

10. REPORTING ACCOUNTANTS' REPORT

(Prepared for inclusion in this Prospectus)



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The Board of Directors
Kawan Food Berhad
Lot 20, Jalan Pengapit 15/19
40200 Shah Alam
Selangor Darul Ehsan

21 JUN 2005

Dear Sirs

**Kawan Food Berhad ("KFB" or "Company")
Accountants' Report**

This report has been prepared by Messrs. KPMG, an approved company auditor, for inclusion in the Prospectus to be dated 30 June 2005 in connection with:

- (i) public issue of 10,320,000 new ordinary shares of RM0.50 each in KFB ("KFB Shares") at an issue price of RM1.00 per KFB Share ("Public Issue");
- (ii) offer for sale of 10,400,000 existing KFB Shares at an offer price of RM1.00 per KFB Share;
- (iii) listing of and quotation for the entire issued and paid-up capital of KFB on the Second Board of Bursa Malaysia Securities Berhad ("Bursa Securities"); and
- (iv) offer of options under the Employees' Share Option Scheme of KFB to non-executive Directors.

1 General information

1.1 Background

KFB was incorporated in Malaysia as a public limited company on 21 January 2004 under the Companies Act, 1965 under the name of "Ganz & Gainz Berhad". It assumed its present name of "Kawan Food Berhad" on 12 March 2004.

The principal activity of KFB is that of an investment holding company.

1.2 Share capital

As at the date of incorporation, KFB's authorised share capital was RM100 consisting of 100 ordinary shares of RM1.00 each and its issued and paid-up share capital was RM2 consisting of 2 ordinary shares of RM1.00 each. The present authorised share capital of KFB is RM100,000,000 consisting of 200,000,000 ordinary shares of RM0.50 each.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

Kawan Food Berhad
Accountants' Report

Pursuant to the restructuring scheme including the listing of and quotation for the entire issued and paid-up capital of KFB on the Second Board of Bursa Securities ("Listing") as set out in Section 1.3 below, the issued and paid-up share capital of KFB was increased to as follows:

Date of allotment	Number of ordinary shares	Par value RM	Purpose	Cumulative issued and paid-up share capital RM
26.01.2004	2	1.00	Subscriber shares for cash	2
30.05.2005	4	0.50	Share split	2
01.06.2005	49,680,347	0.50	Issued pursuant to the acquisition of Kawan Food Manufacturing Sdn Bhd ("KFM")	24,840,176
01.06.2005	19,999,649	0.50	Issued pursuant to the acquisition of KG Pastry Marketing Sdn Bhd (formerly known as Oriental Status Sdn Bhd) ("KGPM")	34,840,000

Upon completion of the Public Issue, the enlarged issued and paid-up share capital of KFB will be RM40,000,000 comprising 80,000,000 ordinary shares of RM0.50 each.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

1.3 Restructuring scheme

As an integral part of and in conjunction with the Listing, KFB has undertaken the following restructuring scheme as approved by the Securities Commission and Ministry of International Trade and Industry ("MITI"). The restructuring scheme involved the following:

1.3.1 Share Split

The share split of 1 ordinary share of RM1.00 each in KFB into 2 ordinary shares of RM0.50 each in KFB ("Share Split").

Prior to the completion of the Share Split, the issued and paid-up share capital of KFB was RM2.00 comprising 2 ordinary shares of RM1.00 each. Following the completion of the Share Split, the issued and paid-up share capital of KFB was RM2.00 comprising 4 ordinary shares of RM0.50 each in KFB.

1.3.2 Acquisitions

i) Acquisitions by KFM of the following:

- a) All that piece of land held under H.S.(D) 98527, Tapak Perusahaan Shah Alam, Daerah Petaling, bearing a postal address Lot 20, Jalan Pengapit 15/19, 40200 Shah Alam, Selangor Darul Ehsan together with the building erected on the land from K.G. Pastry Manufacturing Sdn Bhd ("KG") for a cash consideration of RM6,900,000 ("Acquisition of Lot 20"); and
- b) Certain machineries and equipment from KG for a cash consideration of RM3,879,060 ("Acquisition of Machineries").

(collectively referred to as "KFM Acquisitions")

The purchase consideration for the above acquisitions were arrived at on a willing buyer-willing seller basis after taking into consideration the net book value of the assets as at 31 December 2003.

The Acquisition of Machineries and Acquisition of Lot 20 were completed in April 2005 and May 2005 respectively.

- ii) Acquisition by KGPM of certain assets and business undertakings of KG (comprising all that piece of land held under H.S.(D) 207237 PTD No. 59709, Mukim of Tebrau, Negeri Johor bearing postal address 52, Jalan Mutiara Emas 5/12, Taman Mount Austin, 81100 Johor Bahru together with the buildings erected on the land, trademarks, plant, machinery, book debts and other undertakings of KG) for a purchase consideration of RM11,000,000 satisfied by the issuance of 10,000,000 new ordinary shares of RM1.00 each in KGPM, at an issue price of RM1.00 per ordinary share and a cash consideration of RM1,000,000 ("Acquisition of Net Assets").

The new shares of KGPM were issued and distributed to KG's shareholders as dividend-in-specie by KG.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

Kawan Food Berhad
Accountants' Report

The purchase consideration was arrived at on a willing buyer-willing seller basis after taking into consideration the net book value of the above net assets as at 31 December 2003.

The Acquisition of Net Assets was completed in May 2005 save for the transfer of Johor land to KGPM, which is pending the consent of the state authority for the same.

iii) Acquisitions by KFB of the following:

- a) The entire issued and paid-up share capital of KFM comprising 1,000,000 ordinary shares of RM1.00 each, for a purchase consideration of RM24,840,609 satisfied wholly by the issuance of 49,680,347 new KFB Shares of RM0.50 each at an issue price of approximately RM0.50 per KFB Share ("Acquisition of KFM").

KFM has, prior to the completion of the Acquisition of KFM, declared and paid a total dividend of RM8 million to KFM's then existing shareholders such that the net tangible assets ("NTA") of KFM on the completion date was no less than RM24,840,609, being the purchase consideration of the Acquisition of KFM.

The total purchase consideration of RM24,840,609 was arrived at on a willing buyer-willing seller basis after taking into consideration the audited NTA of KFM as at 31 December 2003 and the KFM Acquisitions in (i) above.

	RM	RM
Audited NTA of KFM as at 31 December 2003		24,840,609
Add: KFM Acquisitions		11,630,866
Less: Settlement of part of the purchase consideration for the KFM Acquisitions against the amount due from KG	(10,024,512)	
Settlement of the remaining purchase consideration for the KFM Acquisitions by cash	<u>(1,606,354)</u>	
		<u>(11,630,866)</u>
		<u>24,840,609</u>

- b) The entire issued and paid-up share capital of KGPM comprising 10,000,002 ordinary shares of RM1.00 each, for a total purchase consideration of RM10,000,002 satisfied by the issuance of 19,999,649 new KFB Shares at an issue price of approximately RM0.50 per KFB Share and cash consideration of RM2.00 ("Acquisition of KGPM").

The 10,000,000 ordinary shares of RM1.00 each in KGPM were issued pursuant to the Acquisition of Net Assets in (ii) above, and distributed as dividend-in-specie by KG to its shareholders, which in turn were acquired by KFB, pursuant to the Acquisition of KGPM.

The purchase consideration of RM10,000,002 was arrived at based on a willing buyer-willing seller basis after taking into consideration the NTA of KGPM upon completion of the Acquisition of Net Assets.

(collectively referred to as "KFB Acquisitions")

The Acquisition of Net Assets and KFB Acquisitions were completed in May 2005.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

1.3.3 Public Issue

Public issue of 10,320,000 new KFB Shares at an issue price of RM1.00 per KFB Share.

1.3.4 Offer for Sale

Offer for sale of 10,400,000 KFB Shares at an offer price of RM1.00 per KFB Share.

1.3.5 Listing and Quotation

Listing of its entire enlarged issued and paid-up share capital of RM40,000,000 comprising 80,000,000 KFB Shares on the Second Board of Bursa Securities.

1.3.6 Employees' Share Option Scheme

Establishment of an Employees' Share Option Scheme ("ESOS") of up to 15% of the issued and paid-up ordinary share capital of KFB for the benefit of the Directors and eligible employees of the KFB Group.

1.4 Information on subsidiaries

The KFB Group comprises KFB and the following subsidiaries, all of which are incorporated in Malaysia as private limited companies under the Companies Act, 1965, except for KFB which is incorporated as a public limited company. The details of KFB's subsidiaries are as follows:

	Date of incorporation	Share Capital		Effective interest %	Principal activities
		Authorised RM	Issued and paid-up RM		
Subsidiaries					
KFM	28 August 1984	5,000,000	1,000,000	100	Manufacturing, trading, distributing and exporting of pastries and other food products.
KGPM	22 May 2004	25,000,000	10,000,002	100	Trading, distributing and exporting of pastries and other food products.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

1.5 Financial statements and auditors

The financial year end of KFB is 31 December.

The financial statements of all companies within the KFB Group were audited for the relevant financial periods/years under review.

KPMG have been the auditors of the following companies:-

- (i) KFM with effect from the financial year ended 31 December 2003;
- (ii) KG (for which certain assets and liabilities were acquired by KFM and KGPM in April 2005 and May 2005 respectively) with effect from the financial year ended 31 December 2003; and
- (iii) KFB and KGPM with effect from the financial period ended 31 December 2004.

Prior to the financial year ended 31 December 2003, the financial statements of KFM and KG were audited by another firm of chartered accountants.

The auditors' reports of the companies within the KFB Group for the relevant financial years/periods under review were not subject to any qualification and did not include any comment made under subsection 3 of Section 174 of the Companies Act, 1965.

1.6 Dividends

Except as detailed below the KFB Group has not paid or declared dividends of the financial year under review:-

<i>Financial year ended</i>	<i>Ordinary shares of RM1.00 each</i>	<i>Type of dividend</i>	<i>Gross dividend rate %</i>	<i>Tax rate %</i>	<i>Net dividend RM</i>
KFM					
31 December 1999	550,000	Final	73%	-	401,500
31 December 2000	1,000,000	Final	54.4%	-	543,600
31 December 2001	1,000,000	Final	60%	-	600,000
31 December 2002	1,000,000	Final	60%	-	600,000
31 December 2004	1,000,000	Interim	150%	-	1,500,000
31 December 2005	1,000,000	Interim	408%	-	4,082,772
			544%	28%	3,917,228
					<u>8,000,000</u>

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

2 Summarised income statements**2.1 Summarised proforma consolidated income statements**

We set out below the summarised proforma consolidated income statements of KFB Group for the past five (5) financial years ended 31 December. The proforma consolidated income statements, provided for illustrative purposes only, are prepared based on the audited financial statements of KFB, KFM and KG (in view that KGPM has acquired KG's business undertakings pursuant to the Acquisition of Net Assets as detailed in Section 1.3) after taking into consideration the adjustments that we considered necessary and on the assumption that the KFB Group under restructuring scheme as detailed in Section 1.3 had been in existence throughout the years under review. The following results are to be read in conjunction with the notes below:

	< ----- Year ended 31 December ----- >				
	2000	2001	2002	2003	2004
	RM'000	RM'000	RM'000	RM'000	RM'000
Revenue	30,333	31,760	35,811	38,595	45,642
Profit before depreciation and interest	10,028	10,728	13,259	13,841	14,934
Depreciation	(953)	(1,618)	(1,794)	(2,268)	(2,575)
Amortisation of goodwill and property rights	(12)	(16)	-	-	-
Interest expenses	(245)	(394)	(372)	(204)	(111)
Interest income	18	49	62	103	229
Profit before taxation	8,836	8,749	11,155	11,472	12,477
Tax expense	(2,222)^	(1,988)^	(2,417)^	(2,316)	(3,228)
Profit after taxation	6,614^	6,761^	8,738^	9,156	9,249
Number of ordinary shares of RM0.50 each assumed in issue ('000)*	69,680	69,680	69,680	69,680	69,680
Earnings per share (RM)					
- Gross	0.13	0.13	0.16	0.16	0.18
- Net	0.09	0.10	0.13	0.13	0.13

* The number of ordinary shares assumed in issue throughout the financial years under review represents the number of shares in issue after the KFB Acquisitions i.e. 69,680,000 ordinary shares of RM0.50 each.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

^ The following adjustments have been made to allocate the under/over provision of income tax expense and deferred tax expense back to the respective years:

	<i>As previously stated RM'000</i>	<i>Adjustments RM'000</i>	<i>As restated RM'000</i>
2000			
Tax expense	(1,630)	(592)	(2,222)
Profit after taxation	7,206	(592)	6,614
	=====	=====	=====
2001			
Tax expense	(2,691)	703	(1,988)
Profit after taxation	6,058	703	6,761
	=====	=====	=====
2002			
Tax expense	(2,592)	175	(2,417)
Profit after taxation	8,563	175	8,738
	=====	=====	=====

Notes:

- (a) The basic gross and net earnings per ordinary share of the Proforma Group for the respective financial years under review is calculated based on the proforma consolidated profit before taxation and consolidated profit after taxation respectively for the years over the enlarged issued and paid-up share capital of 69,680,000 ordinary shares of RM0.50 each.
- (b) There were no extraordinary or exceptional items during the financial years under review.
- (c) There were no changes in accounting policies or accounting estimates for the financial years under review.
- (d) The overall effective tax rate throughout the years under review is lower than the statutory tax rate mainly due to the availability of reinvestment allowance.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

2.2 KFB

The summarised income statement of KFB based on the audited financial statements for the financial period ended 31 December 2004 is as follows:

	Period from 21.1.2004 to 31.12.2004 RM'000
Revenue	-
Other expenses	(12)
Net loss for the financial period	<u>(12)</u>
Number of ordinary shares of RM1.00 each in issue ('000)	*
Net loss per share (RM)	#

* *Based on the paid-up share capital of RM2.00 comprising 2 ordinary shares of RM1.00 each in KFB as at 31 December 2004.*

The Company has not commenced operations as at 31 December 2004. Accordingly, the net loss per share is not computed.

Notes:

- (a) KFB was incorporated on 21 January 2004, the financial statements were drawn up for the period from 21 January 2004 to 31 December 2004.
- (b) There were no extraordinary or exceptional items during the financial period under review.
- (c) There were no changes in accounting policies or accounting estimates for the financial period under review.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

Kawan Food Berhad
Accountants' Report

2.3 KFM

The summarised income statements of KFM based on the audited financial statements for the five (5) financial years ended 31 December are as follows:

	<-----Year ended 31 December----->				
	2000 RM'000	2001 RM'000	2002 RM'000	2003 RM'000	2004 RM'000
Revenue	10,918	13,881	15,338	20,365	23,635
Profit before depreciation and interest	6,085	6,569	7,540	9,826	10,567
Depreciation	(178)	(371)	(462)	(826)	(891)
Interest expenses	-	(1)	(138)	(33)	(28)
Interest income	11	38	37	72	133
Profit before taxation	5,918	6,235	6,977	9,039	9,781
Tax expense	(1,504)	(1,623)	(1,916)	(1,950)	(2,746)
Profit after taxation	4,414	4,612	5,061	7,089	7,035
Number of ordinary shares of RM1.00 each in issue ('000)	1,000	1,000	1,000	1,000	1,000
Earnings per share (RM)					
- Gross	5.92	6.24	6.98	9.04	9.78
- Net	4.41	4.61	5.06	7.09	7.04

Notes:

- (a) The basic gross and net earnings per ordinary share of KFM for the respective financial years under review is calculated based on the profit before taxation and profit after taxation respectively for the years over the paid-up share capital of 1,000,000 ordinary shares of RM1.00 each.
- (b) There were no extraordinary or exceptional items during the financial years under review.
- (c) There were no changes in accounting policies or accounting estimates for the financial years under review.
- (d) The overall effective tax rate throughout the years under review is lower than the statutory tax rate mainly due to the availability of reinvestment allowance.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

2.4 KGPM

The summarised income statement of KGPM based on the audited financial statements for the financial period ended 31 December 2004 is as follows:

	Period from 22.5.2004 to 31.12.2004 RM'000
Revenue	-
Other expenses	(11)
Net loss for the financial period	<u>(11)</u>
Number of ordinary shares of RM1.00 each in issue ('000)	*
Net loss per share (RM)	#

* *Based on the paid-up share capital of RM2.00 comprising 2 ordinary shares of RM1.00 each in KGPM as at 31 December 2004.*

The Company has not commenced operations as at 31 December 2004. Accordingly, the net loss per share is not computed.

Notes:

- (a) KGPM was incorporated on 22 May 2004, the financial statements were drawn up for the period from 22 May 2004 to 31 December 2004.
- (b) There were no extraordinary or exceptional items during the financial period under review.
- (c) There were no changes in accounting policies or accounting estimates for the financial period under review.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

3 Balance sheets**3.1 Proforma consolidated balance sheets**

As the purchase consideration for the acquisition of subsidiaries is based on the audited NTA of the subsidiaries as at 31 December 2003, it is therefore impracticable to present the proforma consolidated balance sheets of KFB Group throughout the years under review. Accordingly, proforma consolidated balance sheet of KFB Group has been presented in respect of 31 December 2004 as shown in Section 4 of this Report.

3.2 KFB

The summarised balance sheet of KFB based on the audited financial statements for the financial period ended 31 December 2004 is as follows:

	As at 31.12.2004 RM'000
Current assets	
Other receivables	463
Cash and cash equivalents	*
	<u>463</u>
Current liabilities	
Other payables and accruals	(475)
	<u>(475)</u>
Net current liabilities	(12)
	<u>(12)</u>
Represented by:	
Capital and reserves	
Share capital	**
Accumulated loss	(12)
Deficit in shareholders' funds	<u>(12)</u>
 NTA per share (RM)	 #

* RM2.00

** Based on the paid-up share capital of RM2.00 comprising 2 ordinary shares of RM1.00 each in KFB as at 31 December 2004.

The Company has not commenced operations as at 31 December 2004. Accordingly, the NTA per share is not computed.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

Kawan Food Berhad
Accountants' Report

3.3 KFM

The summarised balance sheets of KFM based on the audited financial statements for the five (5) financial years ended 31 December after making adjustments that considered necessary, are as follows:

	←----- As at 31 December ----->				
	2000	2001	2002	2003	2004
	RM'000	RM'000	RM'000	RM'000	RM'000
Property, plant and equipment	4,518	5,306	5,617	9,020	8,986
Current assets					
Inventories	1,255	986	1,975	2,615	922
Trade receivables	5,269	8,450 [^]	9,314	10,422	15,721
Other receivables, deposits and prepayments	1,602	1,938	3,796	1,743	2,750
Cash and cash equivalents	1,784	2,226	2,622	4,120	9,778
	9,910	13,600	17,707	18,900	29,171
Current liabilities					
Trade payables	976	863 [^]	1,066	1,010	828
Other payables and accruals	2,097	251 [^]	517	390	233
Borrowings (secured)	-	435	508	861	4,939
Amount due to Director	61	-	-	-	-
Taxation	1,252	1,897	1,686	118	850
	4,386	3,446	3,777	2,379	6,850
Net current assets	5,524	10,154	13,930	16,521	22,321
	10,042	15,460	19,547	25,541	31,307
Financed by:					
Capital and reserves					
Share capital	1,000	1,000	1,000	1,000	1,000
Retained profits	8,277 [#]	12,289	16,751	23,841	29,375
Proposed dividends	544 [*]	600	600	-	-
Shareholders' funds	9,821 [#]	13,889	18,351	24,841	30,375
Long term and deferred liabilities					
Borrowings (secured)	-	1,255	811	-	-
Deferred tax liabilities	221 [#]	316	385	700	932
	10,042	15,460	19,547	25,541	31,307

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

----- As at 31 December ----->

	2000	2001	2002	2003	2004
Number of shares in issue ('000)	1,000	1,000	1,000	1,000	1,000
NTA per share (RM)	9.8	13.9	18.4	24.8	30.4

* *Proposed dividends have been restated from current liabilities to shareholders' funds to conform to the presentation for the rest of the years under review.*

^ *Reclassification of comparative figures was made in financial year ended 31 December 2002 to reclassify advance payments of approximately RM164,000 from trade receivables to trade and other payables as follows:*

	<i>As previously stated</i>	<i>As restated</i>
<u>2001</u>	<i>RM'000</i>	<i>RM'000</i>
Trade receivables	8,286	8,450
Trade payables	847	863
Other payables	103	251
	=====	=====

The following adjustments have been made to allocate the under/over provision of deferred tax expense back to the respective years:

	<i>As previously stated</i>	<i>Adjustments</i>	<i>As restated</i>
<u>2000</u>	<i>RM'000</i>	<i>RM'000</i>	<i>RM'000</i>
Retained profits	8,498	(221)	8,277
Shareholders' fund	10,042	(221)	9,821
Deferred tax liabilities	-	221	221
	=====	=====	=====

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

3.4 KGPM

The summarised balance sheet of KGPM based on the audited financial statements for the financial period ended 31 December 2004 is as follows:

	As at 31.12.2004 RM'000
Current assets	
Other receivables	1
Cash and cash equivalents	*
	<u>1</u>
Current liabilities	
Other payables and accruals	(12)
	<u>(12)</u>
Net current liabilities	<u>(11)</u>
	<u>(11)</u>
Represented by:	
Capital and reserves	
Share capital	**
Accumulated loss	(11)
Deficit in shareholders' funds	<u>(11)</u>
	<u>(11)</u>
NTA per share (RM)	#

* RM2.00

** Based on the paid-up share capital of RM2.00 comprising 2 ordinary shares of RM1.00 each in KGPM as at 31 December 2004.

The Company has not commenced operations as at 31 December 2004. Accordingly, the NTA per share is not computed.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

4 Proforma statement of assets and liabilities

The following proforma statement of assets and liabilities of KFB Group is prepared for illustrative purposes only based on the audited financial statement of KFB and its subsidiaries as at 31 December 2004. The proforma statement of assets and liabilities of the KFB Group have been prepared using accounting principles and bases consistent with those normally adopted in the preparation of the audited financial statements except that adjustments have not been made to account for the fair value of the assets and liabilities of KFM and KGPM upon acquisition by KFB. The proforma statement of assets and liabilities of the KFB Group has been prepared on the assumption that the restructuring scheme, before the Public Issue and utilisation of listing proceeds, was completed on 31 December 2004. The proforma statement of assets and liabilities should be read in conjunction with the notes thereon.

	<i>Note</i>	Company RM'000	Proforma Group RM'000
Property, plant and equipment	4.2	-	24,222
Current assets			
Inventories	4.3	-	2,681
Trade and other receivables	4.4	463	9,410
Cash and cash equivalents	4.5	*	7,121
		463	19,212
Current liabilities			
Trade and other payables	4.6	475	1,895
Borrowings (secured)	4.7	-	4,939
Taxation		-	850
		475	7,684
Net current (liabilities) / assets		(12)	11,528
		(12)	35,750
(Represented by) / Financed by:			
Capital and reserves			
Share capital	4.8	*	34,840
Accumulated losses		(12)	(22)
(Deficit) / Surplus in shareholders' funds		(12)	34,818
Long term and deferred liabilities			
Deferred tax liabilities	4.9	-	932
		(12)	35,750
Number of shares in issue ('000)		*	69,680
NTA per share (RM)		-	0.50

* Based on the paid-up share capital of RM2.00 comprises 2 ordinary shares of RM1.00 each in KFB as at 31 December 2004.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

4.1 Notes to the proforma statement of assets and liabilities**4.1.1 Basis of accounting**

The proforma statement of assets and liabilities of the KFB Group is prepared on the historical cost basis except as disclosed in the notes to the financial statements and in compliance with the provisions of the Companies Act, 1965 and applicable approved accounting standards in Malaysia.

The KFB Group's proforma statement of assets and liabilities is prepared on the basis that the KFB Group is in existence as at 31 December 2004.

4.1.2 Basis of consolidation

The KFB Group's proforma statement of assets and liabilities has been prepared based on the audited financial statements of KFB and its subsidiaries as at 31 December 2004. All material related company transactions and balances have been eliminated on consolidation. The acquisition of its subsidiaries is accounted for under the acquisition method of accounting.

Subsidiaries are those enterprises controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases. Subsidiaries are consolidated using the acquisition method of accounting.

A subsidiary is excluded from consolidation when either control is intended to be temporary if the subsidiary is acquired and held exclusively with a view of its subsequent disposal in the near future and it has not previously been consolidated or it operates under severe long term restrictions which significantly impair its ability to transfer funds to the Company. Subsidiaries excluded on these grounds are accounted for as investments.

Under the acquisition method of accounting, the results of subsidiaries acquired or disposed of during the year are included from the date of acquisition or up to the date of disposal. At the date of acquisition, the fair values of the subsidiaries' net assets are determined and these values are reflected in the Group financial statements. The difference between the acquisition cost and the fair values of the subsidiaries' net assets is reflected as goodwill or negative goodwill as appropriate.

Intra group transactions and balances and the resulting unrealised profits are eliminated on consolidation. Unrealised losses resulting from intra group transactions are also eliminated unless cost cannot be recovered.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

Kawan Food Berhad
Accountants' Report

4.1.3 Property, plant and equipment

Freehold land is stated at cost less accumulated impairment losses. All other property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses.

Depreciation

Freehold land is not amortised. Long-term leasehold land is amortised in equal instalments over the remaining lease period which range from 75 to 95 years. All other property, plant and equipment are depreciated on a straight-line basis to write off the cost of the property, plant and equipment over the term of their estimated useful lives.

The principal annual rates of depreciation used are as follows:

Buildings	2%
Renovation	10%
Furniture, fittings and office equipment	10%
Plant and machinery	10%
Motor vehicles	20%

4.1.4 Impairment

The carrying amounts of assets, other than inventories, deferred tax assets and financial assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or the cash-generating unit to which it belongs exceeds its recoverable amount. Impairment losses are recognised in the income statement.

The recoverable amount is the greater of the asset's net selling price and its value in use. In assessing value in use, estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. The reversal is recognised in the income statement.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

4.1.5 Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in first-out basis, and comprises the purchase price and incidentals incurred in bringing the inventories to their present location and condition. Cost of finished goods includes cost of materials, labour and an appropriate proportion of production overheads.

4.1.6 Trade and other receivables

Trade and other receivables are stated at cost less allowance for doubtful debts. Bad debts are written off in the financial year in which they are identified.

4.1.7 Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances and deposits with banks.

4.1.8 Liabilities

Borrowings and trade and other payables are stated at cost.

4.1.9 Income tax

Tax on the profit or loss for the financial year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax expense is the expected tax payable on the taxable income for the financial year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous financial years.

Deferred tax is provided, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Temporary differences are not recognised for the initial recognition of assets or liabilities that at the time of the transaction affects neither accounting nor taxable profit. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

4.2 Property, plant and equipment

Proforma Group	Cost RM'000	Accumulated depreciation RM'000	Net book value RM'000
Freehold land	78	-	78
Long-term leasehold land	3,181	215	2,966
Buildings	7,564	653	6,911
Renovation	203	171	32
Furniture, fittings and office equipment	1,821	687	1,134
Plant and machinery	19,363	7,302	12,061
Motor vehicles	2,647	1,607	1,040
	<u>34,857</u>	<u>10,635</u>	<u>24,222</u>

The title deed to the freehold land and the strata titles of the apartments are in the process of being transferred to the name of its subsidiaries.

The subsidiaries of the Company are in the process of securing the discharge on the leasehold land and buildings and certain plant and machinery as the term loans were fully repaid in 2004.

4.3 Inventories

<i>At cost</i>	Proforma Group RM'000
Raw materials	80
Packaging materials	524
Finished goods	2,077
	<u>2,681</u>

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

4.4 Trade and other receivables

	Company	Proforma
	RM'000	Group
		RM'000
Trade receivables	-	8,418
Less: Allowance for doubtful debts	-	(388)
	-	8,030
Other receivables, deposits and prepayments	463	1,380
	463	9,410

Included in other receivables, deposits and prepayments of the Company is an amount of RM463,258 pertains to listing expenses which will be set off against share premium account upon completion of the listing exercise.

Included in trade receivables is an amount of RM55,399 due from a company in which certain Directors have interests and an amount of RM257,814 due from a Director related company.

Included in other receivables, deposits and prepayments of the Group is deposit for the purchase of plant and machinery amounting to RM654,230.

4.5 Cash and cash equivalents

	Proforma
	Group
	RM'000
Deposits placed with licensed banks	3,517
Cash and bank balances	3,604
	7,121

4.6 Trade and other payables

	Company	Proforma
	RM'000	Group
		RM'000
Trade payables	-	828
Other payables and accruals	475	1,067
	475	1,895

Included in other payables and accruals of the Group is advance payment by a customer amounting to RM13,167.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

4.7 Borrowings (secured)

	Proforma Group RM'000
Current:	
Revolving credit	4,939

The revolving credit facility is subject to interest at 4.6% per annum and is secured by:

- (i) negative pledge by a subsidiary; and
- (ii) personal guarantee executed by one of the Directors of a subsidiary.

4.8 Share capital

	Proforma Group / Company RM'000
Ordinary shares of RM0.50 each	
Authorised	100,000
Issued and fully paid	34,840

4.9 Deferred tax liabilities

The recognised deferred tax liabilities are as follows:

	Proforma Group RM'000
Property, plant and equipment	
– capital allowances in excess of depreciation	932

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

4.10 Financial instruments**Financial risk management objectives and policies**

The Proforma Group's financial risk management policy seeks to ensure that adequate financial resources are available for the development of the Proforma Group's business whilst managing its currency, interest rate, credit, liquidity and cash flow risk. The Proforma Group operates within the procedures and policies in respect of the major areas of treasury activity as follows:

Currency risk

The Proforma Group is exposed to foreign exchange risk on sales that are denominated in foreign currencies. It manages its foreign exchange exposure by a policy of matching as far as possible receipts and payments in each individual currency.

Due to the present Ringgit Malaysia exchange rate pegged against the US Dollar, the Directors are of the opinion that the Proforma Group's exposure to currency risk is not significant.

Interest rate risk

The Proforma Group obtains financing through bank borrowings. Its policy is to obtain the most favourable interest rates available without increasing its foreign currency exposure.

Surplus funds are placed with reputable financial institutions at the most favourable interest rates.

Credit risk

The Proforma Group's exposure to credit risk, or the risk of counterparties defaulting, arises mainly from cash deposits and receivables. The maximum exposure to credit risk is represented by the total carrying amount of these financial assets in the balance sheet reduced by the effects of any netting arrangements with counterparties.

The Proforma Group manages its exposure to credit risk by investing its cash assets safely and profitably, and by the application of credit approvals, credit limits and monitoring procedures on an ongoing basis.

Liquidity and cash flow risk

The Proforma Group's exposure to liquidity and cash flow risk arises mainly from general funding and business activities.

It practises prudent liquidity risk management by maintaining sufficient cash balances and the availability of funding through certain committed credit facilities.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

Effective interest rates

In respect of interest-bearing financial assets and liabilities, the following table indicates the effective interest rates at the balance sheet date and the periods in which the financial instruments reprice or mature, whichever is earlier.

	Within 1 year RM'000	Total RM'000	Effective interest rate per annum %
Financial assets			
Deposit placed with licensed banks	3,517	3,517	2.9
Financial liabilities			
Borrowings (secured)	4,939	4,939	4.6

Fair values of recognised financial assets and liabilities

In respect of cash and cash equivalents, trade and other receivables, trade and other payables and borrowings of the Proforma Group, the fair values approximate carrying amounts due to the relatively short-term nature of these financial instruments.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

5 Proforma consolidated cash flow

The summarised proforma consolidated cash flow of the KFB Group based on the audited financial statements of KFB, KFM and KG for the year ended 31 December 2004. The proforma consolidated cash flow is prepared on the assumption that the KFB Group under the restructuring scheme, as detailed in Section 1.3, has been in effect throughout the year under review. The cash flow is to be read in conjunction with the notes below:

	Year ended 31 December 2004
	RM'000
Cash flows from operating activities	
Cash receipts from customers	43,735
Cash payments to suppliers, employees and administrative expenses	(30,755)
Cash generated from operations	12,980
Interest paid	(28)
Income taxes paid	(1,872)
Net cash generated from operating activities	11,080
Cash flows from investing activities	
Purchase of property, plant and equipment	(2,727)
Interest received	229
Proceeds from disposal of property, plant and equipment	9
Net cash used in investing activities	(2,489)
Cash flows from financing activities	
Proceeds from issuance of shares	*
Proceeds from borrowings	2,274
Repayment of hire purchase liability	(217)
Interest paid	(82)
Dividend paid to former shareholders of KFM	(7,035)
Net cash used in financing activities	(5,060)
Net increase in cash and cash equivalents	3,531
Cash and equivalents at beginning of year	3,590
Cash and equivalents at end of year	7,121

* Based on the paid-up share capital of RM2.00 comprises 2 ordinary shares of RM1.00 each in KFB as at 31 December 2004.

10. REPORTING ACCOUNTANTS' REPORT (CONT'D)

*Kawan Food Berhad
Accountants' Report*

6 Proforma net tangible assets cover

Based on the proforma statement of assets and liabilities of KFB Group as at 31 December 2004, and after adjusting for the Public Issue and estimated shares issue expenses, the net tangible assets cover per ordinary share is calculated as follows:

	RM'000
Proforma net tangible assets as at 31 December 2004	34,818
Add : Proceeds from Public Issue	10,320
Less : Estimated shares issue expenses	(2,000)
Adjusted balance as at 31 December 2004	<u>43,138</u>
Number of ordinary shares of RM0.50 each in issue as per proforma statement of assets and liabilities as at 31 December 2004	69,680
Add : Public Issue	10,320
Number of ordinary shares of RM0.50 each in issue after the Public Issue	<u>80,000</u>
Proforma net tangible assets per ordinary share (RM)	<u>0.54</u>

7 Events subsequent to the balance sheet date as at 31 December 2004

Subsequent to balance sheet date as at 31 December 2004, other than the acquisitions referred in Section 1.3.2, KFM entered into a Sale and Purchase Agreement in May 2005 with a third party to purchase a leasehold property for a total purchase consideration of RM7,880,000.

8 Audited financial statements

No audited financial statements have been drawn up for any period subsequent to 31 December 2004.

Yours faithfully

KPMG

Firm Number: AF 0758

Chartered Accountants

Lim Hun Soon @ David Lim

Partner

Approval Number: 1514/05/06(J)

Signed copies of this document have been prepared in English and Bahasa Malaysia versions. In the event of any inconsistency between these, the English version shall prevail.

11. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT

(Prepared for inclusion in this Prospectus)

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Infocredit D&B (Malaysia) Sdn Bhd (527570-M)
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Pusat Bandar Damansara, 50490 Kuala Lumpur, Malaysia.
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21 June 2005

The Board of Directors
Kawan Food Berhad
Unit 07-02, Level 7
Menara Luxor
6B, Persiaran Tropicana
47410 Petaling Jaya
Selangor Darul Ehsan

RE: EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT (“EXECUTIVE SUMMARY”) FOR KAWAN FOOD BERHAD

This Executive Summary has been prepared for inclusion in the Prospectus to be dated **30 June 2005** pursuant to the proposed listing of Kawan Food Berhad (“Company”) on the Second Board of Bursa Malaysia Securities Berhad.

This research is undertaken with the purpose of providing an overview of the Frozen Food Industry in Malaysia as well as the operations of the Company and/or its subsidiaries (“Group” or “KFB Group”) within the industry.

The research methodology includes both primary research, involving in-depth interviews of pertinent companies, as well as secondary research such as reviewing press articles, periodicals, trade/government literatures, in-house corporate databases, Internet research as well as online databases.

Infocredit D&B (Malaysia) Sdn Bhd (“Infocredit D&B”) has prepared this Executive Summary in an independent and objective manner and has taken all reasonable consideration and care to ensure the accuracy and completeness of the Executive Summary. In addition, Infocredit D&B acknowledges that if there are significant changes affecting the content of the Executive Summary after the issue of the Prospectus and before the issue of securities, then Infocredit D&B has an on-going obligation to either cause the Executive Summary to be updated for the changes and, where applicable, cause the Company to issue a Supplementary Prospectus, or withdraw our consent to the inclusion of the Executive Summary in the Prospectus.

This Executive Summary is highlighted in the following sections.

For and on behalf
INFOCREDIT D&B (MALAYSIA) SDN BHD



Tan Sze Chong
Managing Director



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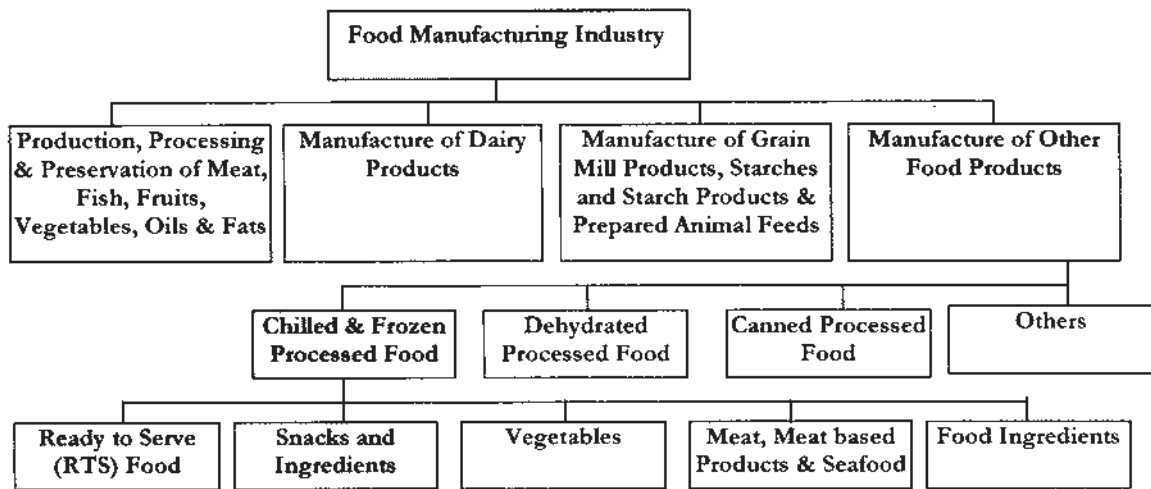
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1 INTRODUCTION

1.1 INDUSTRY CLASSIFICATION

The Malaysian food manufacturing industry covers a wide variety of industries which can be segmented as follows:

Figure 1.1 Market Segmentation of the Food Manufacturing Industry in Malaysia



Notes: The focus industry of the KFB Group is highlighted

Source: Malaysian Industrial Development Authority ("MIDA"), Agri-BDC, Ministry of Agriculture ("MOA"), and Infocredit D&B

Frozen foods are those which are able to undergo quick freezing process with minimal effect on the quality and freshness. The shelf life of frozen food is one (1) year and above. These foods must be stored at temperatures of minus 18°C while chilled foods are those where the quality and texture will be compromised during the freezing process. These chilled foods need to be stored at temperatures of minus 1°C to 10°C with shelf life of about two (2) weeks. The chilled food industry and frozen food industry is collectively referred to as the frozen food industry throughout this report.

11. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT (CONT'D)

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A summary of the various categories of chilled and frozen processed food in Malaysia is as depicted in the table below:

Table I.1 Classification of the Chilled and Frozen Processed Food

Categories	Examples
Ready-to-serve (RTS) meals are complete meals that require minimum reheating time prior to serving	Nasi lemak, nasi briyani, fried rice, pizza, murtabak, roti chanai, curries and other types of food either local, eastern origin or western cuisine.
Snacks and Ingredients are either sweet or savoury cakes that require a more elaborate reheating process	Springrolls, samosa, dim sums, steam buns, "mantou" donuts etc
Food Ingredients are prepared local spices and ingredients to be used in meals preparation	Onions, lemon grass, ginger etc
Vegetables	Corn kenneis, French fries, carrots, peas, carrots, mixed vegetables
Meat and meat based products and seafood refers to cooked meat, seafood that require reheating prior to serving	Sausages, processed deli meat such as ham, smoked meat etc

Source: Agri-BDC, MOA

For the purpose of this report, the Ready to Serve (RTS) food as well as the Snack and Ingredients under the category of Chilled & Frozen Processed Food is the focused area of the research coverage. RTS food refers to pre-packaged meals that require no cooking or minimum cooking such as steaming or frying to be performed before serving while Snacks and Ingredients are finger food served with the main meals or eaten on its own.

1.2 BACKGROUND

The frozen food industry started in the mid 1930's in the United States of America ("USA") where a quick freezing method was patented. It was however not until the 1950's that frozen food started to take off and gained a lot of publicity due to television advertising. Since then, increasingly more products are being frozen such as meat, poultry and fruits. The frozen food industry trend moved from traditional home cooked meals towards offering RTS frozen meals and healthy low calorie meals as lifestyles and taste buds changed. The industry has evolved from mainly servicing the consumer market to fast food chains and restaurants. This is attributed to the convenience and ease of storage for frozen food.

11. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT (CONT'D)

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2 MARKET DYNAMICS**2.1 FOOD MANUFACTURING INDUSTRY**

In Malaysia, food manufacturing industry is a large industry with over 3,000 establishments in the market place producing a wide variety of food products. Over the five (5) year period from 2000 to 2004, a total of 368 approvals have been granted for a total of over RM5 billion capital investments in the food manufacturing industry. During the same period, the estimated employment from the approved food manufacturing premises was over 24,000 in total.

Table 2.1: Approved Applications for Food Manufacturing Premises (2000 – 2004)

	Number of Approvals	Estimated Employment	Estimated Capital Investment (RM million)
2000	74	4,269	1,057
2001	53	4,039	899
2002	70	5,017	1,220
2003	97	7,224	1,077
2004	74	3,465	1,116
Total	368	24,014	5,369

Source: MIDA

The Government encourages the development of value-added food products and 'halal' food products. The Government provides incentives in terms of product promotion and product branding for local manufacturers to tap into the global 'halal' food market, which is estimated to worth RM150 billion of sales annually.

2.2 Frozen RTS Food Industry

The frozen food industry in Malaysia is estimated to worth over RM3 billion in 2005 and the value is expected to double by the year 2010¹. For the combined RTS segment, Infocredit D&B has researched twelve (12) major selected players that are involved in the manufacturing of frozen RTS food. The findings showed that the combined revenue of these players was worth more than RM60 million in 1999 and the total has grown to over RM100 million in 2004, representing a compounded annual growth rate of about 10.8% over the five (5) year period. In 2000 and 2001 when the Malaysian economy experienced a slowdown in GDP growth, the frozen RTS food industry was also affected. In 2002, the industry had recovered in tandem with the growth in Gross Domestic Product ("GDP") of the country. It can be deduced that the industry performance is related to the economic growth of the country.

2.3 IMPORT & EXPORT

In 2004, Malaysians spent about RM16.6 billion on imported foods, this is an increase of 30.7% over the import recorded in 2003. More than 50% of the food imports were agriculture produce or semi-processed food items for further processing. The value of food export was reported at RM10.0 billion.

¹ *Source: Agri-food BDC, MOA*

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an increase of 19.0% over 2003 export. Overall, the net import bill is a concern for the Government and hence there are many Government policies that encourage local food production to lessen the dependency on imported food.

Table 2.2: Values of Food Exports and Imports in Malaysia

(RM billion)	2000	2001	2002	2003	2004
Exports	6.5	6.6	7.5	8.4	10.0
Imports	11.4	12.3	12.4	12.7	16.6

Source: Department of Statistics, MIDA

It is estimated that only 5% of the RTS food segment are locally produced while 95% of the demand is met by imported food products. The Government is placing more emphasis on locally manufactured food in order to reduce the reliance on imported food products. Establishments such as Agri-Food BDC under the Ministry of Agriculture are part of the Government's initiatives to promote more investments in this industry and to help local food manufacturers understand the industry better.

2.4 COMPETITIVE ENVIRONMENT

Based on Infocredit D&B's research, the level of competition among the industry players is moderately high as the products produced are almost similar. Kawan Food Berhad, Tee Yih Jia Manufacturing Sdn Bhd, Kart Food Industries Sdn Bhd and PA Food Sdn Bhd are competing directly within the same market segment by offering similar frozen RTS food such as roti paratha, spring rolls pastry and steam buns. Ben Fortune Pastry Manufacturing Sdn Bhd carries the mini roti paratha range and also the mantous range as well as the glutinous rice balls which are also part of the Group's range of products. The competitive edge of each player will largely depend on the extensiveness of the distribution network, the variety of products, the level of investment into advertisements to increase consumer awareness, degree of automation and process efficiency to minimise production cost.

Table 2.3: Closest Competitors to the KFB Group in the Frozen RTS Food Industry

Company	Brand	Product Range	Type of Market
Tee Yih Jia Manufacturing Sdn Bhd	Springhome	Springroll Pastry, Roti Paratha, Crepe, Glutinous Rice Balls, Oriental Buns such as mantous, asian pancakes, cocktail prawn rolls etc	RTS Meals and Snacks and Ingredients Category
Kart Food Industries Sdn Bhd	Kart's	Pau, roti paratha, curries, frozen pizzas etc	RTS Meals and Snacks and Ingredients Category
PA Food Sdn Bhd	PA	Roti Paratha, Spring rolls pastry, Steam buns, pau, mantous etc	RTS Meals and Snacks and Ingredients Category
Ben Fortune Pastry Manufacturing Sdn Bhd	Oriental Fortune	Oriental buns such as mantous and mini buns, silver tread buns, steam pous, yutiao, garlic bread, pizzas, etc	RTS Meals and Snacks and Ingredients Category

Source: Infocredit D&B

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2.5 BARRIERS TO ENTRY

2.5.1 LONG PRESENCE AND REPUTATION IN THE INDUSTRY

The KFB Group is the largest RTS food manufacturer in Malaysia and has won numerous awards for its outstanding performance in this industry. The founders of the KFB Group started their business in the late 1970's by distributing Chinese New Year cakes and frozen spring rolls pastries to small convenience stores in Klang Valley. Despite the economic downturn in the mid 1980's, the business managed to survive the period by diversifying its market overseas, to countries such as Australia and United Kingdom. Since then, it has expanded its business by supplying to most of the supermarkets and hypermarkets throughout Malaysia. With its strategic marketing plans, KFB Group believes that it is able to maintain its position as the leader in the industry while new entrants are unlikely to replicate this accomplishment within a short span of time.

2.5.2 HIGH STANDARD OF INNOVATIVE PRODUCTS

The KFB Group has marked its presence in the market with the creation of a number of highly innovative products. The Group has always set high standards and lead in the introduction of new products that are convenient, affordable and tasty without compromising its quality especially in terms of hygiene. Many of the KFB Group's products have gained market confidence and the products under "KG" and "Kawan" are among the favourite selection by the consumers. All the products of the KFB Group have been certified 'halal' and one of the Group's product, namely, Roti Paratha has been certified with Hazard Analysis and Critical Control Point ("HACCP") standard in 2002. In the following year, Roti Paratha was also awarded as Highly Commended Product 2003 for Malaysian Food Industry by the Malaysian Institute of Food Technology. The Group intends to obtain HACCP accreditation for all its products in the future.

2.5.3 AUTOMATION OF PRODUCTION PROCESS

Over the years, the KFB Group has progressed from manual production to using automation in its production processes as it continues to invest in new machineries and technologies in order to improve the production efficiency and achieve higher economies of scale. The Roti Paratha automation process, for example, is a testament of the KFB Group's innovative production processes which was developed through the research and development ("R&D") team's initiatives and collaboration with a European food equipment manufacturer. These machinery and equipment have not only increased production capacity, it has also reduced the dependency on labour. Automation of the production process also reduces the need for manual intervention and helps to raise the hygiene standards. As a result of automation, the KFB Group is able to meet the industry demands especially those from the overseas where the time to market is crucial. In addition, automation of production processes reduce human resource problems such as hiring and training of new production staff and has enabled the KFB Group to allocate its resources more effectively. The KFB Group plans to continue to invest in the automation of production processes and to keep abreast with the latest food production process and technology in order to maintain its position as one of the market leaders in the industry.



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2.6 GROWTH FACTORS & OPPORTUNITIES

2.6.1 DOMESTIC MARKET

Malaysia has a high percentage of young people, a growing population, increasing per capita income and a high percentage of middle to upper class population. Underlying that, a sound economy ensures these fundamentals remain favourable.

- About 38% of the population are between the ages of 20 to 44. This age group comprises avid consumers of convenience foods and RTS food due to the trend of increasing number of double income families.
- Malaysia is among the countries with high per capita income in the ASEAN region, which has grown from RM12,310 in 1997 to RM14,838 in 2003. An increasing number of the population consists of middle income households compared to past years. Further, an increasing number of populations is living in urban areas. These augur well for the frozen RTS food market.
- Increasing retail outlets and chain hypermarkets such as Carrefour, Dairy Farm Giant Retail, Makro Cash & Carry, Tesco and The Store, make the distribution chain more efficient and the purchase of frozen RTS food convenient for the consumers.

2.6.2 OVERSEAS MARKETS

The export market holds great potential for the frozen RTS food manufacturers in Malaysia. Export markets present great potential due to higher standard of living for the average citizens and higher demand for convenient foods as more working adults work longer hours. Australia, the USA and European countries have a large migrant community from diverse Asian countries such as Malaysia, Vietnam, Thailand and Hong Kong. These Asian communities also represent a large consumer potential for many food manufacturers to market their products as they are more receptive to familiar foods from their home countries. It is estimated that by the year 2025, 16% of the population in Australia will be from an Asian background.

2.6.3 'HALAL' FOOD INDUSTRY

According to Agri-Food BDC, the 'halal' food industry is estimated to worth US\$80 billion a year with the increasing number of Muslim population in Middle East, North America, South Asia, Southeast Asia and China. This reflects the importance of 'halal' certification for food products including frozen RTS food in the targeted Muslim community.

In Malaysia, the 'halal' certification is issued by the Department of Islamic Advancement of Malaysia ("JAKIM") under the Prime Minister's Department. This 'halal' certification is fast becoming one of the most acceptable certifications among the global Muslim communities. It is the Government's wish that Malaysia be seen as the hub of the global 'halal' food industry as every effort has and will continue to be made to ensure that this materialises.



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2.6.4 CHANGING CONSUMER LIFESTYLES

Consumer food preferences are subject to change as a result of lifestyle changes, exposure to overseas cultures, higher disposable income and dual income households. With improving income per capita, particularly in urban areas, consumers tend to look for convenient, easy to cook food rather than meals that need to be prepared from fresh materials. In this regard, frozen RTS food is considered convenient food that requires minimal preparation/cooking prior to serving that meet this demand. In order to keep up with the market demand trends, market players continuously introduce quality and tasty food products with innovative formulations and attractive packaging.

3 MARKET OUTLOOK

The past two (2) decades have been challenging for the frozen food industry in Malaysia with small and medium enterprises expanding operations from small backyard industry to multi-million Ringgit establishments. The frozen food industry undergoes changes as the lifestyles of Malaysians experience changes during the past decade. In addition, with globalisation, export markets especially in the 'halal' food market have become increasingly attractive. The critical success factors for market players in this industry can be summarised as follows:

- **Research and Development**

For local manufacturers to keep up with global competitors and changing consumer preferences, they would need to invest in R&D activities. Food products would have to be continuously developed or modified to meet consumer tastes. A reduced reliance on imported technology and development of home grown R&D may pave the way for original products developed specifically to meet the requirements of Malaysians and their regional neighbours. There should be more research into frozen RTS food in terms of enhanced quality, nutritional value and longer shelf life.

- **Invest in Technology**

New production techniques, equipment, ingredients and packaging are constantly being developed in the global food industry. One of the most important technologies of the frozen food industry is quick food freezing techniques and the refrigeration of frozen food. Another area is the packaging of frozen food where the use of advanced equipment and packaging materials will result in food becoming more durable and visually pleasing.

- **Production Efficiency**

Market players need to continuously upgrade and enhance their production process and deploy automation process whenever applicable and feasible. Many processes in the food manufacturing industry are currently controlled by computers to ensure accuracy, especially during the mixing process, efficiency and quality. Computers are being used as part of the process controls as they monitor the flow of information so that it can be highlighted at the appropriate time to the relevant department. During the production process the computers will be used to signal the introduction of any unnecessary foreign products during the input of raw materials and detection of foreign materials.

11. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT (CONT'D)

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Computerisation in the production equipment is now an integral part of the food manufacturing industry in order to ensure consistency and premium quality for its end product.

▪ Distribution Networks

The success in frozen food industry is dependent on the ability of manufacturers to establish wide distribution coverage and the brand awareness among consumers. The stronger the ability of the manufacturers to promote their products through the displays in the chain stores, the higher the probability that the consumers will become more aware of the products' existence. Due to the limited space available in the refrigeration section of some of these chain stores, smaller companies with lesser known brands and products may find it difficult to persuade these chain stores to display their products.

12. DRAFT ESOS BY-LAWS**DRAFT BY-LAWS OF THE EMPLOYEES' SHARE OPTION SCHEME****1. DEFINITIONS**

1.1 In these By-Laws, except where the context otherwise requires, the following expressions shall have the following meanings:

“Act”	:	Companies Act 1965, as amended from time to time and any re-enactment thereof
“Board”	:	Board of Directors of KFB
“Bursa Securities”	:	Bursa Malaysia Securities Berhad
“By-Laws”	:	The by-laws governing the Scheme
“CDS”	:	Central Depository System
“Central Depositories Act”	:	Securities Industry (Central Depositories) Act, 1991
“Eligible Director”	:	A director (who can either be an executive director or non-executive director) of the KFB Group, save for companies which are dormant, who meets the criteria of eligibility for participation in the Scheme as set out in By-Law 4
“Eligible Person”	:	An eligible employee and/ or Eligible Director of the KFB Group, save for companies which are dormant, who meets the criteria of eligibility for participation in the Scheme as set out in By-Law 4
“ESOS”	:	Employees’ share option scheme
“Grantee”	:	An Eligible Person who has accepted an Offer in accordance with the provisions of By-Law 8
“KFB” or “Company”	:	Kawan Food Berhad
“KFB Group” or “Group”	:	KFB and/or its subsidiaries, collectively
“KFB Shares” or “Shares”	:	Ordinary shares of RM0.50 each in KFB
“Listing Requirements”	:	Listing Requirements of Bursa Securities, as amended from time to time
“Market Day”	:	A day on which Bursa Securities is open for trading in securities
“Maximum Allowable Allotment”	:	The maximum number of new KFB Shares in respect of which Offers may be made to the Eligible Person in accordance with the provisions of By-Law 6
“Offer”	:	An offer of an Option made in writing by the Option Committee to an Eligible Person in the manner set out in By-Law 5
“Offer Date”	:	The date on which an Offer is made by the Option Committee to an Eligible Person to participate in the Scheme

12. DRAFT ESOS BY-LAWS (CONT'D)

“Option”	:	The rights of a Grantee to subscribe for new KFB Shares pursuant to the contract constituted by acceptance of an Offer in the manner as set out in By-Law 8
“Option Committee”	:	The committee comprising such persons as may be appointed by the Board to administer the Scheme
“Option Period”	:	A period commencing from the Offer Date until the expiry date and/or termination of the Scheme or such date as may be specifically stated in such Offer for an Eligible Person to exercise the Option PROVIDED THAT no option period shall extend beyond the duration of the Scheme as referred to By-Law 19 hereof
“Option Price”	:	The price at which a Grantee shall be entitled to subscribe for a new KFB Share upon the exercise of an Option as set out in By-Law 7
“RM”	:	Ringgit Malaysia
“SC”	:	Securities Commission
“Scheme”	:	The Scheme for the grant of Options to Eligible Persons to subscribe for new KFB Shares on the terms as set out herein
“Subsidiary(ies)”	:	The subsidiary(ies) of KFB as defined in Section 5 of the Act

1.2 In these By-Laws:

- (i) Any reference to a statutory provision shall include any subordinate legislation made from time to time under any listing requirements, policies and/or guidelines of Bursa Securities, SC and/or other relevant authorities (in each case, whether or not having the force of law but, if not having the force of law, the compliance of which is in accordance with the reasonable commercial practice of persons to whom such requirements, policies and/or guidelines are addressed to by Bursa Securities, SC and/or other relevant authorities).
- (ii) Any reference to the provisions of any legislation shall include a reference to any statutory modification and re-enactment thereof made from time to time.
- (iii) References to gender shall include both genders and words importing the singular shall include the plural.
- (iv) The headings in these By-Laws are for convenience only and shall not be taken into account in the interpretation of these By-Laws.
- (v) If an event is to occur on a stipulated day which is not a Market Day, then the stipulated day will be taken to be the first Market Day after that day.
- (vi) Any liberty or power which may be exercised or any determination which may be made hereunder by the Option Committee may be exercised with the Option Committee’s absolute discretion.

2. NAME OF SCHEME

This Scheme will be known as the “**Kawan Food Berhad Employees’ Share Option Scheme**”.

12. DRAFT ESOS BY-LAWS (CONT'D)

3. MAXIMUM NUMBER OF SHARES ALLOWABLE UNDER THE SCHEME

3.1 The total number of new KFB Shares, which may be available under the Scheme, shall not exceed in aggregate fifteen percent (15%), or any such amount or percentage as may be permitted by the relevant authorities, of the total issued and paid-up share capital of the Company at any one time during the existence of the Scheme.

3.2 Notwithstanding the provision of By-Law 3.1 and any other provisions herein contained, in the event the aggregate number of new KFB Shares available under the Scheme exceeds the aggregate fifteen percent (15%) or any such amount or percentage as may be permitted by the relevant authorities of the issued and paid-up share capital of the Company as a result of the Company purchasing its own Shares or undertaking any other corporate proposals which diminishes its issued and paid-up share capital, then all such Options granted prior to the adjustment of the issued and paid-up share capital of the Company shall remain valid and exercisable in accordance with the provisions of this Scheme.

However, no further Offer shall be made until the total number of Shares to be issued under the Scheme falls below fifteen percent (15%) of the issued and paid-up share capital of the Company.

3.3 The Company will during the Option Period keep available sufficient authorised and unissued shares to satisfy all outstanding Options, which may be exercised, in whole or in part during the Option Period.

4. ELIGIBILITY

Subject to the eligibility criteria as may be set by the Option Committee, an Eligible Person shall be eligible to participate in the Scheme.

Eligibility under the Scheme does not confer on an Eligible Person a claim or right to participate in or any rights whatsoever under the Scheme and an Eligible Person does not acquire or have any rights over or in connection with the Options or the new Shares comprised herein unless an Offer has been made by the Option Committee to the Eligible Person and the Eligible Person has accepted the Offer in accordance with the terms of the Offer and the Scheme.

5. OFFER

5.1.1 The Option Committee may, at its discretion at any time and from time to time within the duration of the Scheme as defined in By-Law 19 hereof, make one or more Offers to any Eligible Person whom the Option Committee may in its discretion select in accordance with the terms of the Scheme, **PROVIDED ALWAYS THAT** an Offer shall not be less than one hundred (100) KFB Shares or the minimum board lot for shares as may be prescribed by Bursa Securities from time to time and shall always be in multiples of one hundred (100) KFB Shares or the minimum board lot for shares as may be prescribed by Bursa Securities from time to time.

5.2 Unless otherwise stated, nothing herein shall prevent the Option Committee from making more than one Offer to any Eligible Person **PROVIDED ALWAYS THAT** the total aggregate number of new KFB Shares in respect of the Options granted shall not exceed the Maximum Allowable Allotment of such Eligible Person.

5.3 Each Offer shall be made in writing by the Option Committee and shall state the number of new KFB Shares which the Eligible Person shall be entitled to subscribe, the Option Price, the Option Period and the closing date for acceptance of the Offer.

5.4 No Option shall be granted to any Eligible Director of the Company unless specific grant of Options to that Eligible Director shall have previously been approved by the shareholders of the Company in a general meeting.

12. DRAFT ESOS BY-LAWS (CONT'D)

- 5.5 The Offer shall automatically lapse and be null and void in the event of death of the Eligible Person, or the Eligible Person ceasing to be employed, or ceasing to be appointed as a Director of the KFB Group for any reason whatsoever prior to the acceptance of the Offer by the Eligible Person in the manner set out in By-Law 8 hereof.

6. MAXIMUM ALLOWABLE ALLOTMENT AND THE BASIS OF ALLOTMENT

- 6.1 Subject to any adjustments which may be made under By-Law 14, the maximum number of new KFB Shares that may be offered and allotted to an Eligible Person shall be determined at the discretion of the Option Committee after taking into consideration the performance, seniority and length of service of the Eligible Person and/or such other factors that the Option Committee may deem relevant, subject always to the following:

- (i) the aggregate allocation to the Eligible Directors and senior management of the KFB Group, save for the companies which are dormant, shall not exceed fifty percent (50%) of the new KFB Shares available under the Scheme; and
- (ii) the allocation to any Eligible Person who, either singly or collectively, through persons connected to him (as defined in paragraph 1.01 of the Listing Requirements), holds twenty percent (20%) or more of the issued and paid-up capital of the Company, shall not exceed ten percent (10%) of the new KFB Shares available under the Scheme.

- 6.2 The number of Options offered pursuant to the Scheme and new KFB Shares arising from the exercise of the Options shall be verified by the audit committee of the Company and a statement to that effect that the audit committee has conducted such verification shall be disclosed in the Company's annual report.

- 6.3 A set of criteria on employees' and directors' eligibility of options pursuant to the Scheme shall be clearly specified and all employees and directors shall be made aware of it through notification in writing or any other appropriate mediums.

- 6.4 In circumstances where the maximum share allocation as provided in the Listing Requirements is amended by Bursa Securities from time to time, the Option Committee shall have the discretion to make the necessary adjustments in the Options that may be offered to any one of the Eligible Person so as to comply with such amended Listing Requirements.

7. OPTION PRICE

Subject to any adjustments in accordance with By-Law 14 hereof, the price at which a Grantee is entitled to subscribe for each new KFB Share shall be determined by the Option Committee based on the five (5)-day weighted average market price of KFB Shares immediately preceding the Offer Date of the Option, with a discount of not more than ten percent (10%), or at the par value of KFB Shares, whichever is higher. For any Option granted as part of the listing proposal of the Company, the Option Price must not be less than the initial public offer price.

12. DRAFT ESOS BY-LAWS (CONT'D)

8. ACCEPTANCE OF THE OFFER

- 8.1 The Offer to participate in the Scheme shall be valid for acceptance for a period of thirty (30) days from the Offer Date or such longer period as may be determined by the Option Committee on a case-to-case basis at its discretion. The acceptance of an Offer shall be made by way of a written notice from the Eligible Person to the Option Committee in the form prescribed by the Option Committee within the prescribed period. In the event that the Eligible Person fails to accept the Offer within the prescribed period, the Offer shall automatically lapse, and be null and void and of no further effect PROVIDED THAT the Option Committee shall not be precluded from making a new Offer to the Eligible Person subsequently.
- 8.2 Acceptance of the Offer by an Eligible Person shall be accompanied by the payment of Ringgit Malaysia One (RM1.00) as non-refundable consideration for the Option.
- 8.3 An Option shall be personal to the Grantee and cannot be assigned, transferred or otherwise disposed of in any manner whatsoever save and except as provided for in By-Law 10.3.

9. EXERCISE OF OPTIONS

- 9.1 Subject to By-Law 9.2, an Option may be exercised by the Grantee by notice in writing to the Company in the prescribed form during the Option Period in respect of all or any part of the new KFB Shares comprised in the Option, PROVIDED THAT where an Option is exercised in respect of a part of the new KFB Shares comprised therein, the number of new KFB Shares of which such Option may be exercised shall be in multiples of and not less than one hundred (100) new Shares or such board lot as may be prescribed by Bursa Securities from time to time.
- 9.2 Subject to any adjustments in accordance with By-Law 14, the Option Committee may, at any time and from time to time, before or after an Option is granted, limit the exercise of the Option to a maximum number of new KFB Shares and/or such percentage of the total new KFB Shares comprised in the Option during such periods within the Option Period and impose any other terms and/or conditions deemed appropriate by the Option Committee in its discretion including amending or varying any terms and conditions imposed earlier.

The partial exercise of an Option shall not preclude the Grantee from exercising the Option for the remaining duration of the Option Period in respect of the balance of the new KFB Shares comprised in the Option.

Any new KFB Shares comprised in an Option not subscribed for in any year following the Offer Date, may be subscribed for in any subsequent year until and including the last year of the Option Period.

- 9.3 A Grantee who exercises his Option shall provide the Option Committee with his CDS account number or the CDS account number of his authorised nominee, as the case may be, in the notice referred to in By-Law 9.1. Every such written notice must be accompanied by a remittance for the full amount of the subscription monies for the new KFB Shares in respect of which notice is given. Within ten (10) Market Days or such other period as may be prescribed by Bursa Securities, from the receipt by the Company of the aforesaid notice and remittance from the Grantee, the Company shall allot and issue such new KFB Shares, despatch the notice of allotment stating the number of shares to be credited into the CDS account of the Grantee or the Grantee's authorised nominee with a copy to the Grantee, as the case may be, and make an application for the quotation of the new KFB Shares, subject to and in accordance with the provisions of the Articles of Association of the Company. No physical share certificate(s) will be issued.
- 9.4 All Options to the extent unexercised on the expiry of the Option Period shall lapse.

12. DRAFT ESOS BY-LAWS (CONT'D)

- 9.5 In the event that a Grantee is subject to disciplinary proceedings (whether or not such disciplinary proceedings will give rise to a dismissal or termination of service) the Option Committee may, in its discretion, suspend the right of the Grantee to exercise his Option pending the outcome of such disciplinary proceedings. The Option Committee may impose such terms and conditions on the Grantee's right to exercise his Option after having regard to the nature of charges made or brought against the Grantee PROVIDED ALWAYS THAT in the event that such Grantee shall subsequently be found to be not guilty of the charges which gave rise to such disciplinary proceedings, the Option Committee shall reinstate the rights of such Grantee to exercise his Option.
- 9.6 The Board, the Option Committee, the Company and/or any officer of the Company shall not be held liable for any cost, loss, expense and/or damages whatsoever or howsoever arising in the event of any delay on the part of the Company in allotting and issuing the new KFB Shares or in procuring Bursa Securities to list and quote the KFB Shares subscribed for by a Grantee, or any delay in the receipt or non-receipt by the Company of the notice to exercise the Options or for any errors in any Offers.
- 9.7 Subject to the discretion of the Option Committee, failure by the Grantee to comply with the procedure for an exercise of an Option as stipulated in By-Laws 9.1 to 9.4 herein will invalidate the purported exercise of such Option by a Grantee.
- 9.8 Every Option shall be subject to the condition that no new KFB Shares shall be issued to a Grantee pursuant to the exercise of an Option if such issue would be contrary to any law, enactment, rules and/or regulations of any legislative or non-legislative body which may be in force during the Option Period or such period as may be extended.

10. TERMINATION OF THE OPTIONS

- 10.1 All remaining unexercised Options shall forthwith lapse and/or be deemed to be cancelled and cease to be exercisable in respect of which such Options have not been exercised upon the occurrence of one or more of the following events:
- (i) subject to By-Laws 10.2 and 10.3, the Grantee ceasing to be in employment, or ceasing to be a Director of the KFB Group; or
 - (ii) the liquidation of KFB; or
 - (iii) the bankruptcy of the Grantee.
- 10.2 Notwithstanding the provisions of By-Law 10.1(i), the Option Committee may at its discretion allow a Grantee to exercise his unexercised Options within the relevant Option Period or such other shorter period as the Option Committee may at its discretion determine when the Grantee ceases his employment or appointment with the Group by reason of:
- (i) retirement on attaining the retirement age under the KFB Group's retirement policy;
 - (ii) retirement before attaining the normal retirement age but with the consent of the employer company within the Group;
 - (iii) redundancy or retrenchment under any voluntary separation scheme;
 - (iv) ill-health, injury, physical or mental disability;
 - (v) resignation under circumstances which are acceptable to the Option Committee; or
 - (vi) any other circumstances which are acceptable to the Option Committee.

12. DRAFT ESOS BY-LAWS (CONT'D)

- 10.3 In the event of the death of a Grantee before the expiry of the Option Period and on the date of his death, the Grantee held Options which are unexercised, the whole or any part of the unexercised Options shall lapse forthwith and be null and void and of no further force and effect provided however the Option Committee may at its discretion allow the next of kin or beneficiary or legal representatives of the deceased Grantee in question to exercise the deceased's unexercised Options, in whole or in part, within the relevant Option Period or such other shorter period as the Option Committee may at its discretion determine.

11. TAKEOVER

- 11.1 Notwithstanding By-Law 9 and subject to the provisions of any applicable statutes, rules, regulations and/or conditions issued by the relevant authorities, in the event of:

- (i) a takeover offer being made for the KFB Shares under the Malaysian Code on Take-Overs and Mergers, 1998 to acquire the whole of the issued share capital of the Company (or such part thereof not at the time owned by the person making the take-over offer ("Offeror") or any persons acting in concert with the Offeror), a Grantee will be entitled, within such period to be determined by the Option Committee, to exercise all or any part of his Options as yet unexercised; and
- (ii) the Offeror becoming entitled or bound to exercise the right of compulsory acquisition of KFB Shares under the provisions of any applicable statutes, rules and/or regulations and gives notice to the Company that it intends to exercise such right on a specific date, a Grantee will be entitled to exercise all or any part of his Option as yet unexercised from the date of service of the said notice to the Company until and inclusive of the date on which the right of compulsory acquisition is exercised,

PROVIDED ALWAYS THAT any Option to the extent unexercised after the expiry of the periods stipulated in the aforesaid circumstances shall automatically lapse and shall become null and void and of no further effect.

- 11.2 There is no obligation on the part of the Company or the Directors or the Option Committee to ensure that such an offer be extended to any new KFB Shares that may be issued pursuant to the exercise of the Option under the Scheme or any unsubscribed new KFB Shares comprised in the Option.

12. SCHEME OF ARRANGEMENT, AMALGAMATION AND RECONSTRUCTION

Notwithstanding By-Law 9 and subject to the discretion of the Option Committee, in the event of the court sanctioning a compromise or arrangement between the Company and its members proposed for the purposes of, or in connection with, a scheme of arrangement and reconstruction of the Company under Section 176 of the Act or its amalgamation with any other company or companies under Section 178 of the Act, a Grantee may be entitled to exercise all or any part of his Option at any time commencing from the date upon which the compromise or arrangement is sanctioned by the court and ending with the date upon which it becomes effective PROVIDED ALWAYS THAT any part of an Option which remains unexercised after the expiry of the period stipulated above shall be automatically terminated thereafter.

13. RETENTION PERIOD

The new KFB Shares to be issued and allotted to a Grantee pursuant to the exercise of any Options will not be subject to any retention period, unless the Grantee is a non-executive director, in which case, he must not sell, transfer or assign the new KFB Shares obtained through the exercise of the Options offered to him pursuant to the Scheme within one (1) year from the Offer Date.

12. DRAFT ESOS BY-LAWS (CONT'D)

14. ALTERATION OF SHARE CAPITAL DURING THE OPTION PERIOD

14.1 In the event of any alteration in the capital structure of the Company during the Option Period, whether by way of capitalisation of profits or reserves, rights issues, subdivisions or consolidation of shares or capital reduction or any other variation of capital:

- (i) the Option Price; and/or
- (ii) the number of new KFB Shares comprised in the Options (excluding Options already exercised),

shall be adjusted in such manner as the external auditors of the Company for the time being (acting as experts and not as arbitrators), upon reference to them by the Option Committee, confirm in writing to be in their opinion, fair and reasonable, PROVIDED ALWAYS THAT:

- (i) no adjustment to the Option Price shall be made which would result in the new KFB Shares to be issued on the exercise of the Option being issued at a discount to par value, and if such an adjustment would but for this provision have so resulted, the Option Price payable shall be the par value of the new KFB Shares PROVIDED FURTHER THAT no adjustment shall be made to the Option Price in respect of any fraction of a sen;
- (ii) upon any adjustment being made pursuant to this By-Law, the Option Committee shall within thirty (30) days of the effective date of the alteration in the capital structure of the Company notify the Grantee (or his legal or personal representatives where applicable) in writing informing him of the adjusted Option Price thereafter in effect and/or the revised number of new KFB Shares thereafter to be issued on the exercise of the Option;
- (iii) in the event that a fraction of a new KFB Share arising from the adjustments referred to in this By-Law would otherwise be required to be issued upon the exercise of an Option by the Grantee, the Grantee's entitlement shall be rounded down to the nearest whole number.

Any adjustments to the Option Price and/or the number of new KFB Shares comprised in the Options (excluding Options already exercised), other than bonus issue, must be confirmed in writing by the external auditors of the Company.

Should there be other circumstances which give rise to a consideration for adjustments to the Option Price or the number of new KFB Shares in favour of all Grantees, but it is decided that no adjustments will be made, such decision must be made known to all the Grantees via a timely notice, subject to compliance with the Listing Requirements.

14.2 In addition to By-Law 14.1 and not in derogation thereof, the Option Price and the number of Options which a Grantee is entitled to (excluding Options already exercised) shall from time to time be adjusted in accordance with the following relevant provisions in consultation with an external auditor, merchant bank or universal broker:

- (a) If and whenever a KFB Share by reason of any consolidation or subdivision or conversion shall have a different par value, the Option Price shall be adjusted by multiplying it by the revised par value and dividing the result by the former par value and the additional number of Options which a Grantee may be entitled to be issued with shall be calculated in accordance with the following formula:

$$\text{Additional number of Options} = T \times \left[\frac{\text{Former Par Value}}{\text{Revised Par Value}} \right] - T$$

12. DRAFT ESOS BY-LAWS (CONT'D)

Where T = existing number of Options held

Each such adjustment will be effective from the close of business on the next Market Day following the date on which the consolidation or subdivision or conversion becomes effective (being the date when KFB Shares are traded on Bursa Securities at the new par value), or such period as may be prescribed by Bursa Securities.

- (b) If and whenever the Company shall make any issue of KFB Shares to ordinary shareholders credited as fully paid-up, by way of capitalisation of profits or reserves (whether of a capital or income nature and including any share premium account and capital redemption reserve fund), the Option Price shall be adjusted multiplying it by the following fraction:

$$\frac{A}{A + B}$$

and the additional number of Options which a Grantee may be entitled to be issued with shall be calculated as follows:

$$\text{Additional number of Options} = \left[T \times \frac{A + B}{A} \right] - T$$

Where

- A = The aggregate number of issued and paid-up KFB Shares immediately before such capitalisation issue
- B = The aggregate number KFB Shares to be issued pursuant to any allotment to ordinary shareholders credited as fully paid-up by way of capitalisation of profit or reserves (whether of a capital or income nature and including any share premium account and capital redemption reserve fund)
- T = Existing number of Options held

The adjustment pursuant to this By-Law shall be made on the day immediately following the entitlement date for such issue.

- (c) If and whenever the Company shall make:
 - (i) a Capital Distribution (as defined below) to ordinary shareholders whether on a reduction of capital or otherwise (but excluding any cancellation of capital which is lost or unrepresented by available assets);
 - (ii) any offer or invitation to its ordinary shareholders whereunder they may acquire or subscribe for KFB Shares by way of rights; or
 - (iii) any offer or invitation to ordinary shareholders by way of rights whereunder they may acquire or subscribe for securities convertible into KFB Shares or securities with rights to acquire or subscribe for KFB Shares.

then and in respect of each such case, the Option Price shall be adjusted by multiplying it by the following fraction:

$$\frac{C - D}{C}$$

12. DRAFT ESOS BY-LAWS (CONT'D)

and in respect of each such case referred to in By-Law 14.2(c)(ii) hereof, the number of additional Options which a Grantee may be entitled to be issued with, shall be calculated as follows:

$$\text{Additional number of Options} = \left[T \times \frac{C}{C - D} \right] - T$$

Where

- T = Existing number of Options held
- C = The current market price of each KFB Shares on the Market Day immediately preceding the date on which the Capital Distribution or, as the case may be, the offer or invitation is publicly announced to Bursa Securities or immediately preceding the date of the Capital Distribution or, as the case may be, of the offer or invitation
- D = (i) In the case of an offer or invitation to acquire or subscribe for KFB Share under By-Law 14.2(c)(ii) above or for securities convertible into or with rights to acquire or subscribe for KFB Shares under By-Law 14.2(c)(iii) above, the value of rights attributable to one (1) KFB Share (as defined below); or
 (ii) In the case of any other transaction falling within By-Law 14.2(c) hereof, the fair market value as determined (with the concurrence of the external auditor) by the merchant bank or universal broker of that portion of the Capital Distribution attributable to one (1) KFB Shares.

For the purpose of definition (i) of D above, the “value of rights attributable to one (1) KFB Share” shall be calculated in accordance with the formula:

$$\frac{C - E}{F + 1}$$

Where

- C = As C above
- E = The subscription price for one (1) additional KFB Share under the terms of offer or invitation or one (1) additional security convertibles into KFB Shares or one (1) additional security with rights to acquire or subscribe for KFB Shares
- F = The number of KFB Shares which it is necessary to hold in order to be offered or invited to acquire or subscribe for one (1) additional KFB Share or security convertible into KFB Shares or rights to acquire or subscribe for KFB Shares

In the case of paragraphs 14.2 (c)(ii) and 14.2 (c)(iii) hereof, the number of additional Options which a Grantee may be entitled to be issued, shall be calculated as follows:

$$\text{Additional number of Options} = \left[T \times \frac{(C)}{(C - D^*)} \right] - T$$

12. DRAFT ESOS BY-LAWS (CONT'D)

Where:

T = As T above;

C = As C above; and

D* = the "value of the rights attributable to one (1) Share" (as defined below).

For the purpose of D* above, the "value of the rights attributable to one (1) Share" shall be calculated in accordance with the formula:

$$\frac{C - E^*}{F^* + 1}$$

Where:

C = As C above;

E* = the subscription consideration for one (1) new Share under the terms of such offer or invitation to acquire or subscribe for Shares;

F* = the number of Shares which it is necessary to hold in order to be offered or invited to acquire or subscribe for one (1) additional Share; and

1 = one (1).

For the purpose of By-Law 14.2(c) hereof, "Capital Distribution" shall (without prejudice to the generality of that expression) include distribution in cash or specie or by way of issue of KFB Shares (not falling under By-Law 14.2(b) hereof) or other securities credited as fully or partly paid-up by way of capitalisation of profits or reserves (whether of a capital or income nature and including any share premium account or capital redemption reserve fund).

Any dividend charged or provided for in the account of any period shall (whenever paid and howsoever described) be deemed to be a Capital Distribution unless it is paid out of the aggregate of the net profits attributable to the ordinary shareholders as shown in the audited consolidated financial statements of the Company.

The adjustment pursuant to this By-Law shall be made on the day immediately following the books closure date for the above transactions.

- (d) If and whenever the Company makes any allotment to its ordinary shareholders as provided in By-Law 14.2(b) above and also makes any offer or invitation to its ordinary shareholders as provided in By-Laws 14.2(c)(ii) or (iii) above and the record date for the purpose of the allotment is also the entitlement date for the purpose of the offer of invitation, the Option Price shall be adjusted by multiplying it by the following fraction:

$$\frac{(G \times C) + (H \times I)}{(G + H + B) \times C}$$

12. DRAFT ESOS BY-LAWS (CONT'D)

and where the Company makes any allotment to its ordinary shareholders as provided in By-Law 14.2(b) above and also makes any offer or invitation to its ordinary shareholders as provided in By-Law 14.2(c)(ii) above and the record date for the purpose of the allotment is also the record date for the purpose of the offer or invitation, the number of additional Options which a Grantee may be entitled to be issued with shall be calculated as follows:

$$\text{Additional number of Options} = \frac{T \times (G + H^* + B) \times C}{(G \times C) + (H^* \times I^*)} - T$$

Where

- G = The aggregate number of issued and fully paid-up KFB Shares on the entitlement date
- C = As C above
- H = The aggregate number of new KFB Shares under an offer or invitation to acquire or subscribe for KFB Shares by way of rights or under an offer or invitation by way of rights to acquire or subscribe for securities convertible into KFB Shares as the case may be
- H* = The aggregate number of new KFB Shares under an offer or invitation to acquire or subscribe for KFB Shares by way of rights
- I = The subscription price of one (1) additional KFB Share under the offer or invitation to acquire or subscribe for KFB Shares or the exercise price on conversion of such securities or exercise of such rights to acquire or subscribe for one (1) additional KFB Share, as the case may be
- I* = The Option Price of one (1) additional KFB Share under the offer or invitation to acquire or subscribe for KFB Shares
- B = As B above
- T = As T above

The adjustment pursuant to this By-Law shall be made on the day immediately following the entitlement date for such issue.

- (e) If and whenever the Company makes any offer or invitation to its ordinary shareholders to acquire or subscribe for KFB Shares as provided in By-Law 14.2(c)(ii) above together with an offer or invitation to acquire or subscribe for securities convertible into or rights to acquire or subscribe for ordinary shareholders as provided in By-Law 14.2(c)(iii) above, the Option Price shall be adjusted by multiplying it by the following fraction:

$$\frac{(G \times C) + (H \times I) + (J \times K)}{(G + H + J) \times C}$$

and the number of additional Options which a Grantee may be entitled to be issued with shall be calculated as follows:

$$\text{Additional number of Options} = \frac{T \times (G + H^*) \times C}{(G \times C) + (H^* \times I^*)} - T$$

12. DRAFT ESOS BY-LAWS (CONT'D)

Where

G = As G above

C = As C above

H = As H above

H* = As H* above

I = As I above

I* = As I* above

J = The aggregate number of KFB Shares to be issued to its ordinary shareholders upon conversion of such securities or exercise of such rights to subscribe for KFB Shares by the ordinary shareholders

K = The exercise price on conversion of such securities or exercise of such rights to acquire or subscribe for one (1) additional KFB Share

T = As T above

The adjustment pursuant to this By-Law shall be made on the day immediately following the entitlement date for the above transactions.

- (f) If and whenever the Company makes an allotment to its ordinary shareholders as provided in By-Law 14.2(b) above and also makes an offer or invitation to acquire or subscribe for KFB Shares to its ordinary shareholders as provided in By-Law 14.2(c)(ii) above, together with rights to acquire or subscribe for securities convertible into or with rights to acquire or subscribe for KFB Shares as provided in By-Law 14.2(c)(iii) above, and the entitlement date for the purpose of the allotment is also the record date for the purpose of offer or invitation, the Option Price shall be adjusted by multiplying it by the following fraction:

$$\frac{(G \times C) + (H \times I) + (J \times K)}{(G + H + J + B) \times C}$$

and the number of additional Options which a Grantee shall be entitled to be issued with shall be calculated as follows:

$$\text{Additional number of Options} = \left[\frac{T \times (G + H^* + B) \times C}{(G \times C) + (H^* \times I^*)} \right] - T$$

Where

G = As G above

C = As C above

H = As H above

H* = As H* above

I = As I above

I* = As I* above

12. DRAFT ESOS BY-LAWS (CONT'D)

J = As J above

T = As T above

K = As K above

B = As B above

The adjustment pursuant to this By-Law shall be made on the day immediately following the entitlement date for the above transactions.

- (g) If and whenever (otherwise than pursuant to a rights issue available to all ordinary shareholders and requiring an adjustment under By-Law 14.2(c)(ii), (c)(iii), (d), (e) or (f) above), the Company shall issue either any KFB Shares or any securities convertible into KFB Shares or any rights to acquire or subscribe for KFB Shares, and in any such case, the Total Effective Consideration per KFB Share (as defined below) is less than 90% of the average price for one (1) KFB Share (as defined below) or, as the case may be, the price at which the KFB Shares will be issued upon conversion of such securities or exercise of such rights is determined, the Option Price shall be adjusted by multiplying it by the following fraction:

$$\frac{L + M}{L + N}$$

Where

- L = The number of KFB Shares in issue at the close of business on the Market Day immediately preceding the date on which relevant adjustment becomes effective
- M = The number of KFB Shares which the Total Effective Consideration (as defined below) would have purchased at the average price (exclusive of expenses)
- N = The aggregate number of KFB Shares so issued or, in the case of securities convertible into KFB Shares or rights to acquire or subscribe for KFB Shares, the maximum number (assuming no adjustment of such rights) of KFB Shares issuable upon full conversion of such securities or the exercise in full of such rights

For the purpose of By-Law 14.2(g), the "Total Effective Consideration" shall be determined by the Board with the concurrence of an external auditor, merchant bank or universal broker and shall be:

- (i) In the case of the issue of KFB Shares, the aggregate consideration receivable by the Company on payment in full for such KFB Shares; or
- (ii) In the case of the issue by the Company of securities wholly or partly convertible into KFB Shares, the aggregate considerations receivable by the Company on payment in full for such securities or such part of the securities as is convertible together with the total amount receivable by the Company upon full conversion of such securities (if any); or
- (iii) In the case of the issue by the Company of securities with rights to acquire or subscribe for KFB Shares, the aggregate considerations attributable to the issue of such rights together with the total amount receivable by the Company upon full exercise of such rights;

12. DRAFT ESOS BY-LAWS (CONT'D)

in each case without any deduction of any commission, discount or expenses paid, allowed or incurred in connection with the issue thereof, and the "Total Effective Considerations per KFB Share" shall be the Total Effective Consideration divided by the number of KFB Shares issued as aforesaid or, in the case of securities convertible into KFB Shares or securities with rights to acquire or subscribe for KFB Shares, by the maximum number of KFB Shares issuable on full conversion of such securities or on exercise in full of such rights.

For the purpose of By-Law 14.2(h), the average price of a KFB Share shall be the average price of one (1) KFB Shares as derived from the last dealt prices for one or more board lots of KFB Shares as quoted on Bursa Securities on the Market Days comprised in the period used as a basis upon which the issue price of such KFB Shares is determined.

Each such adjustment will be calculated (if appropriate retroactively) from the close of business on Bursa Securities on the Market Day next following the date on which the issue is announced, or on the Market Day next following the date on which the Company determines the offering price of such KFB Shares. Each such adjustment will be effective (if appropriate retroactively) from the commencement of the Market Day next following the completion of the above transactions.

14.3 The provisions of this By-Law shall not apply where the alteration in the capital structure of the Company arises from:

- (a) the issue of securities as consideration for an acquisition;
- (b) a special issue of new KFB Shares to Bumiputera parties approved by the Ministry of International Trade and Industry, Malaysia and/or other Government authorities to comply with the Government policy on Bumiputera capital participation;
- (c) a private placement or restricted issue of new KFB Shares by the Company;
- (d) a share buy-back arrangement by the Company pursuant to the Section 67A of the Act;
- (e) an issue of new KFB Shares arising from the exercise of any conversion rights attached to securities convertible to new KFB Shares or upon exercise of any other rights including warrants (if any) issued by the Company; and
- (f) an issue of new KFB Shares upon the exercise of Options pursuant to the Scheme.

14.4 An adjustment pursuant to this By-Law shall be made according to the following terms:

- (i) In the case of a rights issue, bonus issue or other capitalisation issue, on the Market Day immediately following the entitlement date in respect of such issue; or
- (ii) In the case of a consolidation or subdivision of shares or reduction of capital, on the Market Day immediately following the date of allotment of new KFB Shares in respect of such consolidation, subdivision or reduction.

15. QUOTATION OF SHARES

The new KFB Shares to be allotted and issued to the Grantee will not be listed or quoted on Bursa Securities until the Option is exercised in accordance with By-Law 9 whereupon the Company shall make the necessary application to Bursa Securities for its permission to deal in and for the listing of and quotation for such new KFB Shares.

12. DRAFT ESOS BY-LAWS (CONT'D)

16. RANKING OF NEW KFB SHARES

The new KFB Shares to be allotted and issued upon any exercise of any Options granted shall upon allotment and issuance, rank pari passu in all respects with the existing KFB Shares PROVIDED ALWAYS THAT the new KFB Shares so allotted and issued, will not be entitled to any dividends, rights, allotments and/or other distributions declared, the entitlement date of which is prior to the date of allotment and issuance of the new KFB Shares. The new KFB Shares will be subject to all the provisions of the Articles of Association of the Company.

17. ADMINISTRATION

The Scheme shall be administered by the Option Committee on behalf of the Board. The Option Committee shall consist of such persons appointed by the Board. The Option Committee shall administer the Scheme in such manner as it shall in its discretion deem fit. For the purpose of administering the Scheme, the Option Committee may do all such acts and things and enter into any transactions, agreements, deeds, documents or arrangements, and make rules, regulations or impose terms and conditions or delegate part of its power relating to the administration of the Scheme, as the Option Committee may in its discretion deem fit necessary and/or expedient for the implementation of the Scheme. The Board shall have power from time to time to rescind the appointment of any person to the Option Committee as it deems fit.

The Board shall have power at any time and from time to time to assume and/or exercise or execute any of the powers and authorities conferred upon the Option Committee pursuant to this By-Law.

18. AMENDMENT AND/OR MODIFICATION TO THE SCHEME

The Board shall have the power at any time and from time to time by resolution to amend and/or modify, at the recommendation of the Option Committee, all or any of the provisions of these By-Laws PROVIDED THAT no such amendment and/or modification of these By-Laws shall be made which will:

- (i) prejudice the rights then accrued to any Grantee without his prior consent or sanction; or
- (ii) alter to the benefit of the Grantee, any matter which is required by the Listing Requirements to be contained in the By-Law, including matters in By-Laws 3.1, 3.2, 4, 6.1, 7, 8, 13, 14, 16 and 19 without the prior approval of the Company's shareholders in a general meeting.

Upon amending and/or modifying all or any of the provisions of the Scheme, the Company shall submit to Bursa Securities a letter confirming that the said amendment and/or modification does not contravene any of the provisions of the Listing Requirements on ESOS.

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12. DRAFT ESOS BY-LAWS (CONT'D)

19. DURATION OF THE SCHEME

19.1.1 The Scheme shall be in force for a period of five (5) years commencing from the effective date for the implementation of the Scheme, which shall be the date of full compliance with all relevant requirements including the following:

- (i) submission of the final copy of the By-Laws to Bursa Securities;
- (ii) receipt of approval-in-principle for the listing of the KFB Shares to be issued under the Scheme from Bursa Securities;
- (iii) procurement of shareholders' approval for the Scheme;
- (iv) receipt of approval of any other relevant authorities, where applicable; and
- (v) fulfilment of all conditions attached to the above approvals, if any.

19.2 Upon the expiry of the Scheme, the Board shall have the discretion, without approval of the Company's shareholders, to extend the duration of the Scheme PROVIDED THAT any extension of the Scheme shall be for a maximum duration of up to five (5) years. In the event the Scheme is extended in accordance with this provision, the Option Committee shall furnish a written notification to all Grantees and the Company shall make necessary announcements to Bursa Securities prior to the proposed extension of the Scheme.

20. TERMINATION OF THE SCHEME

Notwithstanding the provisions of By-Law 19, the Company has the right to terminate the Scheme at any time during the duration of the Scheme provided the following approvals/consents are obtained:

- (i) consent of the shareholders of the Company at a general meeting wherein at least a majority of the shareholders present voted in favour of the termination; and
- (ii) written consent of all Grantees who have yet to exercise their Options, either in part or in whole.

21. SUBSEQUENT EMPLOYEES' SHARE OPTION SCHEME

The Company may establish a new ESOS after the expiry of the Scheme or upon termination of the Scheme pursuant to the provisions of By-Law 20, subject to the approval of Bursa Securities, shareholders of the Company at a general meeting and any other relevant authorities/parties.

22. DISPUTES / DIFFERENCES

In the event of any dispute or differences between the Option Committee and an Eligible Person and/or Grantee, as to any matter or thing of any nature arising hereunder, the Option Committee shall determine such dispute or difference by a written decision (without any obligation to give any reason therefor) given to the Eligible Person and/or Grantee, as the case may be. The said decision shall be final and binding on the parties.

12. DRAFT ESOS BY-LAWS (CONT'D)

23. COMPENSATION

- 23.1.1 An Eligible Person or Grantee who ceases to hold office or employment shall not be entitled to any compensation for the loss of any right or benefit or prospective right or benefit under the Scheme which he might otherwise have enjoyed whether such compensation is claimed by way of damages for wrongful dismissal or other breach of contract or by way of compensation for loss of office.
- 23.2 No Eligible Person or Grantee or legal or personal representatives shall bring any claim, action or proceeding against the Company or the Option Committee or any other party for compensation, loss or damages whatsoever and howsoever arising from the suspension of his rights to exercise his Option or his Option ceasing to be valid pursuant to the provisions of these By-Laws, or as the same may be amended from time to time in accordance with By-Law 18.

24. SUBSIDIARIES OF KFB

In the event there is any new member to the KFB Group as a result of any acquisition or incorporation of any Subsidiaries during the tenure of this Scheme, the Scheme shall apply to such eligible employees and directors of the new Subsidiaries falling within the expression of "Eligible Person" under By-Law 1 and the provisions of these By-Laws shall apply.

25. DIVESTMENT FROM THE GROUP

If a Grantee who was in the employment of a company in the Group which was subsequently divested wholly, or in part, from the Group which resulted in a subsequent holding of 50% or less by the Group, then such Grantee:

- (i) may be entitled to continue to exercise all such unexercised Options which were granted to him under the Scheme within a particular time frame determined within the Option Period at the discretion of the Option Committee, failing which such Options together with all other Options, the exercise of which is not due, shall automatically lapse and be null and void and of no further effect; and
- (ii) shall not be eligible to participate for further Options under the Scheme.

26. COSTS AND EXPENSES

The Company will bear all costs of and incidental to the setting-up and administration of the Scheme. Any expenses incurred by the Company in any issuance of new KFB Shares in the name of the Grantee shall be payable by the Company.

27. NOT A TERM OF EMPLOYMENT

This Scheme does not form part nor shall it in any way be construed as part of the terms and conditions of employment or appointment of any Eligible Person.

28. ARTICLES OF ASSOCIATION

Notwithstanding the terms and conditions contained in these By-Laws, if a situation of conflict should arise between this Scheme and the Articles of Association of the Company, the provisions of the Articles of Association of the Company shall at all times prevail.

13. DIRECTORS' REPORT



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47410 Petaling Jaya
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21 June 2005


The shareholders of Kawan Food Berhad

Dear Sir/Madam:

On behalf of the Board of Directors of Kawan Food Berhad ("KFB"), I report that after making due enquiries in relation to the interval between 31 December 2004, being the date to which the last audited financial statements of KFB and/or its subsidiary companies have been made up, and 21 June 2005, being a date not earlier than fourteen (14) days before the issue of this Prospectus:

- (a) the business of KFB and/or its subsidiaries has, in the opinion of the Directors of KFB, been satisfactorily maintained;
- (b) in the opinion of the Directors of KFB, save as disclosed in the Prospectus, no circumstances have arisen since the last audited financial statements of KFB and/or its subsidiaries which have adversely affected the trading or the value of the assets of KFB and/or its subsidiary companies;
- (c) the current assets of KFB and/or its subsidiary companies appear in the books at values which are believed to be realisable in the ordinary course of business;
- (d) no contingent liabilities have arisen by reason of any guarantee or indemnity given by KFB and/or its subsidiaries;
- (e) since the last audited financial statements of KFB and/or its subsidiaries, there has been no default, or any known event that could give rise to a default situation, in respect of any payment of either interest and/or principal sums in relation to any borrowings of KFB and/or its subsidiaries; and
- (f) save for the changes resulting from continuing operations and save as disclosed in Section 9.11 of the Prospectus, there have been no material changes to the published reserves or any unusual factors affecting the profits of KFB and/or its subsidiaries since the last audited financial statements of KFB and/or its subsidiaries.

Yours faithfully
For and on behalf of the Board of Directors
KAWAN FOOD BERHAD



Tan Sri Dato' Mohd Ibrahim bin Mohd Zain
Non-Independent Non-Executive Chairman