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ARTS OPTICAL INTERNATIONAL HOLDINGS LIMITED

雅視光學集團有限公司 *

(Incorporated in Bermuda with limited liability)

(Stock Code: 1120)

SUPPLEMENTAL ANNOUNCEMENT IN RELATION TO THE ANNUAL REPORT FOR THE YEAR ENDED 31ST DECEMBER, 2020

Reference is made to the annual report (the "Annual Report") of Arts Optical International Holdings Limited (the "Company") for the year ended 31st December, 2020. Capitalised terms used in this announcement shall adopt the same meanings as defined in the Annual Report, unless the contest requires otherwise. The Board wishes to provide to the shareholders and potential investors of the Company additional information in relation to the impairment loss for property, plant and equipment, and right-of-use assets attributable to a cash generating unit ("CGU").

REASONS FOR AND THE CIRCUMSTANCES LEADING TO THE IMPAIRMENT LOSS

As disclosed in the Annual Report, the impairment loss of property, plant and equipment including right-of-use assets recognised was due to the outbreak of COVID-19 and thus the revenue dropped sharply.

Ever since the first outbreak of COVID-19 in early 2020, the Board has been closely monitoring the development of the pandemic and has been assessing the need for impairment. However, as COVID-19 was a novel disease, its effect on the world and the business of the Group was unknown during the initial outbreak in China and there was uncertainty as to how the pandemic would play out. During the first half of 2020, it was anticipated at that time that the effects of COVID-19 were mainly limited to China and would impact more the supply side of the business of the Group as the PRC government adopted different measures to put COVID-19 under control (such as travel restrictions and factory closures). The view taken by the Board at that time was that the effects would be short-term and while the decrease in revenue was significant, this could be recouped in a short period of time once the spread of COVID-19 was brought under control.

* *For identification purpose only*

With the passage of time and the spread of COVID-19 to other parts of the globe during the second half of 2020, it was apparent to the Board that COVID-19 would have a far more serious effect on customer demand for the Group's eyewear products and it was unlikely that COVID-19 would be extinguished within a short period. This in turn meant that the decrease in revenue would not be temporary and the expectation of revenue returning to pre-US-China trade dispute and pre-COVID-19 levels in a short period of time would not be realistic. The situation was also aggravated by the appreciation of Renminbi during the second half of 2020.

Hence, as the Board obtained more information during the second half of 2020, the Board took appropriate actions to assess the impact of COVID-19 and the appreciation of Renminbi on the business of the Group. In view of the significant decrease in customer orders and revenue in the financial year of 2020 and the fact that the plan for the Vietnam manufacturing facility was put on hold due to the travel restrictions, the Board considered that the recovery of revenue to normal levels may take several years and have a long-lasting impact on the Group's business. Given the significant and lasting impact of COVID-19 on the business of the Group, the Board and the Audit Committee considered this as an impairment indicator that may affect the value of the property, plant and equipment of the Group. After careful consideration, the Board conducted an impairment assessment to determine the recoverable amounts of the CGU accordingly.

DETAILS OF THE IMPAIRMENT ASSESSMENT

As disclosed in note 4(z) to the consolidated financial statements of the Company as included in the Annual Report, the Group had conducted value-in-use calculations to determine the amount of the impairment loss. The recoverable amount of the CGU has been determined at the higher of fair value less costs of disposal and value-in-use of the property, plant and equipment and right-of-use assets to which the relevant assets belong to. The value-in-use calculations were based on cash flow projections which were in turn based on the latest financial budgets approved by the Company's management covering a period of five years. Cash flows beyond the 5-year period are extrapolated up to the end of the relevant useful lives of the building fixtures with zero growth rate, and with a discount rate which was provided by an independent professional appraiser. Cash flow projections during the 5-year budget period were mainly based on the expected revenue and gross margins during the budget period.

The Group has adopted the value-in-use method with the same methodology as its standard practice since 2017. Such calculation method had been agreed and recommended by the Group's previous auditor and hence the same method had been used by the Board in this impairment assessment to ensure consistency.

Details of the key assumptions and inputs adopted in the impairment assessment of the CGU are as follows:

(i) Budgeted revenue for the coming five years:

The Group prepared its budgeted revenue for the coming five years based on the Group's past performance, including the average revenue achieved in the period immediately before the budget period, and the expected market development.

The Group had noted a moderate recovery of its revenue during the fourth quarter of 2020 and such recovery in sales had continued up to February 2021. Hence, the Group used the monthly average revenue during the fourth quarter of 2020 as a base to project the annual revenue for the year 2021.

For the years 2022 and 2023, the Group anticipates a steady growth in the Group's revenue and its revenue could resume to pre-COVID-19 level. Such estimated growth in revenue is attributable to the Group's expectation that the global economy would gradually recover from the COVID-19 pandemic due to the availability of vaccines and increase in vaccination rates in most of the developed countries in the world. For the years 2024 and 2025, it is estimated that the growth of the Group's revenue will slow down.

(ii) Budgeted gross profit margins for the coming five years:

The Group prepared its budgeted gross margins based on the Group's past performance, including the average gross margins achieved in the period immediately before the budget period, and other factors such as expected efficiency improvements and expected market development.

In deriving the estimated gross profit margin for the year 2021, the Group had considered its actual gross margin for the fourth quarter and the second half of 2020, i.e. 23.6% and 26.7% respectively. The Board is of the view that it would be too aggressive to estimate a higher gross margin for the year 2021 given that the Group had undertaken some severe costs-cutting exercises during the third quarter of 2020.

The Group further estimates that the gross profit margins could slightly improve in the years 2022 and 2023. The underlying reason for such expected improvement in gross profit margins for the years 2022 and 2023 is mainly due to the positive effect from economies of scale attributed to its expected sales growth for the years 2022 and 2023. The budgeted gross margins for the years 2024 and 2025 are expected to be flat as the positive effect deriving from the further increase in revenue for the years 2024 and 2025 will likely be offset by various factors such as inflation.

(iii) Sales growth rates for the coming five years:

The Group prepared the cash flow projections based on the latest financial budgets approved by the Company's management covering a period of five years using 10% and 6% sales growth rate in the first two years and subsequent three years, respectively.

The growth rates were determined by the Board by reference to its past experience and current market expectation and/or demand based on the long-term average economic growth rate of the geographical area in which the businesses of the CGUs operate.

(iv) Pre-tax discount rate:

A pre-tax discount rate of 11.28% was used to discount the forecasted cash flows from the Group. The discount rate was determined by Vigers Appraisal & Consulting Limited, an independent professional appraiser. Taking into account the appraiser's experience and after careful consideration of the appraisal report, the Board is of the view that it provided a credible basis for the Group's assessment of the impairment loss.

The above additional information does not affect other information contained in the Annual Report and save for those disclosed above, all other information contained in the Annual Report remains unchanged.

By order of the Board
Arts Optical International Holdings Limited
Ng Hoi Ying, Michael
Chairman

Hong Kong, 9th July, 2021

As at the date of this announcement, the Board comprises five directors, two of whom are executive directors, namely Mr. Ng Hoi Ying, Michael and Mr. Ng Kim Ying, and three are independent non-executive directors, namely Mr. Wong Chi Wai, Mr. Chung Hil Lan Eric and Mr. Lam Yu Lung.