

General Announcement

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Submitting Merchant Bank : AVENUE SECURITIES SDN BHD
Company Name : **KNM GROUP BERHAD**
Stock Name : KNM
Date Announced : 30/12/2005

Type : **Announcement**
Subject : **KNM GROUP BERHAD ("KNM" AND "COMPANY")**

PROPOSED ACQUISITION BY KNM PROCESS SYSTEMS SDN BHD ("KNMPS"), A WHOLLY-OWNED SUBSIDIARY OF KNM OF 51% (PLUS 1 SHARE) EQUITY INTEREST IN HUDSON PRODUCTS PACIFIC PTY LTD, A COMPANY INCORPORATED IN AUSTRALIA ("HPP") COMPRISING 2,193,001 FULLY PAID-UP ORDINARY SHARES AND 1 PARTIALLY PAID-UP ORDINARY SHARE FROM PROCESS HEAT TRANSFER PTY LTD FOR A CASH CONSIDERATION OF UNITED STATES DOLLAR ("USD") 3,000,000 ("PROPOSED HPP ACQUISITION")

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1. INTRODUCTION

On behalf of the Board of Directors of KNM ("Board"), Avenue Securities Sdn Bhd wishes to announce that KNMPS had on 30 December 2005 entered into a share purchase agreement ("SPA") with Process Heat Transfer Pty Ltd, a company incorporated in Australia ("HPP Vendor") to acquire 51% (plus 1 share) equity interest in HPP comprising 2,193,001 fully paid-up ordinary shares and 1 partially paid-up ordinary share ("Sale Shares") for a cash consideration of USD3,000,000 ("Cash Consideration"). The Cash Consideration is equivalent to RM11,253,000 based on the exchange rate of RM3.751:USD1.00.

2. DETAILS OF THE PROPOSED HPP ACQUISITION

On 23 December 2005, HPP has issued 2 ordinary shares to the HPP Vendor comprising 1 fully paid-up share and 1 partially paid-up share for value of AUD500,000 per share which has resulted in the shareholding structure of HPP as shown in **Table 1** below.

On or about 24 December 2005, the HPP Vendor had entered into an agreement with HPC to acquire the 2,150,000 HPP Shares from HPC. Pursuant to the said agreement, the HPP Vendor is the beneficial owner of HPP's entire issued share capital comprising 4,300,001 HPP Shares and 1 Partially Paid HPP Share.

The Proposed HPP Acquisition entails the acquisition by KNMPS of the 2,193,001 HPP Shares and 1 Partially Paid HPP Share representing 51% (plus 1 share) of the issued share capital of HPP (comprising 4,300,001 HPP Shares and 1 Partially Paid HPP Share) for the Cash Consideration which is equivalent to RM11,253,000 based on the exchange rate of RM3.751:USD1.00. The 1 Partially Paid HPP Share which was issued at

AUD500,000 shall be paid in the following manner:-

(a) an amount of AUD500,000 less USD175,000 divided by 2 (or AUD129,250 based on the exchange rate of AUD1.38:USD1.00) will be paid-up by the HPP Vendor prior to the completion of the SPA; and

(b) the balance AUD370,750 (or equivalent to RM1,008,440 based on the exchange rate of RM2.720:AUD1.00) shall be paid by KNMPS within 30 business days after the completion of the SPA (“KNMPS Capital Payment”).

The Cash Consideration and KNMPS Capital Payment are expected to be funded through a combination of internally generated funds and borrowings, the proportion of which has yet to be determined. The Cash Consideration and KNMPS Capital Payment which is equivalent to RM12,261,440 in aggregate was arrived at based on a willing buyer-willing seller basis after taking into consideration:-

(i) the future earnings potential of HPP and its subsidiaries (“HPP Group”);

(ii) the audited consolidated profit after taxation (“PAT”) of HPP of AUD1.767 million or equivalent to RM4.806 million (based on the exchange rate of RM2.720: AUD1.00) for the financial year ended 31 December 2004; and

(iii) the audited consolidated net tangible assets (“NTA”) of HPP of AUD11.023 million equivalent to RM29.983 million (based on the exchange rate of RM2.720: AUD1.00) as at 31 December 2004.

The Proposed HPP Acquisition is not expected to give rise to any additional financial commitment to put the HPP Group on-stream.

2.1 Information on HPP

HPP was incorporated in Australia on 28 November 2000 under the Corporations Act, 2001 in Australia as a proprietary company limited by shares under the name of Hudson HEI Pty Ltd. It subsequently changed its name to Hudson Products Pacific Pty Ltd on 19 April 2004. As at the date of this announcement, the issued share capital of HPP is AUD5,300,000 comprising 4,300,001 fully-paid-up ordinary shares and 1 partially paid-up ordinary share.

The principal activities of HPP are design, manufacture, sale and service of heat exchange systems for use throughout the world whilst the principal activities of its subsidiaries are as shown in **Table 2** below:

As at the date of this announcement, HPP does not have any associated companies.

The audited consolidated financial information of HPP for the financial period from 28 November 2000 to 31 December 2001

and the three (3) financial years ended 31 December 2001 to 2004 is shown in **Table 3** below.

2.2 Original Cost and Date of Investment

The 2,193,002 Sale Shares to be acquired by KNMPS comprises the following:-

(a) 43,000 Sale Shares held by the HPP Vendor, of which the original cost of investment is AUD43,000 and the original date of investment is 28 November 2000;

(b) 2,150,000 HPP Shares to be acquired by the HPP Vendor from HPC pursuant to an agreement dated on or about 24 December 2005, of which the consideration payable by the HPP Vendor for these shares is equivalent to the Cash Consideration (i.e.USD3.0 million); and

(c) 2 ordinary shares issued to the HPP Vendor on 23 December 2005 comprising 1 fully paid-up share and 1 partially paid-up share for value of AUD500,000 per share, details of which are set out in Section 2 above.

2.3 Salient Terms of the SPA

The salient terms of the SPA, include the following:-

(a) KNMPS shall acquire the 2,193,002 Sale Shares for the Cash Consideration free from any right, entitlement, interest, power, authority, discretion, claim or remedy in or over any asset as well as third party rights but together with all rights attached and accrued to them on or after the date of completion of the SPA (“Completion Date”) and subject to the SPA.

(b) The Cash Consideration shall be satisfied within five (5) business days of the satisfaction of the conditions precedent and relevant requirement as contained in the SPA.

(c) The Proposed HPP Acquisition is conditional upon the following conditions being fulfilled within 45 days from the date of the SPA or such longer period as the parties may mutually agree in writing or where KNMPS waives its rights in respect of a specific condition not satisfied within the said 45 days:-

(i) The approval of all relevant government/regulatory authorities including Bank Negara Malaysia;

(ii) The HPP Vendor has acquired from HPC any shares previously held by HPC in HPP together with the evidences of such transfer;

(iii) The HPP Vendor has procured that the HPP Group have obtained the consent of applicable third parties to the sale of the Sale Shares from

the HPP Vendor to KNMPS (and such further confirmation that such third parties will not terminate agreements with the HPP Group as a result of the sale of Sale Shares); and

- (iv) The HPP Vendor has paid consideration for:
- one (1) share issued by HPP for value of AUD500,000 by making full payment of AUD500,000;
 - and
 - one (1) share issued by HPP on 23 December 2005 for value of AUD500,000 making partial payment of a sum equal to AUD500,000 less USD175,000 divided by 2.

2.4 Liabilities to be Assumed

KNMPS will not assume any liabilities of HPP under the Proposed HPP Acquisition. The existing liabilities of HPP will be settled by HPP in the normal course of business.

2.5 Information on the HPP Vendor

The HPP Vendor was incorporated in Australia on 13 December 2000 under the Corporations Act, 2001 in Australia as a proprietary company limited by shares under the name of Process Heat Transfer Pty Ltd. As at 12 December 2005, the issued share capital of the HPP Vendor comprises 2,150,000 ordinary shares, all of which have been fully paid up.

The principal activity of the HPP Vendor is investment holding company. The director of the HPP Vendor is John Kenneth Rundell, whilst its substantial shareholders are Process Group Pty Ltd and John Kenneth Rundell.

3. RATIONALE FOR THE PROPOSED HPP ACQUISITION

The Proposed HPP Acquisition will give the KNM group of companies (“KNM Group”) access to technologies involving the manufacture of heat exchange systems using exotic materials such as titanium, zirconium, incolloy, hastalloy and incornel as well as access to HPP’s thermal and mechanical design expertise. Such technologies are only available to a handful of international companies.

The Proposed HPP Acquisition will allow KNM to diversify its range of products and move up the value chain in terms of technology, product complexity and value add. This will provide the boost for KNM to become an integrated global process equipment player in the oil, gas and petrochemical industries. KNM will also have the opportunity of cross selling HPP’s products to its existing customers, particularly process equipment using exotic materials.

Furthermore, the Proposed HPP Acquisition will enhance KNM's access to HPP's existing customers in the minerals processing industry and accelerate KNM's market share in this sector.

4. INDUSTRY OUTLOOK AND RISKS

4.1 Prospects

The growth of the process equipment for the oil, gas, petrochemical and minerals processing industries is dependent on the performance of its user industries which are namely producers and manufacturers of oil, gas, petrochemical and minerals products and engineering multi-national companies of oil, gas, petrochemicals and minerals processing plants.

The growth driver for HPP is dependent on the consumption or end-user demand for oil, gas and petrochemical products. This is largely influenced by the following factors:

- (i) Increase in demand for oil, gas and petrochemicals and minerals driven by improvement in the performances of global economies;
- (ii) Increase in exports of oil, gas, petrochemical and minerals products for the manufacturing sector; and
- (iii) Increase in export of manufactured products that use oil, gas, petrochemical and minerals products.

Prospects for the activities and profitability of HPP will also depend on the continuing exploration and production activities of oil, gas and petrochemical companies to ensure future and long-term supply.

4.2 Risks

(i) Competition

HPP may face competition from local and overseas manufacturers, especially internationally recognised manufacturers of heat exchange systems, with no assurance that HPP is able to maintain its existing market share in the future. Notwithstanding the above, KNM expects that HPP will strive to ensure it remains competitive to maintain and/or to expand its market share in the industry.

(ii) Global Oil Price Fluctuations

Oil, gas and minerals are commodities subject to international long-term and spot prices. Some of the factors that may cause global prices to fluctuate include wars and the threat of wars,

interruption from major producing countries, price and production pressures from cartels such as the Organisation of Petroleum Exporting Countries and significant drop in demand. In such cases, the demand for HPP's products may be affected although this will be mitigated somewhat by the requirements of the replacement market.

(iii) Alternatives to Oil and Gas

The oil and gas-based activities of HPP are subject to the inherent risks within the oil, gas and petrochemical industries, particularly the significant move towards finding other energy sources as an alternative to oil and gas. However, it is not foreseeable that oil and gas will be significantly replaced by alternative energy resources in the immediate and medium term. In addition, regardless of the developments in alternative energy sources, industries throughout the world today and particularly, the manufacturing industry have grown highly dependent on oil and gas products. The high and continuing use of oil and gas products by industries is expected to provide growth opportunities for manufacturers of the process equipments and air-cooled heat exchangers for the oil, gas and petrochemical industries.

(iv) Skilled Manpower

The business undertaken by HPP requires a high level of professionally qualified and skilled labour. In this respect, there is a risk that HPP may face the potential threat of shortages in labour. KNM expects that HPP will ensure that it provides competitive remuneration packages, training and promotional opportunities to retain suitable employees within the company.

(v) Impact of Fluctuations in Foreign Exchange Rates

As the HPP Group supplies its products to the international market, its business is subject to fluctuations in foreign exchange rates. Although the HPP Group monitors these foreign exchange exposure on an on-going basis, there can be no assurance that any significant fluctuation of currencies will not have an adverse impact on the earnings of the HPP Group.

(vi) Fluctuations in the Prices of Raw Materials

The industry is subject to fluctuations in prices of raw materials, especially steel and this may have an impact on the profit margin of the manufacturers. However, it is normal practice in

the industry for any increases in the prices of raw materials, including steel, to be passed on to customers in addition to the prudent procurement policies in place to mitigate such risks.

(vii) Political, Economic and Regulatory Factors

Like all other business entities, changes in political, economic and regulatory conditions in Australia and other countries where the HPP Group has operations, could materially and adversely affect the financial and business prospects of the HPP Group. Amongst the political, economic and regulatory uncertainties are the changes in political leadership, expropriation, nationalisation, re-negotiation or nullification of existing sales orders and contracts, interest rates, method of taxation and currency exchange rates.

While HPP will seek to limit the impact of such risk to its business, there is no assurance that any change in the above factors will not have a material adverse effect on the business and operations of the HPP Group.

5 EFFECTS OF THE PROPOSED HPP ACQUISITION

5.1 Share Capital and Substantial Shareholdings

The Proposed HPP Acquisition does not have any impact on the issued and paid-up share capital and the substantial shareholdings of KNM as the Proposed HPP Acquisition does not involve any issuance of securities by KNM.

5.2 Earnings

The Proposed HPP Acquisition is not expected to have any material impact on the earnings of the KNM Group for the financial year ending 31 December 2005. However, barring unforeseen circumstances, the Board expects the Proposed HPP Acquisition to contribute positively to the future long-term earnings of the KNM Group.

5.3 NTA

Based on the audited consolidated financial statements of KNM for the financial year ended 31 December 2004, the proforma effects of the Proposed HPP Acquisition on the NTA of the KNM Group, assuming the Proposed HPP Acquisition had been effected on the date, are tabulated in **Table 4**.

6. CONDITIONS OF THE PROPOSED HPP ACQUISITION

The Proposed HPP Acquisition is subject to and conditional upon the approvals from the following:-

(i) Bank Negara Malaysia; and

(ii) other relevant authorities (if necessary).

The Proposed HPP Acquisition is not subject to the approval of the shareholders of KNM. However, the Company will despatch an information circular on the Proposed HPP Acquisition in due course.

7. POLICIES ON FOREIGN INVESTMENT AND REPATRIATION OF PROFITS OF HOST COUNTRY

Profits from investments in Australian companies can be repatriated without any restrictions. The Australian Government generally does not restrict or limit foreign equity participation in Australian companies. The Proposed HPP Acquisition represents a long-term investment and profits, as they arise and are available for distribution, will be repatriated accordingly.

8. DIRECTORS' AND SUBSTANTIAL SHAREHOLDERS' INTEREST

None of the Directors and/or substantial shareholders and persons connected to the Directors and substantial shareholders has any interest, direct or indirect, in the Proposed HPP Acquisition.

9. DIRECTORS' STATEMENT

The Board, having considered all aspects of the Proposed HPP Acquisition, is of the opinion that the terms and conditions of the Proposed HPP Acquisition is fair and reasonable and are in the best interest of the Company.

10. ADVISER

Avenue has been appointed as the adviser for the Proposed HPP Acquisition. KNM has also appointed ZJ Advisory Sdn Bhd as the transaction adviser for the Proposed HPP Acquisition.

11. ESTIMATED TIME FRAME

Barring any unforeseen circumstances, the Proposed HPP Acquisition is expected to be completed within three (3) months from the date of this announcement.

12. DEPARTURE FROM THE SECURITIES COMMISSION (“SC”)’S POLICIES AND GUIDELINES ON ISSUE/OFFER OF SECURITIES

The Board is not aware of any departure from the SC’s Policies and Guidelines on Issue/Offer of Securities in relation to the Proposed HPP Acquisition.

13. DOCUMENTS FOR INSPECTION

The SPA may be inspected at the registered office of KNM at 15, Jalan Dagang SB4/1, Taman Sungai Besi Indah, 43300 Seri Kembangan, Selangor Darul Ehsan during normal business hours from Mondays to Fridays (except public holidays) for a period of three (3) months from date of this announcement.

This announcement is dated 30 December 2005.



KNM HPP Acq table.doc

Table 1 – Shareholding structure of HPP

<i>Shareholder</i>	<i>No. of fully paid ordinary share in HPP held (“HPP Shares”)</i>	<i>No. of partially paid ordinary share in HPP held (“Partially Paid HPP Shares”)</i>
HPP Vendor	2,150,001	1*
Hudson Products Corporation (“HPC”)	2,150,000	-
Total	4,300,001	1

* The ordinary share was issued for value of Australian Dollar (“AUD”) 500,000, of which an amount of AUD500,000 less USD175,000 divided by 2 (or AUD129,250 based on the exchange rate of AUD1.38:USD1.00) will be paid-up prior to the completion of the SPA.

Table 2 – Subsidiaries of HPP

<i>Name</i>	<i>Issued and paid-up share capital</i>	<i>Date/Place of incorporation</i>	<i>Effective equity interest %</i>	<i>Principal activities</i>
<i>Subsidiaries of HPP</i>				
W.E. Smith Hudson Pty Ltd	AUD1,300,000	8 March 2001/ Australia	100.0	Thermal & mechanical design, drafting, manufacture of shell & tube heat exchangers, vessels, columns and feedwater heaters
PT Heat Exchangers Indonesia	<u>Issued capital</u> 500,000 Series A shares, with a nominal value of Indonesian Rupiah (“Rp”) 2,150 or equivalent to USD1.00 per share and 389,156 Series B shares with a nominal value of Rp8,235 or equivalent to USD1.00 per share <u>Paid-up capital</u> Rp4,279,669,660 or equivalent to USD889,156	19 May 1994/ Indonesia	100.0	Manufacture of air-cooled, shell & tube and plate & frame heat exchangers, vessels and columns
Hudson Hei (Australia) Pty Ltd	AUD1.00	28 May 2003 / Australia	100.0	Manufacture of air cooled, shell & tube, and plate heat exchangers, vessels and columns

Table 3 – Audited financial information for HPP for the financial period from 28 November 2000 to 31 December 2001 and the three (3) financial years ended 31 December 2002 to 2004

	Financial period from 28 November to 31 December 2001 AUD'000	2002 AUD'000	2003 AUD'000	2004 AUD'000
Revenue	15,332	65,805	72,907	71,285
Profit before tax	(129)	4,664	2,555	1,767
PAT	(129)	4,664	2,555	1,767
Shareholders' funds	2,871	10,002	9,382	11,023
NTA	2,871	10,002	9,382	11,023
Total borrowings	1,572	1,685	700	1,069

Table 4 - Effect of the Proposed HPP Acquisition on the NTA of the KNM Group

	As at 31 December 2004 RM'000	After the Proposed HPP Acquisition RM '000
Share capital	72,956	72,956
Share premium	804	804
Revaluation reserve	6,735	6,735
Retained profits	33,882	^{1&2} 38,793
	<hr/>	<hr/>
Shareholders' equity	114,377	119,288
<i>Less:</i>		
Intangibles	-	-
	<hr/>	<hr/>
NTA	114,377	119,288
	<hr/>	<hr/>
No. of ordinary shares of RM0.50 each	145,912	145,912
NTA per share (RM)	0.78	0.82
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Notes:

1. Does not take into account the expenses and any effects on potential fair value adjustment of the Proposed HPP Acquisition.

2. Computation of negative goodwill arising from the Proposed HPP Acquisition is as follows:-

	<u>RM'000*</u>
Cash Consideration	11,253
Less: 51% of the adjusted NTA of HPP as at 31 December 2004 (after including the AUD0.629 million to be paid by the HPP Vendor as capital) of AUD11.652 million	(16,164)
Negative goodwill [^]	<hr/> <u>(4,911)</u>

* Based on the exchange rates of RM3.751:USD1.00 and RM2.720:AUD1.00

[^] The accounting policy of the KNM Group recognises the negative goodwill arising on an acquisition directly in the income statement.