Issuer: China Flexible Packaging Holdings Limited
Security: China Flexible Packaging Holdings Limited

Meeting details:
Date: 22 February 2017
Time: 11:00H
Venue: Re!Union Function Room, 2nd Floor of Hotel Re, 175A Chin Swee Road, Singapore 169879

Company Description

China Flexible Packaging Holdings Limited, an investment holding company, manufactures and sells plastic packaging films, synthetic papers, and high barrier films in the People's Republic of China. It offers biaxially oriented polypropylene films, including high shrinkage films, such as labeling and tobacco films; and low shrinkage films comprising pearlised, matt, and plain films for printing, lamination, and coating. The company also produces synthetic paper that is used in commercial packaging, printing, food, medical, and cosmeceutical industries; and five-layer high barrier films for use in the vacuum packing of meat products. It serves food processing and tobacco industries, as well as other light industries involved in labeling, printing, and gift wrapping. The company is based in Jieyang, the People's Republic of China.

(Source: http://www.sgx.com/wps/portal/sgxweb/home/company_disclosure/stockfacts?code=BCX)

Q1. In the Chairman's Statement and in the Operations Review, the following headwinds have been listed:

- *We continued to experience weakening demand from the domestic market and faced downward price pressures due to intense competition and also because our persistent machinery issues continued to affect the quality of our products and resulted in us having to sell them at heavily discounted prices.*

- *Internally, we continued to encounter production issues that led to sub-standard products because of persistent problems with our aging machinery.*

- *The Group is also anticipating cost pressures in the form of relatively high raw material prices.*

- *China's plastic packaging industry is likely to remain challenged in the near term due to declining demand from downstream industries triggered by slower manufacturing growth and spending cuts.*

- *The Group is of the view that the aforementioned economic and industry factors as well as our own internal operating issues will persist and will continue affecting our business.*

Over the last five years (as seen on page 15 - Financial Highlights), revenue has fallen from RMB 650.3 million in 2012 to RMB141.3 million in 2016. Other than the small profit of RMB3.0 million in 2014, the losses in the other four years ranged from (RMB125.3) million to (RMB630.0) million. Shareholders' fund has decreased from RMB1.1 billion in 2012 to RMB140.2 million in 2016 and the gearing ratio has jumped from 0% to 30.5% in 2016 as a result of new loans to fund the business.

In addition, the group's remaining production line in Ruixing was set up in 2009 and the equipment would be around eight years old. The quality issues have affected the selling prices, leading to a situation where the cost of inventories included in cost of sales has exceeded revenue (Notes 10 and 11 – page 69) in the last two years. The group has been operating at negative gross margin.

a) **Has the company considered suspending all operations until the quality issue can be fixed?**

b) **Can the company help shareholders understand the long-term viability of operating as a small Biaxially Oriented Polypropylene ("BOPP") film producer, given the current challenges and outlook?**

c) **Has the board evaluated the competitiveness of the group? Has the board considered the option of terminating the BOPP business?**

Q2. The Independent Joint Auditors have included an Emphasis of Matter on the Company's financial statements for the financial year ended 31 October 2016. The Independent Joint Auditors have flagged out the "the existence of a material uncertainty that may cast significant doubt about the Company's and the Group's ability to continue as going concerns".

In Note 2 (Going Concern – page 43), it was disclosed that the company "prepared the financial statements based on the assumption that the Group can be operated as a going concern and is of the view that the Group will have sufficient working capital to finance its operations in the next twelve months from the end of the reporting period".

In the Chairman's Statement, the following considerations were given:

i. *The Group completed the Rights cum Warrants Issue on 7 December 2016 and had raised gross proceeds of approximately S$6.1 million or RMB29.9 million. Following the issuance of over 4.3 million Warrants, the Group* *can also potentially raise an additional S$4.5 million or RMB22.3 million in the event that all the Warrants are exercised;*

ii. *I, as Chairman, have undertaken not to demand for immediate repayment of the advance of RMB30.0 million for the next 12 months after year end until such time when the Group has sufficient financial resources;*

iii. *The less effective production line no. 3 has been shut down, which will result in lower operating losses; and*

iv. *The Group continues to implement measures to improve its liquidity condition, including external debt financing options, shortening the collection of receivables, lowering inventory levels and tightening cost controls over various selling and administrative expenses.*

Bank Loans 1 and 2 of RMB20 million each are due in March and September 2017 respectively. Given that the group expects to continue to report operating losses, there appears to be little buffer in the group's cash flow situation. The Rights cum Warrants Issue were undersubscribed by 11%, possibly indicating a lack of confidence by shareholders.

a) **Can management provide further elaboration on the cash flow situation, especially on the lending environment in the PRC and the expected operating losses?**

b) **What are the other funding options available to the group?**

c) **Has the board considered other strategic alternatives available to the company to preserve shareholders' value?**

Q3. The board has three independent directors, namely Chng Hee Kok, Ling Chung Yee Roy and Prof. Du Jinmin. All three independent directors are also members of the Nominating Committee ("NC"), Remuneration Committee ("RC") and Audit Committee ("AC").

Shareholders appreciate that the company has provided a breakdown of each individual director's remuneration for FY2016, as recommended by the Code of Corporate Governance 2012. This is a good practice that elevates the level of transparency of remuneration for non-executive directors.

The three non-executive directors have largely the same responsibilities and duties as independent directors on the board and all three serve on the sub-committees. Mr Chng has the additional responsibility of being the Lead Independent director.

a) Of the S$115,000 that has been put up for shareholders' approval as directors' fees at the AGM, the allocation is S$56,000, S$48,000 and S$11,000. **Can the remuneration committee help shareholders understand the rationale behind the allocation given that the directors have largely the same duties and responsibilities?**

b) **To further improve transparency in the disclosure of non-executive directors' remuneration, would the board consider disclosing the fee structure for non-executive directors?**