GUAN CHONG BERHAD
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Date : 30 May 2023

Chief Executive Officer
Minority Shareholders Watch Group (MSWG)
Level 23, Unit 23-2
Menara AIA Sentral
No. 30, Jalan Sultan Ismail
50250 Kuala Lumpur

Dear Mr Devanesan Evanson,

<u>RE: 19th Annual General Meeting ("AGM") of Guan Chong Berhad ("GCB" or the "Company") to be held on Wednesday, 31 May 2023</u>

With reference to the letter received on 23 May 2023, please find below our response to your questions:-

<u>Operational & Financial Matters</u>

1. The Group's production facilities at Ivory Coast commenced production in Nov 2022 and undertook its maiden export shipment in Feb 2023. Currently already running at full capacity, GCB's expansion in Ivory Coast has significantly boosted its competitive synergy. (page 27 of Annual Report (AR) 2022)

   (a) What is the potential revenue and pre-tax margin for this plant at optimal capacity?

   Due to the cocoa industry's nature, the selling prices of our products are driven by market forces. As a middlestream player, we have little control over the product pricing.

   Based on current market condition and pricing, our Ivory Coast plant could achieve potential revenue of approximately EUR 170mil and pre-tax margin of 7% on full capacity.

   (b) As the Ivory Coast plant is already running at full capacity, does GCB have any plans to expand its production capacity in the near future? What is the potential capacity over the long term?

   Our Ivory Coast plant only started commissioning in November 2022. We are currently adjusting our grinding processes to ensure it can operate efficiently.

   In terms of future expansion plans for the plant, the factory was designed to command up to 240,000 MT per annum when fully completed. Currently, we are still undergoing the study whether to increase the current 60,000 MT grinding capacity per annum to 120,000 MT per annum.

   We will also be discussing with the local government to have their support for this expansion.

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(c) How much of the current capacity is to fulfill SCHOKINAG requirements? And where does the remaining capacity go to?

Currently approximately 40% of Ivory Coast capacity is used to cater for SCHOKINAG requirement while the remaining capacity is to third party customers in Europe.

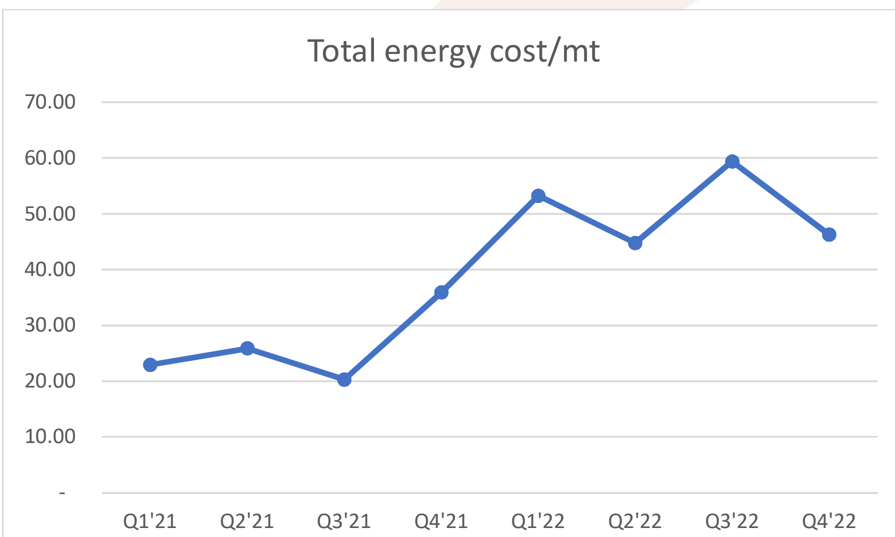
(d) How long is the tax-exempt status for this plant? What is the tax rate after that?

The corporate tax rate for Ivory Coast is 25%. This plant is able to enjoy zero corporate tax for first 5 years and subsequent 5 years with 50% reduction in corporate tax rate.

2. The Group's industrial chocolate operations in Germany faced multiple hurdles, especially from energy costs and rising inflation pressures. Fortunately, energy prices declined in the fourth quarter of FY2022. Despite SCHOKINAG ending the year with a loss, GCB expects to see a gradual recovery as it ramps up production, so long as energy prices remain stable. (page 29 of AR 2022)

   (a) How much were the increase in energy costs in FY2022?

   The energy cost per MT of SCHOKINAG by quarter during FY2021and FY2022 as follow:



   Energy cost was at the highest peak during Q3'22, which was almost triple of the cost as compared to Q3'21.

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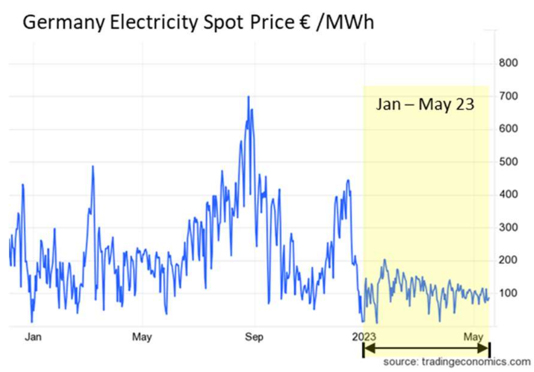
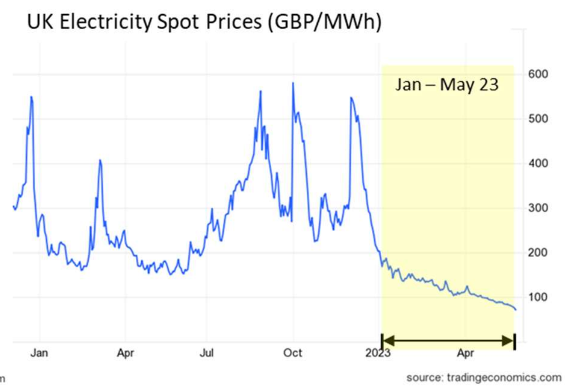
(b) How is the current trend of energy prices in Europe and the UK? What is the outlook for the next 12 months?





Energy prices in Europe and the UK in 2023 has fallen significantly from last year's peak, currently around the range of €110/MWh for Germany and £80/MWh for UK.

We observed the energy prices have normalised this year and expect the price to stabilise should there be no other unforeseen factor or further geopolitical tension.

(c) When do you expect SCHOKINAG to turn around? And what are your plans to turn it around?

SCHOKINAG's operation has turned around in first quarter of 2023 as energy cost has decreased and stabilised. At the same time, we managed to lock in higher selling price, as the previous higher energy cost has been priced into the selling prices offered to customers.

3. The Group's revenue has grown consistently over the last five years, from RM2.27 billion in FY2018 to RM4.42 billion in FY2022. However, profit before tax (PBT) margin has declined consistently during the same period, from 9.2% to 4.3%. As a result, ROE has declined from a high of 28.5% in FY2018 to 9.0% in FY2022.

(a) What were the main reasons for the decline in PBT margin over the years?

GCB's profit margin fluctuates from year to year mainly due to the market demand and supply for cocoa products and chocolate. The operating margins in 2018 and 2019 were higher primarily due to the overall favorable demand and consumers' sentiment in the cocoa industry.

However, in 2020, the operating profit margin was being impacted by the sudden outbreak of COVID-19 pandemic and subsequent worldwide lockdown which had an adverse effect on the demand for cocoa products.

The fluctuating energy prices since 2020 has not been helpful as well, especially after the Russia-Ukraine tensions amplified in 2022.

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(b) What are the Group's strategies to improve its profit margins going forward?

The selling prices of our products are driven by market forces, as cocoa is a commodity product. As a middlestream player, we sell products at market prices and have little control over the product pricing.

Our margins can be easily eaten up if not managed properly. That being said, we employ a set of strategies to protect our margins. Our pricing strategy involves several components, including:

(i) producing at higher volume to achieve economy of scale:

Through grinding at higher volumes, we are able to lower fixed processing costs per MT, thereby achieving higher processing margins per MT at our grinding facilities. We always strive to debottleneck to improve our capacity. In 2022, we increased our annual cocoa grinding capacity by 60,000 MT from 277,000 MT to 337,000 MT with the completion of our Ivory Coast facility.

Furthermore, our industrial chocolate capacity in SCHOKINAG was expanded by 5,000 MT during 2022. With our new plant in UK commissioning soon, our industrial chocolate capacity will increase by 16,000 MT, bringing the total capacity to 111,000 MT.

We are constantly seizing the opportunities to expand, because we believe that by achieving economy of scale, we are able to achieve lower processing costs per MT across the group, thereby generating higher profits.

(ii) controlling processing costs:
Since we do not have much control over the prices of our products, one way we can protect our margins is to minimize our processing costs. To this extent, we appoint dedicated personnel to closely monitor our processing costs to ensure that they are within budget.

We also constantly invest in improvement projects that can lower our long-term processing costs, be it the automation project to reduce labour cost, the biomass and solar panel projects to reduce energy cost or the expansion project to Europe to lower the overall freight burden to the group due to the proximity to customers and elimination of repeating routes.

We plan to install solar panel at most of our processing facilities. Not only is it environmentally friendly, but it also helps to reduce energy costs.

(iii) push for product sales with higher margins:

We always aim to sell more heavy alkalised and high fat cocoa powder over natural cocoa cake, and more solid chocolate over liquid chocolate due to their higher margins. Currently, we are also venturing into the gourmet chocolate segment, which will enable us to sell at even higher margins.

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(c) How much has the Group spend on capex over the last five years? What is the budgeted capex for FY2023?

	2018	***2019***	***2020***	***2021***	***2022***
CAPEX incurred (RM'mil)	*97.6*	*64.4*	*212.5*	*174.3*	*274.8*

(extracted from PPE notes in financial statement)

Budgeted CAPEX for FY2023 is approximately RM 102.7mil:

- *RM43.2mil in Ivory for final payment for construction of factory and cocoa processing machineries*
- *RM6.9mil in Germany for upgrading of chocolate line*
- *RM16.9mil in UK on machineries for industrial chocolate factory*
- *RM27.4mil in Malaysia mainly for warehouse expansion and upgrading of cake processing reactor*
- *RM8.3mil in the US for expansion of powder mill and automation on depalletizing of butter and liquor*

Yours sincerely,

Brandon Tay Hoe Lian
Chief Executive Officer