Under-subscription not a deterrent

Companies seeking to raise funds should not be put off by lukewarm response to private placement and rights issue exercises

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BLOOMBERG

PUC Founder to utilise money raised for more renewable energy projects and create recurring revenue

MANY companies have resorted to raising funds via the corporate market in light of the slowing economy but they often face the challenge of convincing minority shareholders to put in more money.

In the last 12 months or so, several companies have embarked on private placement and rights issue exercises but have met with lukewarm response.

For example, TH Heavy Engineering Bhd, XOX Bhd and PUC Founder (MSC) Bhd received relatively low take-up rates for their respective rights issue. Judging by the trend, why do companies still go for such fund-raising exercises considering the poor responses and the valuations of the companies may be low?

Decisions to proceed with fund-raising or listing exercises on the local bourse appear to be determined by two main factors – the economic outlook and the major shareholder.

"Listed companies do look beyond the economic outlook when it comes to making decisions on the timing of listing activities and fund-raising exercises through the local bourse such as cash calls," says an investment banker.

Economic slowdown

Using the FBM KLCI as a yardstick of the state of the economy, when the local bourse declined by 6% last year compared to 2014, the number of listings fell to 13 from 15.

However, in 2014 when the economy was faring relatively well with the KLCI increasing by 5% from 2013 and the gross domestic product growth was 6% versus 4.7%, the number of listings fell to 15 from 17.

PwC Malaysia's Deals practice executive director Paran Puvanesan tells ***FocusM***, "During an economic slowdown, fund-raising and listing activities are generally fewer in number.

"In general, the funds required by companies during these periods are to address temporary changes in revenue or working capital requirements. They are typically not for funding growth plans or capital expenditure, in nature. Thus, companies would look at alternative funding options such as internal funds or mezzanine-type financing to address these funding requirements."

Paran adds that whilst fund-raising activities such as rights issue can be potentially underwritten, there are concerns in going to the market during an economic slowdown.

"We need to consider the potential level of interest by institutional and retail investors, firstly to take up shares in these companies and secondly to help support share prices post-listing with their continued interest in the said company."

"In addition, if the rationale to list in an economic downturn is not clear, that in itself is potentially counterproductive in generating interest in the fund-raising/listing plans of that company," he explains.

A corporate finance official says, "Loads of companies will rush to be listed on the bourse during 'bull run' periods. When the economy and market alike slow down, some companies' owners feel it is a waste of time to conduct such [fund-raising] exercises as in line with the slower market, valuations of the companies concerned will be low. Going through with these exercises will likely end up with a shortfall of proceeds that can be raised."

TH Heavy saw one of the worst acceptances

As it is, TH Heavy's rights issue exercise received one of the worst responses from its shareholders. In September, TH Heavy's renounceable rights issue of 1.2 billion new Islamic irredeemable convertible preference shares at 25 sen each was under-subscribed by 70%.

As a result, its major shareholder Lembaga Tabung Haji had to step in, subscribing for 740.8 million rights shares to enable the company to achieve the minimum subscription level for the rights issue.

Likewise, XOX saw an under-subscription rate of 43.7% for its rights issue. On Feb 10, the company says the total valid acceptances and total valid excess applications received for its rights issue with warrants was equivalent to 56% of the rights shares. In view of the under-subscription, XOX decided to allot the rights issue shares with warrants to all applicants who have applied for the excess shares.

On Feb 18, PUC Founder announced the total valid acceptances and excess applications received under the rights issue of irredeemable convertible unsecured loan stocks (ICULS) with warrants were RM42.7 mil nominal value of the rights ICULS, representing an under-subscription of about 42.8%. Subsequently, PUC Founder decided to allot the rights ICULS to all entitled shareholders and/or their renounces, who have applied for the excess rights ICULS.

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>
> – Paran

On why the economic outlook wasn't a factor, a PUC Founder spokesperson tells ***FocusM***: "When we decided to do the rights issue, the economy was already not doing well. Nevertheless, the management still went on with the transformation plan, diversifying into [the] renewable energy sector. We believe it was the right thing to do at that moment."

"Besides, [PUC] major shareholder [RedHot Media International Ltd] shows full support towards the ICULS plan and undertakes RM28 mil to ensure it is a successful corporate exercise. Out of the RM42 mil subscription, the major shareholder contributed 65.7% of the total subscription. That shows its confidence in PUC Founder.

"Since last year when PUC decided to diversify into renewable energy, we knew that this was going to be a capital expenditure-intensive business. We knew that we need more capital to do this. Immediately after we had built our first solar power plant, we want to be prepared for more to come and that is why we did the fund-raising exercise to raise sufficient cash for the expansion. The decision to do the rights issue is essential," the company spokesperson explains.

Renewable energy projects

On what the under-subscription means to PUC Founder, the company spokesperson says, "Though the ICULS are under-subscribed, we still managed to raise RM42 mil which, in bad times like this, is something to be cheerful for. We will utilise this money for more renewable energy projects and create recurring revenue for the company. Besides, we are a net cash company and we have capacity to do bank borrowings if necessary." PUC Founder's net cash as at end-2015 was RM8.1 mil versus RM24.8 mil as at end-2014.

The corporate finance official highlights that it is easy for investors to get the wrong impression that companies have no qualms in pushing through with fund-raising exercises so long as they are underwritten but in most cases, the underwriter is the major shareholder (as in the case of PUC Founder).

In PUC Founder's case, in the event the minimum subscription of the rights was not achieved, PUC Founder's substantial shareholder, RedHot Media, will underwrite the minimum portion.

He says, "No concerns even if the exercise is under-subscribed, so long as the minimum subscription is achieved and/or the underwriter steps in." FocusM