most appropriate measures for the Group at this stage.

b) There were no sales contribution by “Siwu” and no mention of it was made in the current annual report or the last annual report. **Can management update shareholders if this has been a strategic move to focus the group’s resources on just the “Dukang” brand? If Siwu is no longer in the Group’s strategic plans, could the brand be sold or repositioned? What is the financial impact of the discontinuation of Siwu on the financial position?**

Company’s response to 1b)

Since the start of the anti-corruption campaign in 2012, the baijiu industry has shifted drastically from a stage of rapid growth to a phase of adjustment. The price of premium baijiu has plunged significantly, and the competition among mid-to-low end products became more intense. Likewise, the first-tier baijiu brands have lowered their selling prices drastically to be extremely competitive with the second- or third- tier brands. As a result, second- or third- tier brands are being squeezed by brand value recognition and price rationalisation of first-tier players as consumers tend to favour first-tier baijiu brands which were previously unreachable due to the high price point.

“Siwu”, a provincial brand, was not able to prevail during this adjustment period as for the same pricing, consumers would go for more reputable brands like “Dukang”. Also, it would be more costly to maintain and promote two brands, especially when Siwu’s sales was dwindling at an accelerated pace due to stiff competition. As a result, the Group decided that it was better to phase out the “Siwu” brand and to focus all its resources in promoting the “Dukang” brand. The discontinuation of Siwu had a postive impact on the Group’s financial contribution during the past few financial years.

The Company will make subsequent announcements when there are further material developments on the disposal of the “Siwu” brand.

c) As early as the two years ago (in the FY2014 annual report), the Chairman started reporting the new austerity measures by the Chinese government affecting conspicuous consumption of luxury gifts.

a. Excerpt from Dukang Distillers Holdings Limited Annual Report 2014 (page 5):
b. The financial year ended 30 June 2014 (”FY2014”) is one of the toughest periods in the Group’s years of growth and development. The austerity measures of the Chinese government, the uncertainties in the macroeconomy, the shift in market consumption of baijiu and the stiff competition among the baijiu giants have impinged on the growth of the baijiu sector.

The austerity and anti-corruption drive only intensified since then. Revenue of Dukang has since fallen by the start of the austerity drive. Unfortunately, due to the urbanisation re-zoning plans of the local authorities in Yichuan, the Group is required to relocate its factory and operations. When the plans were announced in February 2015, the proposed new site has a land size of 1,038 mu (310 mu in the first phase) when the existing site is only 173 mu. The production capacity of phase 1 would be 3,500 tonnes when the existing site could only produce 2,000 tonnes a year.

Given the drastic drop in demand and the challenging conditions, **what are the group’s plans with regard to the new Yichuan factory? Can the group review the operational needs and reduce the size of the new land? Can the group update on the development timeline for phase 1 now that it has been delayed?**

Company's response to 1c)

As the current baijiu industry remains weak and if the Group proceeds with the development of its new factory at Pingdengxiang 平等鄉 in Yichuan (the "Development"), there will be a huge pressure on the Group's working capital and will not achieve the intended production efficiency. In view of this, the Group has decided to temporarily slow down the Development.

In the announcement dated 27 November 2015, the Group has updated that it has fully received the purchase consideration of RMB80,000,000 from 河南雅豪商業管理有限公司 ("HYH") and the Group has completed one-third of the relocation of its existing factory in Yichuan District. HYH has agreed with the Group's plan to temporarily slow down its relocation and has signed an agreement with HDD (the "Agreement") to allow the Group to utilize the existing factory in Yichuan District and production facilities which have not been relocated. Depending on the market demand, the Group may utilize these production facilities to meet additional demand. The Agreement is for 1 year and is renewable. Pursuant to the terms of the Agreement, the Group agreed to pay HYH an amount of RMB4,000,000 per annum for the utilization of the factory and production facilities.

The management will decide on the development of the new factory based on the baijiu market outlook and future sales. The Company will make subsequent announcements when there are further material developments on this matter.

Question 2

The group has net assets of RMB 1.4 billion (page 35). Inventories (consisting of raw materials, work in progress and finished goods) account for RMB 644 million or 45% of the group's net assets.

According to the note 4.8 (page 45 – Inventories):

Inventories are carried at the lower of cost and net realisable value. Cost is determined using the weighted average basis, and in the case of work in progress and finished goods, comprise direct materials, direct labour and an appropriate proportion of overheads. Net realisable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and applicable selling expenses.

Can the board, in particular, the audit committee help shareholders understand if the inventories are carried at cost or net realisable value? Has there been any impairment as the average selling price has been severely depressed? What is the audit committee's role in assessing the quantity and value of the inventories? Can the external auditors explain what their roles are in assessing the quantity and value of the inventories?

Company's response to 2)

The inventories are carried at cost. As at each reporting date, the Group assessed the net realisable value for each inventory item based on the most reliable evidence available as at that date (e.g. recent selling prices and latest sale orders) and compared the net realisable values to the respective costs. No impairment was considered necessary based on such assessment as at 30 June 2016.

The effectiveness of the internal control system and procedures at present are monitored by Management who reviews all significant control policies and procedures and highlights all significant matters to the Audit Committee ("AC") and the Board.

The Group's internal audit department ("internal auditors") carries out the internal audit functions and report directly to the AC Chairman. The internal auditors support the AC in ensuring that the Group maintains a sound system of internal controls by monitoring and assessing the effectiveness of key controls and procedures, which complement the audit procedures carried out by the external auditors in their assessment of the quantity and value of inventories as at 30 June 2016. Furthermore, the external joint auditors had conducted the audit procedures in accordance with the relevant International Standards on Auditing in respect of the assessment of the quantity and value of inventories as at 30 June 2016.

The AC has also checked and verified with the external auditors, independent of Management, regarding the state of the inventory. In addition, a member of the AC (which will be on a rotational basis) had visited the Group's sites and conducted physical inspection during the financial year.

The internal and external auditors have, during the course of their audit, carried out a review of the effectiveness of key internal controls within the scope of their audit. No material non-compliance or weaknesses in internal controls were noted during the respective audits and reported to the AC. The AC, with the assistance of the internal and external auditors, had reviewed the adequacy of the Company's internal controls addressing financial, operational, compliance and informational technology risks, and risk management policies established by Management for the financial year ended 30 June 2016.

For more details on the duties and functions carried out by the AC, adequacy and effectiveness of the internal controls and internal audit during the financial year, please refer to pages 24 to 27 and 31 of the Annual Report.

Question 3

In the operations review (page 9), it was disclosed that "cash and cash equivalents increased by RMB 192.6 million from RMB 403.0 million for FY2015 to RMB 595.6 million for FY2016".

Note 9 (page 55 – Finance costs) shows that the group has had RMB 8.89 million in "interest on bank and other loans".

Note 23 (page 66 – Bank and other loans, secured) shows that the group has "Other loan" amounting to RMB 15 million with an effective interest rate of 8.78% per annum and "Bank loans" of RMB 120 million with an effective interest rate of 5.98% per annum.

a) Would the board help shareholders understand why the group has not utilised its cash but relied on bank and other loans and incurred finance costs of nearly RMB 9 million for the financial year?

Company's response to 3a)

This is to establish good relationships with the banks so that it would be easier for us to obtain bank loans when we need huge capital to expand our operations in the future.

b) **With a more stable outlook for baijiu, and with a sizeable cash hoard, would the board consider rewarding shareholders with a dividend?**

Company's response to 3b)

We also wish to share the fruits of success with the shareholders. However, the Group is currently incurring losses, which may not be the right time to distribute dividend at the moment. We will also need to consider the cash that the Group needs for its working capital and development purposes during the bleak baijiu market outlook before distributing dividend.

c) **Would the independent directors comment if they think the group has the ability to give out dividends and manage its cash flow requirements (including the relocation and working capital needs) since the cash and cash equivalent increased to a substantial level of RMB 596 million?**

Company's response to 3c)

The Group's annual working capital is approximately RMB200 to RMB300 million, annual advertising and promotion expenses is budgeted at RMB200 million while capital expenditures for the next financial year is around RMB30 million. As can be seen, a substantial portion of the cash will be required to maintain the operations of the Group while the remainder is required for the Group to withstand the challenging baijiu market condition.

The form, frequency and amount of dividends declared each year will take into consideration the Group's profit growth, cash position, positive cash generated from operations, projected capital requirements for business growth and other factors as the Board may deem appropriate. The Company endeavours to pay dividends and where dividends are not paid, the Company will disclose its reason(s) accordingly. No dividend was declared for FY2016 as the Group has to be prudent with its cash flow requirements for its business operations and future developments/strategies.

By Order of the Board

Zhou Tao
CEO and Executive Chairman
1 November 2016