SOLUTIONS TO WATER & WASTE

DARCO WATER TECHNOLOGIES LIMITED

(Company Registration No. 200106732C)

(Incorporated in the Republic of Singapore)

RESPONSES TO SINGAPORE EXCHANGE SECURITIES TRADING LIMITED'S QUERIES ON THE COMPANY'S ANNOUNCEMENT – ANNUAL REPORT FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2022

The Board of Directors ("**Directors**") of Darco Water Technologies Limited ("**Company**" and together with its subsidiaries, collectively, "**Group**") refers to the Company's Annual Report for the financial year ended 31 December 2022 ("**AR FY2022**") released on the SGXNET on 10 April 2023. The Board would like to respond to the following queries raised by the Singapore Exchange Securities Trading Limited ("**SGX-ST**") on 21 April 2023 (each, an "**SGX Query**") as follows:

SGX Query 1:

We refer to the Company's unaudited and audited financial statements for the financial year ended 31 December 2022, please provide explanations for the following material variance in:

(a) Net cash (used in)/from operating activities from -$2,546,000 to -$2,863,000
(b) Net cash used in investing activities from -$487,000 to -$169,000

Company's response to SGX Query 1:

(a) Variance in Net cash used in operating activities are mainly due to:
    (i) Changes in the depreciation amount;
    (ii) Changes in withdrawal of fixed deposits, reclassified from investing activities; and
    (iii) Changes in the unrealised foreign exchange.

(b) Variance in Net cash used in investing activities are mainly due to:
    (i) Changes in the purchase of property, plant and equipment
    (ii) Changes in withdrawal of fixed deposits, reclassified to operating activities

SGX Query 2:

Listing Rule 704(6) provides that an issuer must immediately announce if it has previously announced its preliminary full-year results, any material adjustments to its preliminary full-year results made subsequently by auditors.

Please clarify whether and how has Listing Rule 704(6) been complied with.

Company's response to SGX Query 2:

The Company, having assessed the above changes, was of the view that the changes did not materially change the profit for the financial year, net assets and cash position of the Company. The Company did not release an announcement as the changes were not regarded as material adjustments.

SGX Query 3:

It is disclosed on page 77 of the AR FY2022 that S$623,000 was recognised as impairment loss on financial assets for the year ended 31 December 2022.

In this regard, please disclose the following information:

(i) the nature of financial assets;
(ii) how the amount of impairment was determined;
(iii) the Board's confirmation as to whether it is satisfied with the reasonableness of the methodologies used to determine amount of impairment; and
(iv) the reasons for the impairment losses.

Company's response to SGX Query 3:

Impairment loss on financial assets are as follow:

	$'000
Expected credit loss	
- increase in ECL allowance	1,874
- reversal of prior year allowance	(1,251)
	623

(i) Financial assets mainly consist of contract assets, trade and other receivables.

(ii) The management assesses the collectability of trade receivables regularly, by considering various factors such as financial condition of the customers, payment history and age of trade debts. Impairment on specific trade receivables would be made if the chance of recovery is deemed low. Additionally, the Expected Credit Losses ("**ECL**") model is also being applied to determine the loss allowance for trade receivables based on historical observed default rates adjusted for forward-looking estimates in accordance with SFRS(I) 9.

(iii) The Board views that the management has made a thorough review of the financial assets and is satisfied with its methodologies used to determine amount of impairment.

(iv) The increase in the ECL allowances are as follows:

		$'000
(a)	Based on ageing profile	577
(b)	Shanghai Huayun Environmental Technology Co., Ltd.	943
(c)	Others - various customers	354
		1,874

(a) Based on ageing profile of the Group's financial assets, the Group has made an additional allowance of $0.6 million;

(b) During the Year 2022, Wuhan Kaidi Water Services Co., Ltd ("**WHKD**") has issued a letter of demand against Shanghai Huayun Environmental Technology Co., Ltd. (上海华蕴环保科技有限公司) ("**SHHY**") in respect of claims for the amount due and owing to WHKD, in relation to WHKD's EPC project, namely Yuanyang Lake Wastewater Treatment Plant in Ningdong Energy Base (宁东基地鸳鸯湖污水处理厂项目) and two other projects (collectively, the "**Huayun Letter of Demand**"). Further details can refer to announcement dated 8 March 2022 and 19 May 2022.

Based on information available, the Group has determined that the amount is no longer recoverable and has made an ECL allowance of $0.9 million in FY2022; and

(c) The impairment loss on these customers was made in consideration of the difficulty encountered in the recovery of the balances after considering factors such as outcome of negotiations, significant financial difficulties and potential default or significant delay in payments.

The reversal of unutilised ECL allowance are mainly due to:

(a) WHKD has issued the letter of demand (the "**KTYX Letter of Demand**") against Kuitun Yuanxin Sewage Treatment Co., Ltd (奎屯源鑫污水处理有限公司) ("**KTYX**") and had lodged a Civil Complaint with the People's Court of Xinjiang Production and Construction Corps Kuitun Reclamation Zone (新疆生产建设兵团奎屯垦区人民法院), in respect of claims made for overdue receivables. The Court has issued its judgment on 8 June 2022 that KTYX shall pay the overdue amount to the Group. Further details can refer to announcement dated 14 June 2022.

With the Court Judgement, the Group has made the reversal of unutilised ECL amounting to $1.0 million; and

(b) The Group has received the payment from various customers amounting to $0.2 million where ECL allowance has been made in prior years.

SGX Query 4:

It is disclosed on page 72 of the AR FY2022 that non-current other receivables and refundable deposits amounted to S$578,000, please disclose:

(i) the breakdown of the Group's non-current other receivables and refundable deposits;
(ii) the nature of the non-current receivables; and
(iii) the Board's assessment of the recoverability of the non-current other receivables and refundable deposits.

Company's response to SGX Query 4:

(i) Non-current other receivables and deposits are as follow:

	2022 $'000	2021 $'000
Other receivables – A third party	3	9
Refundable deposits	575	788
	578	797

(ii) Other receivables are mainly the rental deposit paid for office.

Refundable deposits mainly refer to the amount due from CA Trading Co., Ltd. Further details can refer to Annual Report Page 122, "Trade and other receivables", 9(ii) and the announcement dated 25 November 2020.

(iii) CA Trading has been paying the instalments so far and the lease rental of office is still in force. The Board currently does not foresee any recoverability issues in the absence of unforeseen circumstances.

SGX Query 5:

Please explain why interest income amounted to only S$75,000 during the financial year ended 31 Dec 2022 when the Company has significant cash and cash equivalents amounting to $19,828,000.

Company's response to SGX Query 5:

The Group's cash and bank balances amounting to $19.8 million are mainly maintained at subsidiaries for their working capital to run daily operations and support on-going projects. The interest income received is low because most of Group's cash are maintained in current accounts where interest rates are relatively low.

SGX Query 6:

It is disclosed that the Company has a net cash outflow from operating activities of $2,863,000 and a net profit of $871,000 for the financial year ended 31 December 2022. Please explain why the Company is unable to generate net cash inflow from its operating activities, despite the Company's net profit position for the financial period/year.

Company's response to SGX Query 6:

Cash used in operating activities in FY2022 was mainly due to cash outflow amounting to $9.0 million to fund construction of Ba Lai project in Vietnam. Ba Lai project refers to the concession project to supply drinking water in Ben Tre Province of Vietnam where technical studies and development started in Year 2018 and then construction commenced in January 2021. Significant construction work has been carried out in Year 2022 and the Ba Lai project is expected to achieve commercial operation within this year.

SGX Query 7:

Provision 8.1 of the Code of Corporate Governance 2018 (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."

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. No explanations were provided for in the Company's FY2022 annual report on how it is consistent with the intent of Principle 8 of the Code.

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 to SGX Query 7:

Principle 8 of the Code of Corporate Governance dated 6 August 2018 (the "**Code**") states that "*The company is transparent on its remuneration policies, level and mix of remuneration, the procedure for setting remuneration, and the relationships between remuneration, performance and value creation.*".

The Company is transparent on its remuneration policies and the procedure for setting remuneration

As disclosed on pages 32 and 33 of the Company's AR FY2022:

(a) The Board has a formal and transparent procedure for developing policies on Director and executive remuneration, and for fixing the remuneration packages of individual Directors and key management personnel.

(b) No Director is involved in deciding his or her own remuneration. In particular, each Director shall abstain from voting on any resolution and making any recommendation and/or participating in any deliberation in respect of their own remuneration package.

(c) The Remuneration Committee of the Company also periodically reviews and makes recommendations to the Board:

  (i) a framework of remuneration for the Board and key management personnel;

  (ii) the specific remuneration packages for each Director as well as for the key management personnel;

  (iii) all aspects of remuneration (including Directors' fees, salaries, allowances, bonuses, options, share-based incentives and awards, benefits in kind and termination payments) to ensure that they are fair and to avoid rewarding poor performance; and

  (iv) the Company's obligations arising in the event of termination of the executive Directors' and key management personnel's contracts of service, to ensure that such contracts of service contain fair and reasonable termination clauses which are not overly generous.

The Company is transparent on the level and mix of remuneration

As disclosed on pages 34 to 36 of the Company's AR FY2022:

(a) There is a table setting out the names and breakdown of remuneration of each individual Director and the Chief Executive Officer ("**CEO**") in bands of S$250,000.

(b) The Directors' fees payable to the Independent Non-Executive Directors, namely, Mr. Sim Guan Seng, Ms. Gn Jong Yuh Gwendolyn, Ms. Ong Joo Mien Joanna, and Mr. Wang Yingyang for the FY2022 were S$52,929, S$45,000, S$45,000 and S$14,268 respectively.

(c) There is a table setting out the names and breakdown of remuneration of the top two (2) key management personnel (who are not Directors or the CEO of the Company) in bands of S$250,000. As the Company only considers two (2) of its executives (who are not Directors or the CEO) as key management personnel, the Company only disclosed the names and breakdown of remuneration of these two (2) executives.

(d) The aggregate total remuneration paid to these two (2) key management personnel (who are not Directors or the CEO of the Company) for FY2022 amounted to approximately S$262,446.

(e) 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 was of the opinion that it is in the best interests of the Group not to disclose the exact remuneration of each individual Director, the CEO and the top two (2) key management personnel (who are not Directors or the CEO) in the Company's AR FY2022. The Board is of the opinion that the information disclosed in the Company's AR FY2022 strikes an appropriate balance between detailed disclosure and confidentiality.

The Company is transparent on its relationships between remuneration, performance and value creation

As disclosed on pages 34 and 36 of the Company's AR FY2022:

(a) Short-term qualitative performance conditions such as leadership, people development, commitment, teamwork and current market and industry practices and long-term qualitative performance conditions such as current market and industry practices were chosen to assess Executive Directors and key management personnel. The Group believes that assessing Executive Directors and key management personnel on such qualitative performance conditions will allow the Group to remain competitive and will encourage Executive Directors and key management personnel to work in alignment with the goals of all stakeholders.

(b) The Directors' fees paid to the Independent Non-Executive Directors were in accordance with their credentials, qualifications, experience and contributions. Other factors such as responsibilities, effort and time spent for serving on the Board and Board Committees of the Company also form part of the consideration in the determination of the Directors' fees.

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

Conclusion

For the reasons above, the Board is of the view that:

(a) the current remuneration level of the Board and key executives is appropriate and in line with the market;

(b) the disclosures in the Company's AR FY2022 are consistent with the intent of Principle 8 of the Code; and

(c) the practices adopted by the Company as disclosed in the Company's AR FY2022 are consistent with the intent of Principle 8 of the Code.

By Order of the Board

Zhang Zhenpeng
Executive Director and Chief Executive Officer
24 April 2023