



SERN KOU RESOURCES BERHAD 200001016496(519103-X)

Lot PTD 6019 (Lot 8804), Jalan Perindustrian 1, Kawasan Perindustrian Bukit Bakri,
Mukim Bakri 84200 Muar Johor.

Tel: +606-986 5562 Fax: +606-986 5570

24 November 2022

The Chief Executive Officer
Badan Pengawas Pemegang Saham Minoriti Berhad
Level 23, Unit 23-2, Menara AIA Sentral,
No. 30, Jalan Sultan Ismail,
50250 Kuala Lumpur.

BY EMAIL

Attention : Mr Devanesan Evanson

Dear Sir,

**22nd Annual General Meeting (“AGM”) of Sern Kou Resources Berhad (“Sern Kou”
or the “Group”) to be held on Friday, 25 November 2022**

We refer to your letter dated 17 November 2022. Kindly find your issues raised in the interest of minority shareholders and all other stakeholders of Sern Kou and our management replies hereunder.

Operational & Financial Matters

1. The Group's manufacturing and trading of furniture segment in FY22 reported a loss before tax of RM4.4 mil (FY21: RM0.04 mil), while revenue declined by 29.3% to RM58.5 mil from RM82.8 mil a year ago.
 - a) Some of Sern Kou's peers (furniture manufacturing companies listed on Bursa) have remained profitable with decent profit margins. While those peers have the advantage of operating on a larger scale or volume, what are the other areas that Sern Kou could be lacking in that resulted in the segment loss?

REPLY:

The operations of the furniture manufacturing segment were halted for approximately 4 months from 1 June 2021 until end of September 2021 due to the implementation of Full Movement Control Order (“FMCO”) and the subsequent National Recovery Plan (“NRP”) following the surge in number of COVID-19 cases in Malaysia and globally. The segment continued to incur fixed operating expenses such as salaries and bank interest during the closure period.

The segment also incurred unplanned COVID-19 related expenses during the closure period such as sanitisation cost, screening fees and quarantine expenses when close to 100 workers were tested positive for COVID-19.

The financial impact of the above were reflected in the financial results for FYE2022.



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REPLY - Continued:

The operating results were further affected by the decrease in demand for furniture since the beginning of year 2022 following high global inflationary rate accompanied by tightening of monetary policy in countries worldwide.

Despite the segment exported to the US market similarly with the peers, the customers and type of furniture purchased were, however, different.

In order to improve the operating results, the segment will concentrate on process innovation in order to increase both the capacity and efficiency for the manufacturing activities.

- b) Please explain your sales outlook for your key export markets of US and Europe where aggressive interest rate hikes are causing a slowdown in home sales and consumer discretionary spending. Will Sern Kou be able to divert orders to other countries?

REPLY:

The segment expects a softer demand for furniture from the US market. Aside from the US market, the segment exports to other 18 countries worldwide. Being in the industry for the past 30 years, the segment will manage to receive sustained orders from the diversified customers.

2. Sern Kou's wood processing and trading segment's PBT fell 18.4% to RM19.9 mil in FY22, while revenue grew 12.4% to RM279.8 mil. The Group attributed the lower profit to a combination of factors including supply chain disruptions, raw material and labour shortages.

- a) Based on your outlook of the current market conditions, do you expect your cost of sales to moderate or stabilize moving forward?

REPLY:

Cost of sales is expected to stabilise in the 4QFYE2023.



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- b) Has Sern Kou successfully completed phase 3 of its expansion plan to increase its total sawmill annual capacity to 80,000 tonnes? What was the sawmill production capacity and utilisation rate in FY22?

REPLY:

The annual capacity for FYE2022 was 80,000 tonnes and the utilisation rate was 100%

- c) What were the factors driving demand and do you expect this sales momentum to continue?

REPLY:

Despite timber being the main raw materials for the furniture manufacturing and the wood processing segments, any surplus of timber would be sold to local customers.

Demand from local customers has increased in FYE2022 when the global demand for timber shifted to Malaysia following the decrease in production of timber especially in South Africa and Papua New Guinea due to the decrease in area planted, fire damage and pests' diseases.

The demand is expected to continue for FYE2023.

3. Sern Kou's midstream sawmill business has been the key driver for its revenue and record financial performance in the past few years. On the other hand, the downstream furniture manufacturing segment has been dwindling over the years and now accounts for less than 20% of total revenue.

Considering that the downstream segment has been a drag on overall group performance, would Sern Kou be better off phasing out its furniture manufacturing division and reallocating resources to its midstream and upstream operations?

REPLY:

Sern Kou will maintain the furniture manufacturing segment despite the operating results. Please refer to reply for issue no. 1. The management will continue to enhance the performance for the upstream and midstream operations.



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4. According to information on the company's website, timber supply shortage is not an issue as Sern Kou has its own direct raw material supply and is currently extracting timber from approximately 2,000 acres of forest.

Does Sern Kou own a timber extraction concession or license? If yes, please provide details including when it was granted, the concession period and expiry, costs related to the concession, and the likelihood of renewing the concession.

REPLY:

Sern Kou relentlessly develop diverse sources of supply to ensure business continuity.

The timber extraction license was first obtained on January 2018. The license was renewed and extended numerous times until the last expiry date on March 2022.

5. Sern Kou has identified sustainable forestry as its new growth area. Sern Kou had established its own research lab and nursery production to support this new venture (page 9 of AR2022).

Please shed some light on this new venture, including the growth potential.

REPLY:

Sern Kou plans to venture into sustainable forestry through planting of trees. Own plantation will ensure uninterrupted supply of timber as raw material for the business operations for the Group.

Sustainable forestry management involves great management skills and care to protect wildlife and the community. The business venture will generate jobs for the community. It will also create a sustainable forest life cycle and combat climate change at the same time.

Hence, the venture into sustainable forestry will create a balance between three main pillars, namely, Ecological, Economic and Socio-cultural.

Sern Kou is currently in search for suitable location for planting purpose.



Corporate Governance Matters

1. Practice 5.3 of Malaysian Code on Corporate Governance 2021 (MCCG) stipulates that the tenure of an independent director should not exceed a cumulative term limit of nine years. If the board intends to retain an independent director beyond nine years, it should provide justification and seek annual shareholders' approval through a two-tier voting process.

Sern Kou in its Corporate Governance Report 2022 (page 24) states that there are three Independent Non-Executive Directors, namely, Tan Sri Abdul Rahim Bin Mohd Noor, Datuk Tay Puay Chuan and Mr Leou Thiam Lai, whose tenure are more than nine years.

Tan Sri Abdul Rahim Bin Mohd Noor and Datuk Tay Puay Chuan, who are also subject to retirement by rotation at the forthcoming Annual General Meeting (AGM) had expressed their intention not to seek for re-election as directors at the AGM, in view of the nine-year policy for Independent Non-Executive Director pursuant to the MCCG.

However, the continuance of Mr. Leou Thiam Lai's office as Independent Non- Executive Director will be subject to the shareholders' approval at the forthcoming AGM

Sern Kou's Board is of the opinion that the two-tier voting outlined in the MCCG is not compatible with the provisions in the Companies Act 2016 and the Company's Constitution.

The Securities Commission Malaysia has issued a Frequently Asked Questions on the MCCG on 26 April 2017, and revised on 30 April 2021 ("MCCG FAQ") where provisions under the Companies Act 2016 (particularly Section 291) was clarified as follows:

"Section 291 of Companies Act 2016 defines the application of ordinary resolution of members or a class of members of a company; that an ordinary resolution is passed by a simple majority of more than half of such members. It does not specifically deal with the appointment or re-appointment of directors.

Section 202(2) of Companies Act 2016 states that the appointment of any subsequent director may be appointed by an ordinary resolution. In this section. The term 'may' is used and it is well settled that the use of the word 'may' in a statutory provision would not by itself show that the provision is directory in nature. Therefore, companies are allowed to determine the manner in which shareholders will exercise their rights in relation to the appointment or re-appointment of directors.



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The two-tier voting process is also consistent with the rights and powers attached to shares as accorded in the Companies Act 2016. In exercising the votes under two tier voting process, each shareholder continues to have only one vote for each shares held."

The Securities Commission in its MCCG FAQ also advocates that a company should adopt the two-tier voting process in its constitution to provide clarity on the company's approach and procedure to retain independent directors.

Hence, two-tier voting for Mr. Leou Thiam Lai whose tenure is more than nine years should be adopted as per the MCCG.

REPLY:

The Board acknowledged the recommendation and will prepare the necessarily in order to comply with the MCCG in the very near future.

Sern Kou is finalising the selection of suitable and qualified candidates to be appointed as the Independent Non-Executive Directors.

Please feel free to contact our Company Secretary should you require further clarification.

Thank you.

Yours faithfully,
Sern Kou Resources Berhad

Low Peng Sian @ Chua Peng Sian
Group Managing Director