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26 February 2021

Minority Shareholders Watch Group

Tingkat 11, Bangunan KWSP
No.3, Changkat Raja Chulan
Off Jalan Raja Chulan
50200 Kuala Lumpur.

Attention : Mr Devanesan Evanson
Chief Executive Officer

Dear Sir,

SCH Group Berhad ("SCH" OR "THE COMPANY")
9th Annual General Meeting ("AGM") of SCH to be held on Friday, 26 February 2021

We refer to the queries raised by the Minority Shareholders Watch Group's letter dated 17 February 2021. We set out below our replies to the questions raised:-

Operational and Financial Matters

1. The demand for fertilisers is expected to remain healthy as Crude Palm Oil ("CPO") prices have shown improvement in the near term due to the resumption and implementation of the national B20 Biodiesel programme (B20 Biodiesel is a blend of 20% palm methyl esters and 80% petroleum diesel). (Page 12 of Annual Report - AR)

What has been the percentage growth in demand for fertilisers registered by the Group? For how long more are CPO prices expected to remain healthy?

Answer

Despite the disruption of the Covid-19 pandemic, SCH Fertilisers division continues surpassed market expectation registered 11% sales growth for the financial year ended 31 August 2020.

There are many factors that might affected the CPO price in long term except for biodiesel programme, such as global supply of vegetable oils, soybean price, weather, CPO import duty policy, etc. Generally, we of the mixed views on how long the current CPO price can maintain due to the uncertainty factors.

2. SCH's wholly-owned subsidiary, TK Rentals Sdn Bhd, has been appointed as an authorised distributor of industrial batteries for the storage of renewable energy. The Equipment Rental division also did well to diversify outside its traditional events sector into building services and oil and gas sectors. (Page 12 of AR)

How were the performances of the industrial batteries business and the Equipment Rental division's diversification into building services and oil and gas sectors?



Answer

The trading of industrial battery was commenced in the second half of FY2020 and achieved remarkable financial performance. Within 6 months, the new business recorded revenues of RM6.2 mil which contributed 36% of the revenue of TK Rental Sdn Bhd for the FY2020. Whereas the diversification into non-event sector reported revenue of RM2.7 mil representing 16% of the total revenue of TK Rental Sdn Bhd.

3. The Group's other income increased by RM3.5 million from RM8.7 million in FY 2019 to RM12.2 million in FY 2020. The increase was mainly driven by the gain of RM10.2 million arising from the shortfall of profit guarantee payable by the vendor of TK Rentals Sdn Bhd. (Page 34 of AR).

- a) How was the shortfall of profit guarantee calculated? For how long will the profit guarantee last?
- b) Considering the substantial shortfall of profit guarantee, how does the Board see the outlook and prospects for TK Rentals Sdn Bhd?

Answer 3(a)

The profit guarantee is TK Rentals Sdn Bhd need to achieve targeted profit after tax of not less than RM15.5 million in aggregate for three consecutive financial year 2018 to 2020. Based on the audited financial statements, TK Rentals Sdn Bhd recorded total profit after tax of RM5.3 million for FY2018-FY2020, resulted in shortfall of RM10.2 million. As of today, the shortfall claim for the profit guarantee had been fully paid the vendor.

Answer 3(b)

TK Rental Sdn Bhd recorded substantial shortfall of profit guarantee principally due to the restriction of movement control order result in the cancellation of the events. The Board remain cautiously optimistic for the prospect of Equipment Rental division in view of the Covid-19 pandemic shall be ending soon with availability of the vaccine worldwide.

4. Despite the Group's recorded gain on profit guarantee of RM10.2 million, the financial impact has been offset by the impairment of goodwill and inventory written down amounting to RM9.5 million and RM2.6 million respectively. (Page 34 of AR)
- a) What specifically caused the impairment of goodwill and which business segment/s contributed to the impairment? What is the likelihood of further impairment in the near term?
- b) Which inventory was written down and why? Has the Management reviewed its inventory management system to minimize such write-down in future?

Answer 4(a)

Due to the pandemic of Covid-19, Equipment Rental had revised the cash projection for TK Rentals Sdn Bhd which caused the deviation from the initial cash flow projection used in the cash generated unit (CGU). In the event the business environment back to normal in 2023, the chances of further impairment (in near term) shall be minimal.



Answer 4(b)

The inventory were written down principally due to the obsolescence equipment and spare parts in the Heavy Equipment division. Those obsolescence stocks mostly due to slow moving items which were purchased more than two (2) years ago resulted in the net realisable value potentially lower than it's carry value. The Management had taken necessary steps to avoid the over stocking issue evidenced by lower inventory level for the financial year under review.

5. The Fertilisers will remain a key focus and SCH Group will collaborate with Hextar Global Berhad (HGB) in the future in a synergistic and complementary approach by leveraging on HGB's core competencies in agrochemicals to further expand and penetrate clientele in the agriculture industry with a more robust and complete product offerings. (Page 38 of AR)

a) What is the relationship between SCH and HGB and how would they collaborate meaningfully to benefit both parties?

b) Are there sizeable number of HGB's clients which SCH can tap into?

Answer 5(a)

Hextar Holdings Sdn. Bhd. ("HHSB") is the major shareholder of Hextar Global Berhad ("HGB") and also the substantial shareholder of SCH. SCH fertilizer existing customer base focus in Sarawak only. Whereas HGB is one of the leading agrochemical companies in Malaysia. Therefore, SCH might potentially benefit by leveraging HGB's customer base in Peninsular Malaysia and Sabah. SCH and HGB are serving difference products within agriculture industry. Hence, the potential benefit for both parties are inevitable.

Answer 5 (b)

As mentioned in the above, there always sizeable number of HGB's clients which SCH can tap into. Other businesses units within SCH Group such as forklift, equipment rental, etc might be potentially benefit as well.

6. SCH Group's financial performance may be affected by fluctuation in foreign currency exchange rates as some of its purchases are transacted in United States Dollar ("USD"), Singapore Dollar ("SGD"), Japanese Yen ("JPY") and Euro Dollar ("EUR"). (Page 39 of AR)

What percentages of the Group revenue and purchases respectively are denominated in USD? To what extent are the purchases hedged, if any?

Answer

During the financial year under review, the Group revenue and purchases denominated USD approximately 5% and 12% respectively. Due to the net impact is immaterial, SCH do not extensively use the hedging facility on hand in FY2020. However, we will start to hedge in FY2021 due to the volatility of the USD.



7. The key assumptions used in value-in-use ("VIU") calculations to determine whether there are impairment losses on goodwill are as follows (Page 133 of AR):

	2020	2019
Revenue growth rate	Range from 0% to 48% for the first four year-period and -10% for the next six-year period.	Range from 0% to 16% for the first five-year period and -10% for the next five-year period.
Pre-tax discount rate	18.60%	11.27%

- a) Why do revenue growth rates for both financial years differ so significantly in the first four years and why is there a negative growth rate of 10% for the next six-year period?
- b) Why is the pre-tax discount rate for 2020 so high at 18.60?

Answer 7(a)

In view of the Covid-19 pandemic, the revenue from event sector has been substantially reduced in the FY2020. As such, we estimated in the next four (4) years revenue will accelerate with an V-shape recovery. The negative growth rate is assume some of the equipment performance will be progressively deteriorate after four (4) years.

Answer 7(b)

The pre-tax discount rate of 18.6% was calculated using weighted average cost of capital (WACC) model. The demand for the equity return (%) is much higher as compared to 2019 as equipment rental is subject to higher operating risk under Covid-19 pandemic.

Corporate Governance Matters

1. Practice 4.3 - Step Up of Malaysian Code on Corporate Governance (MCCG) stipulates that the board has a policy which limits the tenure of its independent directors to nine years.

The Company states that it has adopted the Practice as its Board Charter, among others, stipulates that where the Board is of the view that the Independent Director can continue beyond the 9-year tenure, it would justify and seek annual shareholders' approval.

MSWG's Comments: The Company has not adopted the Practice as it still allows an independent director to continue serving as an independent director beyond the 9-year tenure so long as approval is given by shareholders.

Answer

The Management noted MSWG comment above.



2. The costs incurred for the internal audit function in respect of the financial year ended 31 August 2020 is approximately RM20,000.00. (Page 66 of AR)

Given that the fee is rather small (approximately RM1,666 per month), how does the Audit Committee assure itself that there would be adequate coverage and an effective audit function? What are the areas covered by the internal auditors during the financial year ended 31 August 2020? How many internal audit reports were issued during the said period?

Answer

The Risk Management Committee ("RMC") is currently review the risk assessment and mitigation plan formulated by the Management on regular basis. RMC will assist Audit Committee ("AC") to identify the areas of high risk faced by the Group. Once the high risk area being identified, the internal auditors (Eco Asia Advisory Sdn Bhd) will assist the AC, during the internal audit plan, to assure the adequacy coverage and effectiveness of the internal control systems.

During the financial year under review, the internal auditors had reviewed the purchasing procedures, payment control management and human resource of SCH Group. Total two (2) reports were issued and presented to the AC members.

We trust the above answers will address all your questions. Should you require any further information or clarification, please do not hesitate to write to us.

Yours faithfully
SCH Group Berhad

- Signed -

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Dato' Chan Choun Sien
Independent Non-Executive Chairman