

Pestech minorities caught between a rock and a hard place

Having IJM Corp Bhd as its largest shareholder could be a blessing for financially stressed Pestech International Bhd, given the former's track record and expertise in the construction industry.

However, Pestech's shareholders appear to be paying a high price to have the construction giant on board. IJM will emerge as its single largest shareholder with a 44.83% stake via a restricted offer of 800 million shares at 15.5 sen apiece, or RM124 million in total.

The few factors that have raised eyebrows are the transaction price and the sheer size of the restricted offer, resulting in massive dilution. On top of that, IJM is seeking a waiver from making a mandatory general offer even though the offer price is substantially lower than the prevailing market price.

At 15.5 sen each, Pestech shares will be issued at a steep discount of 47.5% over the last traded price of 29.5 sen prior to the announcement. At that price, the company — which provides pure system services in rail electrification and signalling — will be valued at RM152 million.

Pestech's share price closed at 26 sen last Friday. The stock was hovering at the 32 sen level after doubling since last month. It fell to a low of 23.5 sen when news of the proposed acquisition by IJM broke.

It is understandable that minority shareholders may conclude that the proposed restricted issue seems to be selling Pestech shares cheap. The sharp discount on the transaction price shows that the company's bargaining power is low, partly because of its debt-laden balance sheet, which has total debts of RM1.36 billion, of which short-term borrowings amounted to RM602.8 million.

Furthermore, recent news flow put Pestech in the spotlight for all the wrong reasons. The company's executive chairman Lim Ah Hock and managing director and group CEO Paul Lim Pay Chuan were charged by the Malaysian Anti-Corruption Commission on Jan 27 for abetting four payments amounting to RM10.6 million made by its wholly-owned subsidiary Pestech Technology Sdn Bhd to a consulting company for works that were not rendered. However, the duo were discharged and acquitted of all charges early this month.

On top of that, Pestech lost its RM399 million subcontractor job for the Gemas-Johor Baru electrified double-track project in May. The contract was awarded by Syarikat Pembeanaan Yeoh Tiong Lay Sdn Bhd (SPYTL).

When contacted Pay Chuan, whose existing 19.32% stake is expected to be diluted to 10.66% after the proposed restricted offer, says the proposed restricted issue should not be compared with a normal placement exercise as IJM brings more than financial support to Pestech.

He believes the construction giant also "extends collaborative synergistic business advantages to Pestech". "This is particularly important from a long-term growth point of view to propel [Pestech] forward sustainably in the power infrastructure industry."

Minority Shareholders Watch Group CEO Devanesan Evanson has called out the lopsidedness of the deal, saying that while it is commonplace to offer a discount in the issuance of a substantial block of shares, the 47% discount in the proposed acquisition is too much for the issuance of a 45% stake. "In that context, the transaction is not beneficial to shareholders of Pestech, especially its minority shareholders, due to the dilution effect at such a low price," he points out.

However, he adds that given the risks associated with Pestech, IJM probably needs the deep discount to justify the acquisition.

"With the substantial stake, IJM will be in a comfortable driving seat to pursue its corporate strategies and be able to equity account its investment.

"Meanwhile, Pestech needs to finance its immediate day-to-day working capital requirements for projects and repay part of its bank borrowings. It probably wanted to obtain as much cash as it possibly could from IJM."

IJM managing director and group CEO Lee Chun Fai stresses that the acquisition of the stake in Pestech for RM124 million comes with its share of risks.

"We have to balance the risks of the acquisition. People say this is a bailout because of Pestech's cash situation. [But] it is a willing-buyer, willing-seller situation. Of course, Pestech wanted a higher price while we wanted a lower price ... 15.5 sen was what was finally

acceptable to both sides," he tells *The Edge*.

"Pestech is facing a cash crunch. We [can] turn the tap on for [Pestech]," he adds.

What the SC says

Apart from approval from Pestech's shareholders on the waiver to make an MGO, IJM needs to seek the Securities Commission Malaysia's (SC) consent as well in order to be exempted from the obligation.

When asked about the justification for the regulator to grant the waiver, the SC tells *The Edge* that the safeguards for IJM's request for a waiver of the obligation to undertake a mandatory offer are "embedded in the rules under subparagraph 4.08(1)(b) of the Rules on take-overs, Mergers and Compulsory Acquisition".

"These include the obligation on Pestech to appoint an independent adviser to provide independent advice to its shareholders on, among others, the financial and shareholding impact on the company and its shareholders respectively. This requirement applies before the shareholders decide whether or not to approve the proposed exemption at the general meeting," the SC says in a reply to the query.

On the proposed massive share issuance by Pestech to IJM, the regulator replies that the proposed restricted issue and issuance price were commercial decisions made within the purview of Pestech's board and were subject to the approval of Pestech's shareholders at its upcoming general meeting. "It is the responsibility of the board, management and advisers to ensure transparency and compliance with the relevant guidelines and provisions in undertaking the proposal."

Niche player

The RM399 million subcontract for the Gemas-JB electrified double-track project, which was terminated, was a major endeavour for Pestech, which has established itself as a leading contender for railway systems jobs in the last two years.

The system's components include electrification, communication and signalling. These were works previously undertaken by foreign companies. Pestech is the only local company that has the expertise to compete

with foreign firms for domestic rail projects.

Pestech is disputing the termination of the contract. It claims that the termination is unlawful and amounting to SPYTL's repudiation of the subcontract.

Pestech also denies that its subsidiary that undertakes the contract is insolvent as claimed by SPYTL.

It alleged that the rail project was experiencing serious negative cash flow issues created by SPYTL, due to rear-loaded project payment milestones and a delay in SPYTL's works, which resulted in the need for an extension of time of over two years for its unit to complete the works.

Other jobs on Pestech's books are the automated people mover (APM) aerotrain project in the Kuala Lumpur International Airport and the Rapid Transit System (RTS) job between Johor Baru and Singapore.

Pestech had not been in the red until the financial year ended June 30, 2023 (FY2023). The company posted a net loss of RM132 million on revenue of RM329.3 million for the nine-month period ended March 31 this year.

The large loss was partly due to litigation settlement of RM20 million plus interest expenses of RM61.24 million and fair value adjustment on concession assets of RM109.06 million.

The projects on Pestech's books are currently not within IJM's job scope. Given the government's efforts to expand public rail transport in the country, this is expected to augur well for Pestech.

Paying RM124 million for a substantial stake in a company might not be that big a deal for IJM, whose coffers expanded by RM1.53 billion after it sold its plantation business in late 2021. But this is surely a major corporate exercise for Pestech.

"We are confident that the proposal will get the support of the shareholders as it boosts the company positively — financially and collaboratively in support of our business," says Pay Chuan.

Is the steep discount a price too big to pay for Pestech to get out of the rough patch it is in? Its minority shareholders will need to decide at the extraordinary general meeting.