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Riding on an M&A theme

Inside Insights
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THE Malaysian stock market has never been a dull one. It has always been able to attract investors' interest in the form of corporate actions, merger and acquisition (M&A) activities, frenzied buying (or selling) interest among selected situational stocks, listing of a new public issue and of course, market themes.

We have observed how some of these themes can either send the sector riding sky high or down to the dumps based on investors' sentiment towards the sector.

The rally in the healthcare sector, in particular glove stocks, has been instrumental in sustaining the market's momentum while the worst performing sector is the energy sector as valuations took a dive on lower crude oil prices.

This is followed by the property sector on the back of lower housing demand due to Covid-19 and the huge overhang across most segments.

Nevertheless, the property sector recently got a boost when UEM Group, the major shareholder of UEM Sunrise, wrote to their subsidiary company and Eco World Development for a proposed merger of the two to create a larger and bigger entity with the objective of enhancing the merged company's economics of scale, diversity in geographical landbank and to tap on each other's expertise.

This proposal is still subject to the respective board's deliberation and if approved, it will create Malaysia' largest property company with potential gross development value in excess of RM150bil. While there is always potential benefit on paper when it comes to M&A activities, it is never as straightforward as it seems.

Jobs will be at stake as well as the merger benefit may result in a value which is less than the sum of the two. Nevertheless, we have seen mergers that bring synergistic benefits and shareholders should always explore potential mergers to create larger business enterprises.

In Malaysia's case, other than M&A activities driven by entrepreneurs, we often see that it is the government-linked companies (GLCs) that are in the forefront of business union as their major shareholders, typically a government institution or a government-linked investment company (GLIC) are of the opinion that a merger may be fruitful if the synergistic benefits makes sense while at the same time creating bigger and larger entities.

Our GLICs hold strategic government-owned listed assets like airports and banks, which among others include Maybank, CIMB and RHB. There are also utility companies like Tenaga Nasional and telecommunication providers like TM and Axiata and there are some companies where the strategic holdings are significant but are not in the critical sectors. Permodalan Nasional Bhd (PNB) and shareholding of companies held under their respective unit trust funds include companies like Sime Darby where they own a stake of some 48.9%; Sime Darby Plantation (56.5%); Sime Darby Property (51%); SP Setia (62.4%); UMW Holdings (49.7%); Velesto Energy (46.6%); Chemical Company of Malaysia (56.3%); Duopharma Biotech (47.1%) and Sapura Energy (39.2%).

For Khazanah Nasional, the key assets include their 69.2% stake in UEM Edgenta while their 66% stake in UEM Sunrise will be diluted post-merger with Eco World, if the merger gets the green light.

Speaking of mergers, there have been previous attempt to merge several of these strategic assets held by the GLICs and those include that of the planned merger between Digi and Axiata; between RHB and AmBank; and earlier on, between RHB, CIMB and MBSB, but, alas, all fell through for one reason or another.

Other potential M&As?

There are two parts to this analysis and it boils down to fitting of the two or more companies and at the same time to see if some of these companies are even better off in private hands than as a listed entity.

The first obvious choice of a merger and following-up on UEM Sunrise/Eco World merger proposal is to have a merger between the two giants in the property sector, ie a merged entity arising from the union of SP Setia and Sime Darby Property.

PNB and EPF are the major shareholders of both the companies while Kumpulan Wang Amanah Pencen (KWAP) also owns close to 10% shareholding in SP Setia.

All in, the major shareholders own 60.7% of Sime Darby Property and 79.2% of SP Setia. With a combined market value of RM6.71bil, a merger between the two companies will make the combined entity the largest landowner in the country and with combined undeveloped GDV of more than RM220bil.

The next potential merger is between Sapura Energy and Velesto. Other than PNB as major shareholder in the two companies, Velesto is also owned by Urusharta Jamaah with a 5.3% stake while EPF has a marginal 2.3% holding, making the total shareholding of the three shareholders at 54.2%.

Sapura Energy is 2.8% owned by KWAP and hence the combined stake together with PNB is 42%.

A merger between the two will result in a combined entity with total market value of about RM2.66bil. Not very big in the scheme of things but the merger of two companies in similar business does make sense.

The third merger is a merger between one of PNB's companies with another GLIC company, but not among the three others mentioned above.

With the healthcare issue remaining elevated and as Malaysia prepares to fill and finish a Covid-19 vaccine, perhaps it is an opportune time to merge the two state-owned pharmaceutical companies to make them even bigger. Duopharma is presently 54.7% owned by PNB/EPF while Pharmaniaga is 67% owned by Lembaga Tabung Angkatan Tentera and another 3.5% or so between KWAP, PNB and Urusharta Jamaah.

The merger between these two companies could see the market value of the combined entity at just over RM4.1bil.

Other than merger possibilities, there are also potential privatisations that may take place.

Last month we saw PNB and parties acting in concert with combined holding of 46.1% extending a Selective Unit Redemption exercise on Amanah Harta Tanah PNB at an offer price of RM1.00, which was almost 50% higher than its last traded price.

The question is what are other potential privatisation candidates? On top of recent market rumour that PNB is looking to sell its stake in CCM, which was of course denied by the board, there are other potential privatisation candidates.

Interestingly, two out of three companies that are potential candidates have a common major shareholder, Tan Sri T Ananda Krishnan. Of course, this refers to two of its listed companies – Bumi Armada and Astro, in which he holds both directly or indirectly, 34.9% and 41.3% stake respectively.

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Merger and acquisition scene in Malaysia remains active

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After adjusting for a bonus and rights issue on the basis of one for two each, Bumi Armada is presently trading at a massive 87% discount to its adjusted re-listed IPO price of RM1.85 per share, while Astro, which was last seen at 73 sen, is now 75.7% below its re-listed IPO price of RM3.00 per share.

Bumi Armada's other major shareholders are PNB with a 13% stake, while EPF and Urusharta Jamaah have a combined stake of 2.7%, bringing the GLICs combined stake with the major shareholder just above the 50% mark. As for Astro, Khazanah is the second largest shareholder with a 20.7% stake followed by EPF at 8.1%. On a combined basis, together with the major shareholder, they hold just over 70% in Astro.

Hence, with the capital market no longer providing an avenue for these two companies to continue to remain listed, it is perhaps time to take them private. The major shareholder could easily obtain the support of the GLICs to cross the critical hurdles to take these two companies private, but of course the price offered needs to be substantially higher than current market price.

The third potential privatisation candidate is UEM Edgenta. After proposing to merge UEM Sunrise with Eco World, there is strong likelihood that UEM Edgenta may be next candidate to see some corporate action. Other than Khazanah, UEM Edgenta's other major shareholders are Urusharta Jamaah (5.9%); EPF (1.1%) and KWAP (0.7%).

Khazanah has substantial stake in UEM Edgenta and with small net cash position, Khazanah itself could initiate a selective capital repayment to acquire the remaining shares it does not already owned.

Indeed, the M&A space in corporate Malaysia remains active and there are opportunities to create bigger and larger entities among some of these listed entities owned by our GLICs.

This could create market excitement and trading opportunities but as always, execution is the key to ensure the merger synergies far outweigh individual stand-alone companies in the same sector or industry.

Pankaj Kumar is a financial analyst. Views experssed here are his own.

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