MINORITY SHAREHOLDERS WATCH GROUP

BADAN PENGAWAS PEMEGANG SAHAM MINORITI BERHAD

(Incorporated in Malaysia . Registration No. 200001022382 (524989-M))

The Observer

MSWG would like to wish all our Muslim friends Selamat Hari Raya. Wishing you and your family a prosperous and blessed celebration, Eid Mubarak!

The Observer will take a break next week and resume publication on 19 April 2024.

Deloitte is conducting the 2024 Conduct Watch Survey to gain insight into organisational attitudes and capabilities toward whistleblowing. Participants, especially senior management, c-suite, or board-level executives who oversee whistleblowing from diverse backgrounds such as legal, internal audit, risk, compliance, and integrity, are encouraged to participate.

Please click the link or scan the QR code on the right to access the survey.

05.04.2024

❖ Equity fundraising: Examine the utilisation of proceeds

Access to financial capital through equity fundraising presents a significant advantage for public-listed companies (PLCs) compared to privately held entities. This avenue allows companies to leverage the vast potential of the capital market to secure funding for their operations and expansion efforts.

PLCs frequently issue new shares through placements or rights issues to meet specific funding requirements, such as acquisitions, working capital, or debt repayment. Moreover, companies may utilise various share issuance schemes (SIS) or employee share option schemes (ESOS) to reward and retain their employees.

When a listed entity issues new shares via private placement, SIS, or ESOS (excluding rights issue), existing shareholders may experience a short-term loss due to the dilution of their existing shareholding. Mathematically, the pie has not changed in size, but the slice has shrunk to reflect the increased share count. The increased number of shares leads to a corresponding decline in share price.

Nevertheless, shareholders may realise long-term gains if the company effectively utilises the proceeds from the share issuance to enhance its revenues and profitability. Suppose the motivation behind the share issuance is to seize an exceptional opportunity for rapid growth that requires additional funding. In that case, shareholders may benefit from subsequent price appreciation as the company expands its operations which in turn is expected to improve its profitability in the medium term.

Some questions to ask

While equity fundraising is common for PLCs, it is imperative for minority shareholders to scrutinise how the proceeds are utilised carefully. In light of this, minority shareholders should pose pertinent questions whenever investee companies propose to issue new shares:

- Have recent share issuances occurred, and when were they conducted? How were the proceeds utilised, and what were the businesses or activities invested? Are there any remaining unutilised funds?

- What was the company's liquidity position when proposing the share issuance? Was it financially robust? If yes, what was the rationale for raising funds by issuing new shares?

- Who were the placees for private placements, and what were the sizes of the placements? Were placement shares issued at a premium or discount to market prices?

- How many ESOS/SIS shares were granted and exercised? Who were the recipients, and what are the vesting conditions and periods for the shares? How were the proceeds utilised?

- Has the company demonstrated improved financial performance following the fundraising exercise, and how long is this expected to continue?

It is intriguing to see how some PLCs issue shares of all shapes and sizes to raise funds despite their robust balance sheets.

Over the past few years, one listed company has conducted multiple rounds of share issuances, including private placements, rights issues, SIS, ESOS, and conversion of ICPS, to fund its business expansion.

Primarily engaged in technology incubation and investment holding activities, the Company raised approximately RM250 million by issuing 5.1 billion new shares between 2020 and 2022. Consequently, its total issued shares surged from around 810 million to 5.9 billion within a span of twenty-plus months.

About 60% of the total funds raised via placements and rights issue were spearheaded for the Company's glove manufacturing business – a venture initiated during the peak of the COVID-19 pandemic. The money was utilised to construct a new glove plant, install glove dipping lines, and provide working capital for the glove business.

Notably, when it announced a placement to issue up to 20% of issued share capital to fund its glove business, it was in a net cash position with hundreds of millions of investment securities.

Indeed, high expectations were placed on the glove business, with reports suggesting that the factory could generate RM700 million in annual revenue for the Group at maximum production output.

Three years later, the performance of its glove business was far from its aspiration. In the six months ended 30 June 2024, the glove business recorded lower sales of RM292,000 compared to RM668,000 in the previous corresponding period, accompanied by a widened pre-tax loss of RM2.8 million (1HFY2022: -RM1.89 million). The segment contributed 8% of the six-month revenue. As of the latest quarter, RM18.8 million raised earlier remains to be spent on the glove business.

At the same time, the Company has been experiencing losses for the past three years, with net losses between RM31.8 million and RM313.68 million. As it incurred losses, it reported persistent negative returns on equity (ROE)—a measure of how efficiently a company uses its money to generate profit.

Considering these facts, the question arises: Were the funds utilised effectively? The decision rests with you.

By MSWG Team

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DISCLOSURE OF INTERESTS

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

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