

## **General Announcement**

Reference No **MM-040521-80637**

Submitting Merchant Bank : **COMMERCE INTERNATIONAL MERCHANT BANKERS  
BERHAD**

Company Name : **KNM GROUP BERHAD**

Stock Name : **KNM**

Date Announced : **21/05/2004**

Type : **Announcement**

Subject : **KNM GROUP BERHAD (“KNM” OR “COMPANY”)**

Contents :

**- THE PROPOSED JOINT VENTURE ARRANGEMENT BETWEEN KNM INTERNATIONAL SDN BHD (“KNMI”), A WHOLLY-OWNED SUBSIDIARY OF KNM AND FBM-HUDSON ITALIANA SPA (“FBM”), WHICH INVOLVES THE FOLLOWING:**

**- THE PROPOSED ACQUISITION BY KNMI OF 50% OF THE ISSUED AND PAID-UP SHARE CAPITAL OF A COMPANY (“JVCO”) TO BE INCORPORATED IN JEBEL ALI FREE ZONE, DUBAI, UNITED ARAB EMIRATES (“JAFZ”) FROM FBM FOR A CASH CONSIDERATION OF EURO 10 MILLION OR EQUIVALENT TO RM45.6 MILLION (BASED ON EXCHANGE RATE OF RM4.56 PER EURO1.00) (“PROPOSED ACQUISITION”); AND**

**- THE PROPOSED SUBSCRIPTION OF EURO 2 MILLION OR EQUIVALENT TO RM9.12 MILLION (BASED ON EXCHANGE RATE OF RM4.56 PER EURO1.00) EACH BY KNMI AND FBM RESPECTIVELY NEW ORDINARY SHARES OF THE JVCO UPON COMPLETION OF THE PROPOSED ACQUISITION (“PROPOSED SUBSCRIPTION”)**

**(“COLLECTIVELY REFERRED TO AS THE “PROPOSED JOINT VENTURE”); AND**

**- THE PROPOSED COMMERCIAL COOPERATION BETWEEN KNMI AND FBM (“PROPOSED COMMERCIAL COOPERATION”)**

**(THE ABOVE ARE COLLECTIVELY REFERRED TO AS THE “PROPOSALS”)**

### **1. INTRODUCTION**

On behalf of KNM, CIMB is pleased to announce that KNMI, a wholly-owned subsidiary of KNM, has on 21 May 2004 entered into a conditional Share Sale and Shareholders Agreement (“SSSA”) and Commercial Cooperation Agreement (“CCA”) with FBM-Hudson Italiana SpA (“FBM”).

### **2. DETAILS OF THE PROPOSALS**

#### **2.1 The Proposed Joint Venture**

KNM proposes to enter into a joint venture arrangement with FBM, through the acquisition by KNMI of 50% of the entire issued and paid up share capital ("Sale Shares") of JVCO from FBM for a cash consideration of Euro 10 million (or equivalent to RM45.6 million). Upon the completion of the Proposed Acquisition, KNMI and FBM will each subscribe to Euro 2 million (or equivalent to RM9.12 million) respectively in new ordinary shares to be issued by JVCO. The equivalent RM value in this announcement has been determined based on an illustrative foreign exchange rate of RM4.56 per Euro1.00.

### **2.1.1 Introduction**

Pursuant to the SSSA, FBM will incorporate JVCO in JAFZ under the United Arab Emirates Free Zone Company law. Upon incorporation of the JVCO, JVCO will be a wholly owned subsidiary of FBM. FBM will then contribute its entire business and assets of its Jebel Ali, Dubai manufacturing facility ("FBM Jebel Ali Manufacturing Facility") to JVCO at its revalued net tangible asset value, in exchange for the issuance of JVCO shares to FBM.

Upon the contribution of FBM Jebel Ali Manufacturing Facility to JVCO and subject to all condition precedents set out in the SSSA being met, KNMI will acquire 50% of the issued and paid up share capital of JVCO from FBM for a cash consideration of Euro 10 million (or equivalent to RM45.6 million).

On completion of the acquisition of JVCO by KNMI, KNMI and FBM will further subscribe to Euro 2 million (or equivalent to RM9.12 million) each in new ordinary shares to be issued by JVCO. The proceeds of Euro 4 million (or equivalent to RM18.24 million) to be received by JVCO pursuant to the Proposed Subscription will be used for working capital requirements of JVCO as well as for the expansion of the operations of the FBM Jebel Ali Manufacturing Facility. The SSSA will also regulate the rights of KNMI and FBM as

shareholders of JVCO.

In consideration of KNMI's purchase of the Sale Shares from FBM pursuant to the SSSA, and subject to no income taxes being levied on JVCO and no mandatory reserves or setting aside of funds being required to be made by JVCO, FBM provides a guarantee to KNMI that KNMI will receive guaranteed dividends ("Guaranteed Dividend") over the guarantee period ("Guarantee Period") as follows:

<b>Anniversary year (cumulatively the Guarantee Period)</b>	<b>Amount of Guaranteed Dividend Euro 'million</b>
1st year from the Completion Date (as defined in Section 2.1.3 hereof)	1.80 (or equivalent to RM8.21 million)
2nd year from the Completion Date	2.00 (or equivalent to RM9.12 million)
3rd year from the Completion Date	2.25 (or equivalent to RM10.26 million)

With regard to the above, FBM will provide the following security for the Guaranteed Dividend:

(i) All shares held by FBM in the JVCO ("FBM JVCO Shares") shall be placed with a Trustee to be approved by both parties, to be dealt with by the Trustee in accordance with a mandate letter to be provided to the Trustee, together with all necessary documents required by the Trustee for the performance of his duties; and

(ii) A Bank Guarantee ("BG") of Euro 2 million (or equivalent to RM9.12 million) from a reputable bank in Dubai to be approved by KNMI. Dividends of JVCO will be paid pro-rata temporis by JVCO in accordance with the percentage shareholdings of FBM and KNMI. During the Guarantee Period, the dividends payable to FBM will first be paid to the Trustee, who will hold the dividend payments on behalf of FBM.

In the event that the actual dividends

received by KNM during the Guarantee Period is equal to or exceeds the Guaranteed Dividend for the applicable period, the Trustee shall pay to FBM the dividends received on behalf of FBM. However, in the event that the actual dividends received by KNM during the Guarantee Period is less than the Guaranteed Dividend for the applicable period, the Trustee shall pay KNM the shortfall from the cash dividends received by the Trustee on behalf of FBM and to pay the remaining balance, if any to FBM. Should this payment be insufficient to fully cover the shortfall, the Trustee shall demand that FBM pay to KNM the outstanding shortfall. In the event that FBM fails to pay the outstanding shortfall within a certain pre-agreed period, the Trustee shall encash the BG in accordance with the amount of the outstanding shortfall. Should the BG still be insufficient to cover in full the shortfall, the Trustee shall then cause to be transferred to KNM such number of FBM JVCO Shares to be calculated by the Trustee by dividing the net tangible assets per ordinary share of JVCO (based on the latest audited accounts of JVCO) with the balance shortfall amount.

#### **2.1.2 Basis of Arriving at Purchase Consideration and Payment Methodology**

The cash consideration of Euro 10 million (or equivalent to RM45.6 million) was arrived at on a willing buyer-willing seller basis after taking into account the following:

(i) The Guaranteed Dividends to be received by KNMI during the Guarantee Period;

(ii) The earnings potential of the JVCO; and

(iii) That the JVCO will have a net tangible asset value of at least Euro

10 million (or equivalent to RM45.6 million) (as at the date the SSSA becomes unconditional).

The purchase consideration will be paid to FBM on the Completion Date and will be funded by a combination of internally generated funds and borrowings. There are no liabilities to be assumed by KNMI pursuant to the Proposed Acquisition.

Similarly, the subscription price of Euro 2 million (or equivalent to RM9.12 million) under the Proposed Subscription from KNMI will be paid to JVCO on the Completion Date and will be funded by a combination of internally generated funds and borrowings. The subscription price of the Euro 2 million (or equivalent to RM9.12 million) under the Proposed Subscription from FBM will be made via part of the proceeds arising from the Proposed Acquisition which will be directly paid by KNMI to JVCO. As JVCO will be a newly incorporated company and its only asset upon the completion of the SSSA would be the FBM Jebel Ali Manufacturing Facility, which will have a minimal net tangible assets value of Euro 10 million (or equivalent to RM45.6 million), the total cost of investment by FBM in the JVCO will be at least Euro 10 million (or equivalent to RM45.6 million).

### **2.1.3 Other Salient Terms and Conditions of the SSSA**

The other salient terms of the SSSA are, amongst others, as follows:

(i) The JVCO shares will be acquired by KNMI free from all charges, liens, encumbrances and with full legal and beneficial title and with all rights attaching thereto (including all dividends and distributions declared in respect thereof) with effect from the Completion Date;

(ii) The SSSA is conditional upon, amongst others:

(a) The approval or non-objection of the Jebel Ali Free Zone Authority and other relevant United Arab Emirates Authorities to the sale by FBM to KNMI of the Sale Shares;

(b) The approval of the board of directors and shareholders of KNM and FBM for the Proposed Joint Venture;

(c) The approval of other relevant authorities, including Bank Negara Malaysia;

(d) KNMI being satisfied with the outcome of the financial and legal due diligence exercise to be carried out;

(e) KNMI being satisfied with the outcome of the valuation exercise to be carried out;

(f) The execution, perfection and delivery of the mandate letter to the Trustee together with all necessary documentation for the performance of the Trustee's duties, including a charge on the FBM JVCO Shares if necessary;

(g) The execution, perfection and delivery of the Bank Guarantee to the Trustee; and

(h) The JVCO having a net tangible asset value of at least Euro 10 million (or equivalent to RM45.6 million) as at the date the SSSA becomes unconditional;

(iii) The completion of the SSSA will take place on the day falling seven (7) days after the Unconditional Date or such other date as may be agreed upon between the parties ("Completion Date"). The Unconditional Date is the date where all the condition precedents of the SSSA have been fulfilled or waived;

(iv) If any of the approvals required under the condition precedents of the SSSA, are not obtained within three (3) months from the date of the SSSA or such later time as the parties may agree, the parties may terminate the SSSA;

(v) The shareholdings of KNMI and FBM in JVCO will at all times be maintained at 50% respectively, unless otherwise agreed by the parties;

(vi) On the Completion Date, the persons nominated by KNMI and FBM will be appointed as directors of JVCO;

(vii) The management of JVCO will be carried out by the board of directors of JVCO, which shall comprise of six (6) directors, whereby KNMI and FBM will be entitled to nominate three (3) directors each. The Chairman of the board of directors during the Guarantee Period will be appointed

from the directors appointed by FBM and after the Guarantee Period will be appointed from the directors appointed by KNMI or FBM on a rotation and annual basis; and

(viii) The SSSA shall be governed by, and construed in accordance with, the laws of United Arab Emirates.

## **2.2 The Proposed Commercial Cooperation**

As provided in the CCA, the Proposed Commercial Cooperation between KNMI and FBM will involve the following:

(i) KNMI and/or FBM will use their respective manufacturing facilities to manufacture or part manufacture air-cooled heat exchangers including air finned coolers (“Products”) for orders from the ASEAN countries and China (“Territory”); and

(ii) KNMI and FBM will jointly and exclusively market the Products in the Territory.

The commencement date of the CCA will be on the Completion Date (for the SSSA).

The CCA shall apply for an initial term of four (4) years (“Initial Term”). Upon the expiry of the Initial Term, the CCA will be automatically extended for a further term of four (4) years (“Further Term”) if KNMI meets the minimum performance target as set out in the CCA. After the Further Term, both parties have the option to either terminate the CCA or to continue for a further period to be mutually agreed or to enter into a licence agreement with FBM to licence certain technical information and intellectual property rights of FBM on terms acceptable to both parties.

To enable KNMI to efficiently perform its obligations under the CCA, FBM will provide the personnel of KNMI with the necessary technical training and assistance to enable them to have sufficient knowledge and expertise required to carry out their work hereunder.

The respective parties shall retain full ownership of their individual brand names and logos but will allow the other party rights to use their individual brand names, logos and intellectual property rights in accordance with the provision of the CCA.

## **2.3 Inter-Conditionality of the Proposals**

The Proposed Joint Venture and the Proposed Commercial Cooperation are inter-conditional to one another.

### **3. RATIONALE FOR THE PROPOSALS**

The Proposed Joint Venture is in line with KNM's expansion plans to the Middle East region by providing KNM and its subsidiaries ("KNM Group") with immediate presence and a manufacturing facility in the JAFZ. The importance of having a manufacturing facility in the Middle East is that the KNM Group will be able to expand its market and provide more competitive services to its customers in the region. The Proposed Joint Venture is expected to contribute positively to the KNM Group.

The partnership with FBM, which is one of the market leaders in aircooled heat exchangers for the oil and gas and petrochemical industries will increase KNM's international profile and enhance KNM's global presence. KNM is also expected to benefit from the manufacturing and technical expertise to be provided by FBM under the Proposed Commercial Cooperation.

The Proposed Commercial Cooperation will enable KNM to diversify its product range by enabling KNM to manufacture and/or part manufacture FBM's aircooled heat exchangers for orders from the Territory. As FBM will be providing KNM with technical training and assistance, KNM's engineering capabilities will be further enhanced with the knowledge transfer. KNM's marketing network in the Territory will provide it with the means to exploit the CCA in the joint marketing of the Products, for the mutual benefit of KNM and FBM.

### **4. INFORMATION ON KNM AND KNMI**

KNM was incorporated in Malaysia as a private limited company under the Companies Act, 1965 on 22 July 2000. It was subsequently converted into a public company on 12 September 2000 and assumed its present name. KNM was listed on the Second Board of Bursa Malaysia Securities Berhad on 11 August 2003.

KNM has an authorised share capital of RM50,000,000 comprising 50,000,000 ordinary shares of RM1.00 each of which RM44,000,000 comprising 44,000,000 ordinary shares of RM1.00 each have been issued and fully paid-up.

KNM is an investment holding company with its subsidiaries mainly involved in the design, manufacture, fabrication, assembly, commissioning and maintenance of process equipment, pressure vessels, heat exchangers, skid mounted assemblies, process pipe systems, storage tanks, specialised structural assemblies and module assemblies for the oil, gas

and petrochemical industries.

KNMI was incorporated on 10 May 2002 and commenced operations in 2003. KNMI has an authorised share capital of RM1,000,000 comprising 1,000,000 ordinary shares of RM1.00 each of which RM500,002 comprising 500,002 ordinary shares of RM1.00 each have been issued and fully paid-up. The principal activities of KNMI are provision of management, technical advisory, license and trademark services to international related companies and related international investments.

## **5. INFORMATION ON FBM AND FBM JEBEL ALI MANUFACTURING FACILITY**

### **5.1 Information on FBM**

FBM was founded in 1941 and incorporated in its current corporate organisation in Milano, Italy as a private joint-stock company on 27 October 1992. FBM has an authorised share capital of Euro 7,098,000 (or equivalent to RM32.37 million) comprising 13,650,000 ordinary shares of Euro 0.52 each of which Euro 7,098,000 (or equivalent to RM32.37 million) comprising 13,650,000 ordinary shares of Euro 0.52 each have been issued and fully paid-up.

FBM is principally involved in the sale, design and manufacture of air-cooled heat exchangers, shell and tube heat exchangers, process gas boilers and welded plate exchangers for the oil, gas and petrochemical industries.

### **5.2 Information on FBM Jebel Ali Manufacturing Facility**

FBM Jebel Ali Manufacturing Facility became a branch of FBM in year 1994. The manufacturing facility is located in the JAFZ on a land area of approximately 90,000 square metres with an existing built up area of approximately 8,500 square metres. The main products manufactured at the FBM Jebel Ali Manufacturing Facility are air-cooled heat exchangers, shell and tube exchangers, reactors, pressure vessels, condensers and desalination equipment, primarily for the oil and gas and petrochemical industries.

As FBM Jebel Ali Manufacturing Facility is a branch operation of FBM, it does not have separate sets of audited accounts. Nevertheless, based on the management branch accounts of the FBM Jebel Ali Manufacturing Facility, which is subject to the due diligence to be carried out by

KNM, the FBM Jebel Ali Manufacturing Facility recorded profit before tax of approximately Euro 3.00 million, Euro 1.69 million and Euro 2.41 million (or equivalent to RM13.68 million, RM7.71 million and RM10.99 million) respectively for the financial years ended 31 December 2001, 2002 and 2003 respectively. As it is located in the JAFZ, no corporate taxes are applicable.

As provided in the SSSA, the FBM Jebel Ali Manufacturing Facility will be injected into JVCO, and prior to the completion of the SSSA, JVCO will have a net tangible asset value of at least Euro 10 million (or equivalent to RM45.6 million).

## **6. EFFECTS OF THE PROPOSALS**

### **6.1 Issued and paid-up share capital and shareholdings of substantial shareholders**

As the Proposed Acquisition and Proposed Subscription involves the purchase of JVCO shares for cash consideration, they will not have any effect on the issued and paid-up share capital and shareholdings of the substantial shareholders of KNM.

The Proposed Commercial Corporation will also not have any effect on the issued and paid-up share capital and shareholdings of the substantial shareholders of KNM.

### **6.2 NTA and NTA per Share**

As the Proposed Acquisition and Proposed Subscription involve the purchase of JVCO shares for cash consideration, the above proposals are not expected to have any material effect of the NTA and NTA per share of the KNM Group.

The Proposed Commercial Cooperation will not have any material effect on the NTA and NTA per share of the KNM Group.

### **6.3 Earnings**

Barring unforeseen circumstances, the Proposals are expected to contribute positively to the earnings of the KNM Group for the financial year ended 31 December 2004 as well as for the future financial years.

## **7. INDUSTRY OUTLOOK AND RISKS**

### **7.1. Prospects**

#### **7.1.1 Prospects**

The growth of the manufacturing of process equipment for the oil, gas and petrochemical industries is dependent on the performance of its user industries which are namely producers and manufacturers of oil, gas and petrochemical products, intermediate users of oil, gas and petrochemical products for products manufactured for such industries and end-users of oil, gas and petrochemical products.

The growth driver for JVCO 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 crude oil and natural gas driven by improvement in the performances of global economies;
- (ii) Increase in exports of oil, gas and petrochemical products for the manufacturing sector; and
- (iii) Increase in export of manufactured products that use oil, gas and petrochemical products.

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

#### **7.1.2 Business Environment in JAFZ**

The JAFZ is located in the Emirate of Dubai in the United Arab Emirates. JAFZ combines warehousing and distribution and industrial hub that provides access to some 2 billion plus consumer markets in the region. JAFZ serves the Gulf Co-operation Council countries namely Saudi Arabia, Kuwait, Qatar, United Arab Emirates, Bahrain and Oman, the

markets of the Commonwealth of Independent States, Indian sub-continent and Africa.

Amongst the business benefits and incentives for a JAFZ company are no duties on all import and export goods and machinery within JAFZ, all capital and profits can be transferred out of the country without restriction, companies within JAFZ are 100% foreign owned, no corporate taxes for 50 years (with renewable concession), no personal income tax and no currency restrictions.

## **7.2 Risk Factors**

### **(i) Competition**

JVCO may face competition from local and overseas manufacturers, especially internationally recognised manufacturers of process equipments and air-cooled heat exchangers, with no assurance that JVCO is able to maintain its existing market share in the future.

Notwithstanding the above, KNM expects that the parties to the joint venture arrangement will strive to ensure that the JVCO will remain competitive to maintain and/or to expand its market share in the industry.

### **(ii) Global Oil Price Fluctuations**

Crude oil and gas is a commodity subject to international long-term and spot prices. Some of the factors that may cause global oil prices to fluctuate include wars and the threat of wars, interruption from major oil producing countries, price and production pressures from cartels such as the Organisation of Petroleum Exporting Countries ("OPEC") and significant drop in demand. Thus, an extended period of poor oil and gas prices may discourage exploration. At the same time, an extended high oil and gas prices may reduce the demand for

oil, gas and petrochemical products. In such cases, the demand for the JVCO'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 JVCO 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 JVCO requires a high level of professionally qualified and skilled labour such as welders and machine operators. In this respect, there is a risk that JVCO may face the potential threat of shortages in labour, which is deemed unlikely at present. KNM expects that the parties to the joint venture arrangement will ensure that JVCO will provide competitive remuneration packages, training and promotional opportunities to retain suitable employees within the company.

**(v) Impact of Fluctuations in Foreign Exchange Rates**

The business of JVCO is subject to fluctuations in foreign exchange rates. However, as both its revenue and costs are commonly denominated in the same currency, a natural hedge exists to protect the JVCO against unfavourable fluctuations in foreign exchange rates. It is also the intention of FBM and KNMI to hedge their foreign currency exposure.

As the Dividend Guarantee is denominated in Euro, the actual amount received by KNMI is subject to fluctuations in foreign exchange rates. KNMI may hedge its position to minimise the impact of foreign currency fluctuations.

**(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.

**(vii) Political, economic and regulatory factors**

JVCO's business, prospects, financial condition and results of operations may be adversely affected by the political, economic and social developments in Dubai as well as in the surrounding regions. Other political and economic uncertainties include, but are not limited to, the risks of war, terrorism, riots, expropriation, nationalism, changes in interest rates and changes in the benefits granted by JAFZ. Nonetheless, the Government of Dubai has made special efforts to make JAFZ one of the most successful free zones of the world.

**8. APPROVALS REQUIRED**

The Proposals are subject to and conditional upon the following approvals:

- (i) Approval or non-objection of the JAFZ Authority and any other relevant authority in the United Arab Emirates for the Proposed Acquisition;
- (ii) Approval of the shareholders of FBM at a general meeting to be convened at a later date for the Proposed Joint Venture;
- (iii) Approval of the shareholders of KNM at a general meeting to be convened at a later date for the Proposed Joint Venture;
- (iv) Approval of Bank Negara Malaysia for the Proposed Joint Venture;
- (v) Approval of the Board of Directors of JVCO at a board meeting to be held at a later date for the Proposed Joint Venture; and
- (vi) Approvals of any other relevant authorities, where applicable.

#### **9. DIRECTORS' AND SUBSTANTIAL SHAREHOLDERS' INTERESTS**

To the best of the Company's knowledge, none of the Company's directors, major shareholders and persons connected with them have any interest, whether direct or indirect, in the Proposals.

#### **10. STATEMENT BY THE DIRECTORS**

The Board of Directors of KNM, having considered all aspects of the Proposals, is of the opinion that the Proposals are in the best interest of KNM.

#### **11. EXPECTED DATE OF COMPLETION**

Barring any unforeseen circumstances, the Proposed Joint Venture is expected to be completed by the third quarter of 2004, whilst the Proposed Commercial Cooperation will take effect upon the completion of the Proposed Joint Venture.

#### **12. DEPARTURES FROM THE SECURITIES COMMISSION'S POLICIES AND GUIDELINES ON ISSUE/OFFER OF SECURITIES**

To the best of the Company's knowledge, the Proposals have not departed from the SC's Policies and Guidelines on Issue/Offer of Securities.

#### **13. DOCUMENTS FOR INSPECTION**

The SSSA and the CCA are available for inspection at the registered office of the Company at No. 15, Jalan Dagang SB 4/1, Taman Sungai Besi Indah, 43300 Seri Kembangan,

Selangor Darul Ehsan, Malaysia during the normal business hours from Monday to Friday (except public holidays) for a period of three (3) months from the date of this announcement.

This announcement is dated 21 May 2004.