

1. Executive Summary

1.1 Introduction

HG Metal Manufacturing Ltd (“HGM” or “the Company”) has appointed Deloitte & Touche Enterprise Risk Services Pte Ltd to perform reviews based on certain Agreed-Upon Procedures (“AUP”) on certain possible Interested Person Transactions (“IPT”) pursuant to two engagement letters dated 5 February and 16 April 2014.

1.2 Scope and Limitation

The review covers the period from 1 January 2012 to 31 December 2013. The review covered transactions between and HGM and its subsidiary companies (“the HGM Group”) with:

- (a) Foklien Hardware (M) Sdn Bhd (“Foklien”);
- (b) F&C Supply and Trading (“F&C”); and
- (c) Khun Hong Metal Trading & Transport (“Khun Hong”).

We have completed the procedures as outlined in our terms of reference. In this regard, we have also reviewed and considered the legal opinion from MG Chambers LLC dated 8 April 2014 to HGM on the nature of the transactions with F&C and Khun Hong (“the Legal Opinion”). There were also certain limitations as cited in this report on our ability to ascertain if F&C and/or Khun Hong were indeed “associates” of Foklien. Accordingly, the issues identified and/or discussed in this report are those which came to our attention during the course of performing our procedures and are not necessarily a comprehensive statement of all the issues that exist or should be brought to the Company’s attention.

This summary was prepared for the sole purpose of supporting the Company's disclosure obligations. We did not verify the accuracy, completeness or authenticity of any information or documents, and any assumptions made is based on information, provided by the Company or on the Company’s behalf. We are and shall not be responsible or liable to any third party having access to our report and its use or reliance of the contents of this report, unless expressly consented by us.]

1.3 Key Findings

1.3.1 Transactions with Foklien

Based on available records, the majority shareholder of Foklien was Mr. Tan Chun Tik, who is the brother of a former director of HGM, Mr Tan Chan Too (“CT Tan”). We noted that Foklien started trading with the HGM Group (via a subsidiary company in Malaysia) in 2013. However, other than an unsigned credit approval form dated 30 August 2013, there was no other documentation on the opening of Foklien’s trading account with the HGM Group. There were no formal procedures governing the approval and disclosure of IPT at the time of opening of Foklien’s trading account with HGM. In the same manner, the transactions were not subjected to or in compliance with any formal written procedure as there were none.

The transactions between the HGM Group and Foklien for the financial year ended 31 December 2013 (“FY 2013”) comprised sales to Foklien of about S\$462,000 and purchases from Foklien of about S\$223,000. These transactions were reported to the HGM board of directors as interested person transactions (“IPT”) conducted not within the IPT Mandate. However, there was no documentation of the requisite approval from the CEO or director.

1.3.2 Transactions with F&C and Khun Hong

F&C and Khun Hong commenced trading with the HGM Group in 2006 and 2011. F&C was granted an initial credit limit of S\$500,000 but there was no supporting documentation for the credit approval. The credit limit was subsequently increased to S\$ 6 million with the approval of 4 directors of HGM, including Mr CT Tan. The transactions between the HGM Group and F&C and Khun Hong in FY 2012 and 2013 were as follows:

	FY 2012	% of FY2012 Group Revenue	FY 2013	% of FY2013 Group Revenue
Sales to F&C (S\$'000)	6,623	1.63%	10,556	3.97%
Sales to Khun Hong (S\$'000)	6,083	1.50%	12,190	4.58%

We noted that Foklien had settled and/or assumed various amounts owing by these two entities to the HGM Group in 2012 and 2013. In addition, Mr. Tan Chun Tik has signed contracts with and letters to the HGM Group on behalf of F&C and Khun Hong, and products sold to F&C and Khun Hong were delivered to Mr Tan Chun Tik’s address. When queried, Mr CT Tan responded that this was because “*Foklien placed orders for the Company’s products with F&C and Khun Hong from time-to-time and Foklien was one of the end customers of F&C and Khun Hong in respect of such purchases*”. We understand from Mr. CT Tan that Foklien did not purchase the products directly from HGM as it did not have the required license to import the products into Malaysia.

Based on the HGM Group’s sales invoices, discounts ranging from 5% to 15% were given to F&C and Khun Hong in 2012 and 2013. We understand that these discounts were given based on the negotiations between the (then) Head of Sales, Ms. Tan Yee Lee (who is also the daughter of Mr CT Tan) and/or Mr CT Tan and F&C and Khun Hong. These sales transactions were not considered to be subjected to HGM’s Master Price List and the corresponding approval procedures for discounts to be given. We understand from Mr CT Tan that these were “*indent sales*” and as such, did not fall within the requirements of the Company’s Sales Guide which stipulated that discounts exceeding 5% should be approved by the Executive Director.

As of 31 October 2014, there were no outstanding receivables from F&C and Khun Hong. As of 31 January 2015, there were no outstanding receivables from Yook Cheng Metal Trading¹ (“Yook Cheng”) which took over Khun Hong’s accounts and its credit terms of 60 days. We understand that the payment terms for Yook Cheng was subsequently amended to “Cash on Delivery” but the average payment days for Yook Cheng were 286 days, which was higher than the average collection periods for HGM’s other customers of about 152 days.

¹ We understand Yook Cheng was introduced to HGM by Foklien in January 2014 when Khun Hong’s account with HGM was closed and “replaced” by Yook Cheng.

1.4 Conclusion

Foklien was disclosed as an “Interested Person” and the corresponding transactions as IPT in the annual report for FY 2013. By placing orders for the Company’s products with F&C and Khun Hong as the “end customer”, Foklien could be said to be the effective purchaser of these products. In addition, F&C and Khun Hong’s combined credit limit of \$6 million was secured at the back of guarantees provided by Foklien and Mr Tan Chun Tik and some sales contracts of F&C and Khun Hong with HGM in FY 2013 were endorsed by Mr Tan Chun Tik, the majority shareholder of Foklien, on behalf of F&C and Khun Hong respectively.

Under the above circumstances, it could be argued that the transactions between the HGM Group and F&C/Khun Hong were, in substance, with Foklien and hence considered as IPT. The aggregate value of the transactions between the Company and Foklien, F&C and Khun Hong had exceeded 5% of the group’s net tangible assets for FY 2013. On this premise, disclosure as well as shareholders’ approval and ratification would be required.

However, Mr CT Tan disagreed with this position on the premise that “*there were also other customers of F&C and Khun Hong who made direct payments to HGM for orders placed by F&C and Khun Hong.*” As we did not have access to the financial records of F&C and Khun Hong, we were not able to determine the extent of the transactions in which Foklien was the “end customer”. A separate review commissioned by the Company did not identify any direct relationship between F&C/Khun Hong and Foklien/Mr Tan Chun Tik. In this regard, further consultation with the authorities and/or professional advisors may still be required.

Notwithstanding the limitations to determine the nature of the transactions with F&C and Khun Hong as outlined above, we have made several recommendations to strengthen the Company’s internal controls over the approval of customer contracts and disclosure procedures. These recommendations have been accepted by the management and will be implemented to prevent similar situations in the future.