MSWG "puzzled" about Can One deal - M.A. Wind

MSWG Sat, 23 May 2015, 08:54 AM

From "The Observer" MSWG's newsletter dated May 22, 2015:

Can-One had on 13 June 2014 entered into a conditional share sale agreement with Teh Khoy Gen for the proposed acquisition by Can-One of 3,000,000 ordinary shares of RM1.00 each in F & B Nutrition Sdn Bhd (F&B) representing the remaining 20% of the issued and paid-up share capital of F&B not already owned by Can-One at a purchase consideration of RM112,900,000 to be satisfied entirely via the issuance of 39,753,000 new ordinary shares in Can-One (Can-One Share(s)) representing approximately 20.69% of the enlarged issued and paid-up share capital of Can-One at an issue price of RM2.84 per Can-One Share which represents a premium of approximately 10% over the 5-day volume weighted average market price of can-one share up to and including 12 June 2014 (Proposed Acquisition)

The Board of Can-One further announced that Bursa Malaysia had vide its letter dated 20 April 2015 (which was received on 21 April 2015) approved the listing and quotation of 39,753,000 new Can-One Shares to be issued at an issue price of RM2.84 per Can-One Share as the purchase consideration pursuant to the Proposed Acquisition.

*[Source: Can-One's announcements on Bursa Malaysia's website on **14 June 2014**, **21 April 2015** and **8 May 2015**]*

<u>MSWG'S COMMENTS</u>:
MSWG was puzzled at this deal as Can-One is acquiring from Mr. Teh Khoy Gen, the remaining 20% equity stake in a subsidiary (F&B), which it already owns 80% stake while the remaining 20% is owned by Mr. Teh and how this could result in Mr. Teh emerging as a new shareholder in Can-One with a 20.69% equity stake (from a 20% equity stake in the subsidiary of Can-One).

Thus we need further clarification as it does not appear to add up. This is on account of the following:
(ii) This subsidiary, F&B, makes up only about 56% of Can-One Group's EBITDA.
(iii) There are other subsidiaries and associates such as Kian Joo which contributed the remaining 44% of Can-One Group's EBITDA.
(iii) Can-One is valuing its shares at a 17% discount to its net assets, whereby F&B is valuing it at 4.86 times its book value.
(iv) Can-One's issue price for its shares only represents 6.21 times of price-to-earnings ratio (PER), whereas the PER of F&B is 15 times. F&B is an unlisted entity and yet it is accorded a PER which is much higher.

Based on the above, we, thus, require further explanations at the coming EGM.

I agree, and I like to add the following illustration from page 28 of the **circular**:

	Before the Proposed Acquisition	After the Proposed Acquisition
	RM'000	RM'000
PAT for FYE 31 December 2014 attributable to the owners of the Company	63,776	63,776
Add: Contribution from the 20% interest in F&B	-	7,223
Proforma PAT of Can-One	$\boxed{63,776}$	$\boxed{70,999}$
PAT attributable to the		
- existing shareholders	$\boxed{63,776}$	$\boxed{56,339}$
- the Vendor	-	14,660

Can One will acquire 20% of F&B, so the PAT of Can One will increase (the blue box), that is good.

However, existing shareholders of Can One will get diluted (the red box), that is bad.

Unfortunately, the dilution is much larger than the added earnings, and thus existing shareholders will receive 12% less profit than before the deal.

The deal thus looks clearly bad for existing shareholders, and it is indeed puzzling why the board of directors of Can One supports the current deal.

Three reasons are given:

- the increased earnings, but on a per share basis that doesn't work, as explained above; also the PE of (unlisted) F&B is compared to the PE of listed company, which is really not fair, unlisted companies trade at much lower valuations than listed companies
- about the outlook for F&B (but Can One owns already 80%)
- lastly a rather curious statement:

> **Eliminate the Potential Loss of F&B's Competitive Edge to the Competitors**
>
> The Proposed Acquisition will eliminate the exposure of products' formulas, re-engineered production process and potential operations interruption should the Vendor divests the Sale Shares to external parties who may request for board seat and/or management participation in F&B which enables the external parties to access the Company products' formulas and re-engineered production process. The Board believes that exposures of such information may enable industry players to emulate F&B's success and hence may affect F&B's competitiveness.

First of all, that is three times the word "may", so rather speculative.

Secondly, assuming that there is a genuine buyer, in most contracts (or according to the articles of association) the seller has to offer the shares first to the current shareholders (Can One) under the "Right of First Refusal" rule, so Can One can still decide to buy the shares when that moment arrives.

Thirdly, assuming indeed an outside party buys the 20%, requests and gets a board seat and starts to expose the "secrets". Well, that is plainly against the rules, a director has to act in the best interest of the company, so time to call in the cops.

In other words, all arguments given are rather weak.