MSWG MINORITY SHAREHOLDERS WATCH GROUP
Badan Pengawas Pemegang Saham Minoriti Berhad (524989-M)

The Observer

04.09.2020

❖ The risk of share pledging by substantial shareholders/directors

Share pledging made headlines recently following the move by Genting Berhad's (Genting) chairman and chief executive Tan Sri Lim Kok Thay to pledge nearly all of his 76% stake in Genting Hong Kong (Genting HK) as collateral for loans after shares in Genting HK plunged 38% a day after an announcement that it would suspend all payments to creditors in a bid to maintain critical services.

Considering the quantum of the pledged shares, analysts are concerned that Kok Thay's decision may increase the risk of a margin call which could mean having to increase collateral or even lead to Genting HK shares being sold on the open market to recoup funds, thus pushing the stock price even lower.

At a glance, share pledging which refers to taking loans by using shares that one holds as collateral is a valuable platform for corporate insiders to nominally retain ownership in their companies while at the same time leveraging the liquidity that is tied up in their companies' stock.

This thus allows corporate insiders to diversify their personal wealth by funding other private investment opportunities.

A risky manoeuvre

Nevertheless, share pledging is often regarded as the last resort for company founders or major shareholders to raise fund.

Given that it is comparatively safer to raise fund through equity or debt, the pursuit of share pledging could mean that all the other options of raising fund have been closed.

This can be tell-tale signs of poor cash flow patterns, credit crunch in a company or the corporate insider's inability to meet short-term working capital requirements.

During a bull market, pledging of shares may not create many issues as the market is moving upwards and investors are optimistic.

However, amid a bear market when stock prices are volatile, it must be borne in mind that the value of the collateral (pegged against the secured loan) will fluctuate with the change in the share price.

If share price falls, the value of the collateral will get eroded. In order to make up the difference in the collateral value, the corporate insider will have to cover the shortfall by either pumping additional cash or pledging more shares to the lender.

Should he/she fail to make up for the difference, the lender/s can sell the pledged shares in the open market to recover their money.

If this happens, the stock price can take a beating on the news that lender/s will offload the pledged shares in the open market. The ensuing panic selling by the public may ultimately result in a further decline of the collateral value.

Additionally, selling of the pledged shares by lender/s may also result in a change of the company's shareholding pattern. This may eventually affect the voting power of the corporate insider as he/she is now holding fewer shares.

Knock-on effect

Although Genting and its subsidiary Genting Malaysia Berhad (GENM) do not have cross-shareholdings in Genting HK, both encountered selling pressure after news broke out of the share pledging exercise.

Kok Thay's role as a common shareholder across the three entities has sent jitters across the conglomerate even as Genting HK is a separate entity and it is unlikely that a default at its level will trigger cross defaults on the group's debt.

At the group-wide level, there is concern that Genting Group may resort to related party transaction (RPT) to bail out Genting HK although Kok Thay is likely to strike a deal with creditors by leveraging the family name and reputation.

Aside from his 75.6% stake in Genting HK, Kok Thay also holds a 44.8% stake in the flagship Genting which controls 49.45% of GENM, 52.66% of Genting Singapore Ltd and 55.15% of Genting Plantations Bhd.

Against the backdrop of border closures and movement restrictions to contain the spread of the COVID-19 pandemic, Genting HK announced a whopping net loss of US$742.59 million for the six months ended 30 June 2020, while Genting suffered net loss of RM786.05 million in the three months ended 30 June 2020.

Meanwhile, Genting HK's total loans and borrowings swelled to US$3.26 billion as of 30 June, from US$2.74 billion as of end-2019. The loans that are repayable within a year amounted to US$200.4 million (Source: *Genting HK's result for the six months ended 30 June 2020, announced on 28 August 2020*)

In all fairness, insider pledging can be detrimental to share value of a company if carried out without proper consideration of the credit risk of the pledgor.

Recall that Tan Sri Wan Azmi Wan Hamzah and Datuk Mohd Zakhir Siddiq emerged as substantial shareholders of Scomi Energy Services Bhd following a transfer of shares from Scomi Group Bhd.

The duo had given a loan to Scomi Group two months after it announced a restructuring plan which entails raising up to RM214 million via a rights issue to recapitalise the company.

However, Scomi defaulted a loan of RM42 million from the duo and subsequently filed injunction applications to stop Wan Azmi and Mohd Zakhir from taking over the stake.

The application was dismissed by the High Court. Shares in Scomi Energy were then allowed to be transferred to them.

Directors pledged shares should be disclosed

This above suggests that pledging should be clearly disclosed in a timely manner in line with the preservation of shareholder wealth and maintaining sound corporate governance practices.

On their part, minority shareholders are advised to keep a close eye on share pledging as it can negatively affect their returns during periods of high volatility.

As a thumb rule, pledging of shares above 50% can be a risky affair. In short, minority shareholders should be wary of companies whose owners or major shareholders have pledged a substantial number of shares to obtain loans.

Nevertheless, pledging of shares in moderate quantity (i.e. 5% to 10%), by shareholder-directors, can serve as a springboard for fundamentally sound companies to spur their expansion or fund new projects that will drive future revenue growth.

There should be a disclosure requirement stating that pledging of shares by a shareholder-director above a certain threshold should be disclosed to enable informed decision making by investors.

Devanesan Evanson
Chief Executive Officer

MSWG AGM/EGM Weekly Watch 7 September – 11 September 2020

For this week, the following are the AGMs/EGMs of companies which are in the Minority Shareholders Watch Group's (MSWG) watch list.

The summary of points of interest is highlighted here, while the details of the questions to the companies can be obtained via MSWG's website at www.mswg.org.my.

Date & Time	Company	Quick-take
08.09.20 (Tue) 10.00 am	PBA Holdings Bhd (AGM)	Penang is expected to face an acute water shortage by 2025 if it does not seek an alternative water source. The State government plans to transfer water from Sg. Perak but the Perak government insists to sell treated water to Penang which in turn will entail higher costs. Due to the change in government, the fate of this project now hangs in balance. What are the alternatives to the Company if this project does not materialise? What are the steps taken

		by PBA and the state government to get the Federal government's buy in to advance their cause in the implementation of the project?
10.09.20 (Thur) 01.30 pm	Muhibbah Engineering (M) Bhd (AGM)	The infrastructure construction segment to record a loss of RM45.88 million in FY2019 (FY18: net profit of RM197.32 million) due to provision made on its project in Middle East and delay in the processing of claims and compensation for a government-linked project.
10.09.20 (Thur) 02.00 pm	Eversendai Corporation Bhd (AGM)	The Group recorded a 65.7% y-o-y drop in net profit to RM16.4 million from RM47.8 million recorded in the previous year. The lower profit was due to the inadequate utilisation of the fabrication yard in Ras Al Khaimah, the United Arab Emirates
10.09.20 (Thur) 04.00 pm	Eversendai Corporation Bhd (EGM)	The purchase consideration of RM235 million works out to an earnings multiple of close to 50 times Vahana Offshore (M) Sdn Bhd's earnings. It is deemed to be on the high side, considering the current economic/financial climate where risks are seemed to outweigh benefits.

One of the points of interest to be raised:	
Company	**Points/Issues to Be Raised**
PBA Holdings Bhd (AGM)	On Page 20 of the Chairman's statement it is stated that Penang will face serious water shortage problems if it does not find an alternative to its current source of water supply, Sg, Muda in Kedah by the year 2025. It has been proposed that the Company seeks a water transfer project from Sg Perak and this has been deemed as the most rational solution to the problem. However, the Perak government insists on selling treated water to Penang and this will not be viable from a cost perspective. The proposal which was supposed to be tabled in Parliament in 2019 has not been brought up and since the change of government the fate of the project remains uncertain. a) What are the alternatives to the Company if this project does not materialize?

	b) What are the steps taken by the Company and the State government to get the buy-in from the Federal government to advance their cause in the implementation of this project?
Muhibbah Engineering (M) Bhd (AGM)	As at 29 April 2020, the outstanding secured order book for the construction and engineering division stands at approximately RM897 million (Page 8 of the Annual Report 2019). The outstanding total secured order book for the Crane and Automation division stands at approximately RM521 million (Page 10 of the Annual Report 2019). How long will the divisions' order books last? What is the targeted order book replenishment in the next two financial years?

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DISCLOSURE OF INTERESTS

•With regard to the companies mentioned, MSWG holds a minimum number of shares in all these companies covered in this newsletter.