Transcript of the Responses to Substantial and Relevant Questions received from Shareholders for Avarga Limited's 53rd Annual General Meeting held on 26 June 2020

Slide 1 - Start

Dear fellow shareholders, I wish all of you good health and safety. Thank you for taking the time to join us via this webcast, and I look forward to being able to see all of you in person again soon.

Slide 2 – Shareholder questions

Given the unique circumstances, we have compiled the questions that were submitted during the previous week. The paraphrased questions are the following:

- How has Covid-19 affected Avarga with regards to revenues, expenses, and operations?
- Has Avarga adopted any extraordinary measures or new ways of conducting business due to Covid-19?
- Has Covid-19 led to cancelled or deferred orders, as well as late or non-payments?
- What is the effect of Covid-19 on the outlook of Avarga for 2020 and beyond?
- Has Avarga increased its market share during this crisis?
- What is the updated dividend policy and is it affected by the change to half-yearly reporting?
- What is the share buyback policy?
- Avarga's Return on Equity in recent years has been below 10%. Do we have a target ROE?
- What are the criteria we use to evaluate new investments, and will it lead to a higher ROE in the future?
- Why has gross profit and net profit margin declined so significantly over the last 5 years?

As the questions are broad in scope, we believe the best way to address them are through this presentation. We hope you will find this beneficial.

If you have additional questions following this meeting, please email them to us and we will do our best to respond. The webcast recording, transcript of the presentation, and an expanded slide deck will also be made available on our website.

Slide 3 – Our financing activities

I would like to take you through our financing activities over the last 8 years.

Since 2012, Avarga has generated total net cash of $208 million from our operations. We also raised a total of $152 million. Of this amount, we raised $50 million through two private placement exercises, $24 million through warrant conversions and sale of bonds, sold $20 million of property and increased cash usage by $57 million.

So, what did we do with the cash totaling $360 million?

Over the same 8-year period, we paid out dividends of $80 million. We invested $198 million into Taiga, including the indirect acquisition of Exterior Wood, $59 million in the Myanmar power plant, $5 million buying out the minorities of the Malaysian paper plant, and $3 million in other equity investments. We also invested in $15 million of additional capex and bought back $600,000 of our own shares.

Slide 4 – Net Cash/ (Debt)

To simplify what this all means, in 2011, our net cash position was $21 million with a paper business generating $1 million in operating cash. At end 2019, our net debt position was $37 million.

Slide 5 – Our businesses

Through the sale of non-income generating properties and investing cash outflow of $57 million, we paid out dividends in excess of the capital raised, and own the power business, majority interests in Taiga and Exterior Wood, in addition to the paper business and other miscellaneous investments. Since we've covered these businesses at length during the last few meetings, I will not go through each one today, but the expanded slide deck on our website will carry additional information.

Slide 6 – Profitability charts

These investments combined to deliver a strong 2019, achieving record highs in profitability. EBITDA reached $70 million, pretax profit was $53.3 million, and net profit was $32.6 million. Even adjusting for the gains from the sale of our Tuas property and foreign currency, profitability would still be at its highest historically.

Net excess cash from operations was $53.1 million. It was $52.7 million in 2018 and $44.8 million in 2017. To put this in perspective, this compares to less than $20 million per year between 2014 and 2016, and less than $5 million per year before that.

I thank the shareholders who raised the question of our return on equity, as this is central to how we operate and review ourselves as capital allocators. However, we prefer not to use the accounting definition of return on equity as accounting treatment can distort numbers significantly. For example, we booked a non-cash amortization charge of $5.2 million in relation to the Taiga acquisition for 2019. In a few years, when we have fully amortized the balance of the intangibles, we will see a spike up in earnings. That has everything to do with accounting and nothing to do with our performance. Discrepancies between accounting and cash earnings also arise from the accounting treatment of our power business.

Therefore, we focus our presentation on cash generation and usage because that is the most tangible and transparent way to understand how our company has grown. Basically, we measure investment ROE, whether it is an investment of new assets or reinvestment of our existing businesses, through cash on cash return. Going forward, we will explore ways to communicate this so that shareholders can better follow our company's progress.

I cannot disclose the details of our investment process nor specific targets, but the criteria we utilize is not significantly different from any other investment firm. We have internal target hurdle rates, but they vary based on risk profile. Factors such as geography, market positioning, management track record, et cetera, are all taken into consideration. The primary objective is to maximize the risk reward ratio over a long period of time. Historically, our cash return has been higher than what our accounting ROE would indicate. For example, if we take free cash flow to equity, less the Tuas property disposal and adjusted for minority interests in both cash flow and equity, our returns would be 19.7% and 19.5% in 2019 and 2018, respectively.

To address the question regarding the declining margins, that is a function of consolidating Taiga's P&L into our own. As a wholesale distributor, Taiga moves large volumes with small margins, and is successful because of its cost efficiency and wide network. Although its inclusion lowers our overall group margins, it also boosted our revenues over twentyfold from $60 plus million to over $1.4 billion and led to the record earnings we achieved.

We believe the transformation of our Group through these investments will continue to yield strong and sustainable long-term profitability.

Slide 7 – Dividend policy

We are also reaffirming our dividend policy as stated in the annual report to pay out at least 40% of our net earnings on a quarterly basis. We believe this provides a transparent and sustainable approach in distributing some of the generated cash flows to shareholders while allowing management to continue growing assets held by the group.

The change from quarterly to half yearly reporting is a separate matter and does not impact the decision to declare dividends quarterly as long as the Company is in compliance with the SGX requirements. We did not declare a dividend in the first quarter this year because the delay of this AGM meant delaying the final dividend for 2019, which required shareholder approval. Therefore, we will be declaring a dividend for the first half of 2020, followed by quarterly declarations subsequently.

On share buybacks, we view it as we do any other capital allocation exercise, whether it is new investments, reinvesting into our businesses, repaying debt, or paying out dividends. We will continue to purchase shares when it falls below intrinsic value, but only when it produces an optimal return on capital relative to alternative uses. One other factor to consider is that as an investment holding company, we are constantly evaluating new opportunities. Those situations can be materially sensitive, which would restrict us from conducting share buybacks, although they may not end up completing.

Slide 8 – Covid-19 [Response]

I will now update on the effects of Covid-19.

In response to the spread of Covid-19 across the globe, our priority was for our employees' safety. Managers were quick to develop business continuity plans that emphasized this and adhered to the health guidelines prescribed by the local governments. I am very appreciative of our roughly 800 employees who have risen to the challenge of adapting to this "new normal" and continue to execute their responsibilities safely and effectively. To-date, we have zero Covid-related layoffs.

We have also donated money towards medical equipment such as ventilators and personal protective equipment for healthcare workers in Malaysia. Our teams continue to be active in identifying ways to help our local communities during this challenging period.

Slide 8 – Covid-19 [Impact]

On to our performance, our businesses continued to build on last year's momentum through part of the first quarter in 2020, before the lockdowns put a halt to the global economy. During this period, they have remained operational given their essential nature. Initially, we faced some disruptions with supply chains and implementing workplace safety, but adjustments were quickly made.

We were also fortunate to have invested in technology and systems designed to optimize operations over the last few years. This enabled us to maintain productivity despite the restrictions for onsite and offsite work environments. Overall, we are in good shape operationally.

In terms of financial impact, generally speaking, this is what we have observed so far.

There has been no impact to the power business in Myanmar. For paper, demand has weakened in line with the broader economy in Malaysia and our raw material costs have increased, although our products continue to be critical as packaging for essential and e-commerce goods. For Taiga, while housing starts has declined significantly in North America, most of the impact has been offset by strong demand in the renovation market.

To-date, we have not seen any unusual activity regarding orders or receivables. While we are monitoring this closely, we are not overly concerned given the high turnover nature of our businesses. As a group, revenue has been impacted negatively, but the extent is hard to ascertain right now given the high volatility of the economy.

In terms of expenses, we do not expect material additional costs arising from Covid. As a preemptive measure, we froze salaries since the beginning of the year. We have received employee wage and other subsidies in the countries we operate in, similar to the Jobs Support Scheme here in Singapore, to provide some buffer. I also want to point out that we adopt robust profit sharing pay structures across the group to align shareholders and employees. This means a significant part of payroll expenses increase or decrease in tandem with our company's earnings every year. Given the compensation structure and our ability to remain profitable, we have not taken on any drastic cost-cutting measures or made significant strategic changes to our operations.

Slide 9 – Outlook

Looking forward, I cannot definitively state how we will perform in the short term. In the last few months, we have witnessed the most drastic economic shutdown ever followed by unparalleled government stimulus at a global level. Simply extrapolating the trends from those months is irresponsible because we believe there are still too many variables and too little data. The evolving scientific data around Covid, policy responses, geopolitical tensions, and changes in consumer behavior are some of the trends we monitor and study – this will continue to shape our views of the risks and opportunities that lie ahead.

For example, aggressive stimulus has provided a bridge financing of sorts for both businesses and consumers. With regards to market share, it would take a while before we can identify which industry players are thriving or fading. Having said that, we believe our businesses occupy strong market positioning. Along with our strong balance sheet, this gives us flexibility, which is always valuable during uncertain times.

Finally, I just want to say that while we have worked hard on growing your company over the years, growth will always be secondary to preservation. Our investment decisions are built around protecting your wealth, and we will continue to do so through this crisis and others that will follow.

Slide 10 - End

I hope I have covered all your substantial and relevant questions and concerns. Please contact us if you wish to follow up, keeping in mind that we cannot divulge sensitive information. Thank you again for your participation today and your continued support in us.