

General Announcement

Reference No **KG-061127-63924**

Company Name : **KNM GROUP BERHAD**
Stock Name : **KNM**
Date Announced : **27/11/2006**

Type : **Announcement**
Subject : **KNM GROUP BERHAD ("KNM" OR "COMPANY")
PROPOSED ACQUISITION BY KNM PROCESS SYSTEMS SDN BHD ("KNMPS"), A
WHOLLY-OWNED SUBSIDIARY OF KNM OF 49% (LESS ONE (1) SHARE) EQUITY
INTEREST IN KNM PTY LTD ("KPL") ("PROPOSED ACQUISITION")**

Contents :

1. INTRODUCTION

KNM wishes to announce that KNMPS had on 27 November 2006 entered into a share purchase agreement ("SPA") with Process Heat Transfer Pty Ltd ("KPL Vendor" or "PHT") and shareholders of PHT to acquire 49% (less one (1) share) equity interest in KPL comprising 2,107,000 fully paid-up ordinary shares for a cash consideration of Australian Dollars ("AUD") 5,445,000 ("Cash Consideration"), which is equivalent to RM15,409,350 (based on an exchange rate of RM2.83:AUD1.00).

2. DETAILS OF THE PROPOSED ACQUISITION

Under the SPA, KNMPS may complete the Proposed Acquisition by one of the following options by means of issuance of an election notice within 30 days from the date of the SPA, to be exercised by KNMPS at its absolute discretion:

- (a) KNMPS acquiring all of PHT's interest in KPL;
- (b) KNMPS acquiring all of the PHT shareholders' interest in PHT; or
- (c) KNMPS acquiring a portion of PHT's interest in KPL then all of the PHT shareholders' interest in PHT.

The Cash Consideration is expected to be funded through a combination of internally generated funds and bank borrowings. The Cash Consideration was arrived at based on a willing buyer-willing seller basis after taking into consideration:-

- (i) the current financial position of the KPL and its subsidiaries ("KPL Group");
- (ii) the historical performance of the KPL and its subsidiaries; and
- (iii) the potential future earnings of KPL and its subsidiaries.

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

2.1 Information on KPL

KPL was incorporated in Australia on 28 November 2000 under the Corporations Act, 2001 in Australia as a proprietary company limited by shares. As at the date of this announcement, the issued share capital of KPL is AUD5,300,000 comprising 4,300,002 fully paid up ordinary shares. The shareholding structure of KPL is as shown in **Table 1** below.

The principal activities of KPL 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, KPL does not have any associated companies.

The audited consolidated financial information of KPL for the financial period from 28 November 2000 to 31 December 2001 and the four (4) financial years ended 31 December 2002 to 2005 is shown in **Table 3** below.

2.2 Original Cost and Date of Investment

The Sale Shares to be acquired by KNMPS comprise of 2,107,000 KPL shares held by PHT, of which the original cost of investment is AUD2,107,000 and the original date of investment is 28 November 2000.

2.3 Salient Terms of the SPA

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

(a) KNMPS shall acquire the 49% (less one (1) share) equity interest in KPL 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 SPA to be executed shall contain, inter alia the following conditions precedent:

(i) KNMPS obtaining Bank Negara Malaysia approval;

(ii) Australia and New Zealand Banking Group Limited ("ANZ") and any other applicable third

parties consenting to the Proposed Acquisition (and such further confirmation that such third parties will not terminate agreements with KPL, or its related bodies corporate as a result of the Proposed Acquisition);

(iii) Written correspondence from ANZ addressed to the person or persons who have provided securities to ANZ to secure the banking facilities of KPL confirming the unconditional full discharge and release of the said securities within 30 business days of the Completion Date;

(iv) KPL and Hamilton Drive Property Pty Ltd as trustee for the Hamilton Drive Property Trust, being the landlord for the property utilized by KPL at Hamilton Drive, Boambee, Coffs Harbour, New South Wales, Australia ("Coffs Harbour Property") entering into a further lease in relation to the Coffs Harbour Property on such terms as are acceptable to KNMPS;

(v) documentation evidencing the transfer of the PHT Shareholders' interest in PT Heat Exchangers Indonesia to a nominee of KNMPS;

(vi) ANZ's irrevocable consent in writing acceptable by KNMPS to provide bank guarantees amounting to AUD2.043 million or such other amount as is mutually agreed in writing immediately prior to Completion Date to KNMPS; and

(vii) The resignation of PHT's nominee from the KPL Board of Directors

2.4 Liabilities to be Assumed

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

2.5 Information on PHT

PHT 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 PHT comprises 2,150,000 ordinary shares, all of which have been fully paid up.

The principal activity of PHT is investment holding company. The director of PHT is John Kenneth Rundell, whilst its

substantial shareholders are Process Group Pty Ltd and John Kenneth Rundell.

3. RATIONALE FOR THE PROPOSED ACQUISITION

KNMPS had on 18 January 2006 completed the acquisition of 51% (plus one (1) share) equity interest in KPL. The Proposed Acquisition will result in KNMPS acquiring the balance 49% (less one (1) share) equity interest in KPL, directly or indirectly, in order for KNM to control 100% of KPL. Apart from having full control of KPL operations, the Proposed Acquisition will also result in increased contribution of profits attributable to shareholders of KNM from KPL.

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 KPL 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 KPL 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

KPL may face competition from local and overseas manufacturers, especially internationally recognised manufacturers of heat exchange systems, with no assurance that KPL is able to maintain its existing market

share in the future. Notwithstanding the above, KNM expects that KPL 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 KPL'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 proposed oil and gas-based activities of KPL 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 to be undertaken by KPL requires a high level of professionally qualified and skilled labour. In this respect, there is a risk that KPL may face the potential threat of shortages in labour. KNM expects that KPL 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 KPL Group supplies its products to the international market, its business is subject to fluctuations in foreign exchange rates. Although the KPL 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 KPL 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 KPL Group has operations, could materially and adversely affect the financial and business prospects of the KPL 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 KPL 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 KPL Group.

5 EFFECTS OF THE PROPOSED ACQUISITION

5.1 Share Capital and Substantial Shareholdings

The Proposed Acquisition does not have any impact on the

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

5.2 Earnings

The Proposed Acquisition is not expected to have any material impact on the earnings of the KNM Group for the financial year ending 31 December 2006. However, barring unforeseen circumstances, the Board expects the Proposed 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 2005, the proforma effects of the Proposed Acquisition on the NTA of the KNM Group, assuming the Proposed Acquisition had been effected on the date, are tabulated in **Table 4**.

6. CONDITIONS OF THE PROPOSED ACQUISITION

The Proposed 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 Acquisition is not subject to the approval of the shareholders of KNM.

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 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 Acquisition.

9. DIRECTORS' STATEMENT

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

10. ADVISER

KNM has appointed ZJ Advisory Sdn Bhd as the financial adviser for the Proposed Acquisition.

11. ESTIMATED TIME FRAME

Barring any unforeseen circumstances, the Proposed 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 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 27 November 2006.

Tables Section - This section is to be used to create and insert tables. Please make the appropriate reference to the table(s) in the contents of the Announcement:-

Table 1 – Shareholding structure of KPL

<i>Shareholder</i>	<i>No. of fully paid ordinary share in KPL held (“KPL Shares”)</i>
KNMPS	2,193,002
PHT	2,107,000
Total	4,300,002

Table 2 – Subsidiaries of KPL

<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>
W E Smith Engineering 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	<i>Issued capital</i> 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 <i>Paid-up capital</i> 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
HEA 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 KPL for the financial period from 28 November 2000 to 31 December 2001 and the four (4) financial years ended 31 December 2002 to 2005 and unaudited financial information for the nine months period ended 30 September 2006

	Financial period from 28 November to 31 December					Financial period from 1 January to 30 September 2006
	2001 AUD'000	2002 AUD'000	2003 AUD'000	2004 AUD'000	2005 AUD'000	2006 AUD'000
Revenue	15,332	65,805	72,907	71,285	86,925	71,563
Profit/(loss) before tax	(129)	4,664	2,555	1,767	(3,454)	5,509
Profit/(loss) after tax	(129)	4,664	2,555	1,767	(3,841)	5,456
Shareholders' funds	2,871	10,002	9,382	11,023	7,718	13,406
NTA	2,871	10,002	9,382	11,023	7,718	13,406
Total borrowings	1,572	1,685	700	1,069	920	2,440

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

	As at 31 December 2005 RM'000	After the Proposed KPL Acquisition RM '000
Share capital	74,806	74,806
Share premium	3,638	3,638
Revaluation reserve	6,735	6,735
Translation reserve	374	374
Retained profits	71,866	71,866
Shareholders' equity	157,419	157,419
<i>Less:</i>		
Intangibles	-	4,191
NTA	157,419	153,228
No. of ordinary shares of RM0.50 each	149,612	149,612
NTA per share (RM)	1.05	1.02

Notes:

1. Computation of goodwill arising from the Proposed Acquisition is as follows:-

	RM'000*
Cash Consideration	15,409
Less: 49% of the adjusted NTA of KPL as at 31 December 2005 (after including the AUD0.371 million paid by KNMPS as capital on 10 February 2006) of AUD3.964 million	(11,218)
Goodwill	<u>4,191</u>

* Based on the exchange rates of RM2.83:AUD1.00

