

■ COMMENTARY

Burning issues at Natural Cool Holdings

Has the firm gone into overdrive with a series of transactions? BY CHEW YI HONG AND MAK YUEN TEEN

OVER the past year, Natural Cool Holdings (NCH), a small Catalyst company, has undertaken a series of transactions that have arguably left public investors out in the cold.

NCH was listed on Sesdaq on May 10, 2006, at a price of 20 Singapore cents per share, raising S\$3.2 million. It subsequently transferred to Catalyst. Initially, its continuing sponsor was CNP Compliance, which was replaced by PrimePartners Corporate Finance on July 1, 2014.

In the 10 years since going public, NCH has made multiple placements and issuances of new shares, warrants and convertible loan notes, with the number of issued shares increasing from 88 million to 223 million. However, NCH has not been without its controversies.

On Oct 31, 2013, the Monetary Authority of Singapore (MAS) took civil penalty enforcement action against Ang Choon Cheng, who was then the CEO and executive director of NCH. Mr Ang paid a total civil penalty of S\$150,000 for Securities and Futures Act breaches related to false trading and market rigging transactions, and employment of manipulative and deceptive devices relating to the shares of NCH. He also gave an undertaking to the MAS not to be a company director for one year. Mr Ang resigned as director and CEO but remained as an adviser. He rejoined the company as executive chairman on Nov 3, 2014.

In the past year, NCH went into overdrive with a series of transactions.

Shopping for paint

On July 30, 2015, the group announced that it was acquiring the entire issued and paid-up share capital of Loh & Sons Paint Co (S) Pte Ltd (L&S). NCH noted that the new business was synergistic to its core business and would allow it to diversify its revenue stream.

L&S had net tangible assets of S\$1.34 million and the purchase price was S\$7 million (with up to an additional S\$0.5 million for inventory). NCH stated that the consideration was arrived through arm's length negotiations between the parties after taking into consideration the prevailing market conditions, business prospects and the industrial property held by L&S that was valued at S\$5.87 million.

Under rule 1014 of the Catalyst rulebook, a transaction is classified as a "major transaction" requiring shareholders' approval where any of the "relative figures" for the acquisition exceed 75 per cent but is less than 100 per cent, with rule 1006 setting out the bases for computing the relative figures. For the L&S acquisition that was to be satisfied wholly by cash, the relevant "relative figures" are based on net profits attributable to the assets acquired compared with the group's net profits, and the aggregate value of the consideration paid compared with the issuer's market capitalisation.

The acquisition was 31.2 per cent of NCH's market capitalisation and 14.4 per cent of NCH's group net profit before tax and it was therefore a discloseable transaction that did not require shareholders' approval. The acquisition was completed on Sept 1, 2015, with a final price tag of S\$7.3 million, plus another S\$0.3 million for inventory.

Switching gears

On Sept 16, 2015, the group proposed to sell its wholly owned subsidiary Gathergates Group to a Japanese listed company for a cool S\$33,888,888. The transaction was expected to result in a net gain of about S\$15 million. An extraordinary general meeting (EGM) was called as the sale of the switchgear business represented 148 per cent of its profits and 128 per cent of its market capitalisation (under rule 1014, the threshold for disposals is 50 per cent). Shareholders' approval was obtained and the transaction was completed on Nov 30, 2015.

The company's annual report for the financial year ended Dec 31, 2015 showed a full-year profit of S\$6.5 million. Interestingly, discontinued operations accounted for S\$9.99 million in profit while continuing operations actually lost S\$3.52 million.

At this point, a shareholder would naturally think that management would focus on the core business and the new paint business.

Wrong gear

However, on April 23, 2016, NCH announced that it had entered into an Interested Person Transaction (IPT) with Joseph Ang Choon Cheng, the executive chairman, and Eric Ang Choon Beng, an executive director. For S\$50,000, the Ang brothers will acquire all the shares of Natural Cool Energy Pte Ltd (NCE), the wholly owned subsidiary that holds L&S, the paint business acquired less than eight months earlier.

The group had taken a bank loan of S\$5 million and made an inter-company loan to NCE of about S\$2 million to fund the acquisition of L&S. In the proposed disposal, the entire bank borrowings will be transferred to the purchasers but only about

S\$1.36 million of the inter-company loans will be repaid, with NCH recognising a net loss of S\$0.9 million. NCE had already recorded acquisition costs for the purchase of L&S of S\$0.3 million in FY2015.

No shareholder approval required

The disposal of L&S is governed by chapter 9 of the Catalyst rulebook on interested person transactions (IPTs) and chapter 10 on acquisitions and realisations. Chapter 9 uses net tangible assets (NTA) as the base. As the value of the transaction relative to NTA is determined by the company to be only 1.86 per cent, it does not require immediate announcement or shareholder approval under chapter 9. Since the relative figure is less than 3 per cent, there is also no opinion from the audit committee or an independent financial adviser.

In terms of chapter 10, the profit test is not relevant in this case based on Practice Note 10A, which states that the profit test will not apply if the assets disposed of are non-core or loss-making – and L&S was loss-making. As for the tests based on net asset value and consideration, the relative figures do not exceed 5 per cent. Therefore, the transaction is "non-discloseable" under chapter 10.

It is curious that the NTA in the same announcement varies from S\$48.42 million (in paragraph 9.2 and 10.2) to S\$49.489 million (in paragraph 11). It was mentioned as a note that "Rule 1006(a) has been calculated on the basis that the NCE Recapitalisation has been completed on 31 December 2015". Based on the information given, we are unable to reconcile these differences and we do not understand the rationale behind the recapitalisation.

Further, the net profit attributable to the assets disposed of was a negative S\$256,000. There is no explanation as to how the figure was obtained and we would question its relevance as L&S only contrib-

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uted three months' results. It would seem to us that NCH has not provided enough clarity and details to allow the market to verify the numbers.

Note that the numbers are not verified by the sponsor or by another independent party, based on the information provided. Under normal circumstances, we can rely on the audit committee and the independent directors. However, as we will come to this later, they may not be perceived to be sufficiently independent.

No time for paint to dry

The speed and the manner of the proposed disposal of L&S is puzzling to say the least. Less than eight months ago, L&S was acquired because it will "result in better synergy for the group" and provide NCH with "additional revenue stream". In the 2015 Annual Report issued in mid April 2016, the chairman and the CEO had noted in the Letter to Shareholders that "...we believe it (L&S) has untapped growth potential". By April 23, the company has changed its mind. In announcing the disposal of L&S, NCH now said: "Following the successful sale of the company's switchgear division in November 2015, the company conducted a review of its businesses and operations with a view to streamlining its corporate strategy to focus on its core business, being the air-conditioning business, or invest in businesses that may provide greater shareholder value." In other words, it reversed its diversification strategy before the paint has barely dried.

The board must have expected that NCH will need time to integrate the new paint business and hence small losses in the first year should not be a surprise. Selling off the new business so soon after buying it seems to suggest that the initial acquisition may not have been well thought out. Furthermore, shareholders need to understand the board's considerations in agreeing to an IPT under which the issuer recognises a loss of S\$0.9 million due to the hair-cut on the inter-company loan after already incurring S\$0.3 million of acquisition costs in the past financial year. If L&S has such growth potential, is it not the board's duty to get a better price rather than rush to dispose of it through an IPT? Is Eric Ang, being the executive director responsible for the strategic planning and management of L&S and its chief operating officer, suddenly offering to

buy over L&S because he realised it has terrible prospects after all?

Based on the company's disclosure in the FY2015 annual report, L&S would have contributed about S\$0.67 million in profits for FY2015. The acquisition announcement back on July 30, 2015, stated that L&S had net profits before tax of S\$0.47 million for FY2014. Under the new ownership of NCH and led by Eric Ang, L&S made losses in the three months ended March 31, 2016. This is important because it renders the profit test irrelevant.

Had the board not agreed to take a loss on the inter-company loan, and had asked the purchasers to reimburse the costs of the acquisition made just eight months ago, the value of the transaction could be up to S\$2.6 million. This would have put it just over the 5 per cent limit under rule 906 for IPTs – and with that comes the requirement for the board to appoint an independent financial adviser to state whether the transaction is on normal commercial terms, and whether it is prejudicial to the interests of the issuer and its minority shareholders.

With no EGM because the thresholds were not met, minority shareholders had no opportunity to grill the board and vote on the transaction.

Board of directors

NCH has a board of seven directors. Other than the two Angs, there are two other executive directors – chief executive officer Tsng Joo Peng and chief investment officer Choy Bing Choong. The three independent directors – Lim Siang Kai, Wu Chiaw Ching and William de Silva – have all been on the board since March 7, 2006. That is, the majority of the board is made up of executive directors, and in this case, two of these executive directors are the interested persons in the disposal of L&S. Hopefully, the two conflicted directors recused themselves from the board deliberations on the IPT.

NCH's board only meets twice a year, with the audit and remuneration committees also meeting twice, while the nominating committee meets only once. Unusually, all the executive directors attend all the committee meetings by invitation. In recent years, there were as many as five executive directors attending all the committee meetings. This raises issues as to the ability of the committees to make decisions and recommendations independently from management.

But arguably what raises the eyebrows even more is the ex-gratia payment to the three independent directors.

Ex-gratia payment for the independent directors

On April 26, 2016, NCH held its AGM. Resolution 6 sought shareholders' approval for a one-time ex-gratia payment of S\$313,800 to the independent directors for the financial year ending Dec 31, 2016. The explanatory note to the AGM notice stated that this payment "is a token of appreciation and recognition of their contribution in the past years rendered to the company and/or its subsidiaries as independent directors". This amount is exactly three times the pre-approved director fees for FY2015 and the director fees proposed for FY2016.

The ex-gratia payment would have been proposed by the board and effectively by the executive directors, as the independent directors are the recipients and should not be involved in determining such a payment.

Both the ex-gratia payment and director fees were duly approved by 100 per cent of the shares voted at the AGM. The AGM results included a statement that no party was required to abstain from the resolutions, so it is reasonable to surmise that the two directors involved in the IPT voted to support the ex-gratia payment. The two Angs have total direct and deemed interests of about 17.8 per cent of the total issued shares.

The ex-gratia payment to the independent directors, including its timing, is in our view ill-advised. The independent directors play a critical role in overseeing the various transactions, including serving on the audit committee which is tasked with reviewing IPTs. For them to be rewarded with an ex-gratia payment proposed by management and supported by the interested persons may raise questions about their objectivity in overseeing the various transactions and the IPT. To reiterate, minority shareholders have no idea why the group is disposing of the new paint business in just eight months, and doing it through an IPT which involves the company taking a substantial hair-cut on the inter-company loan.

Looking at the way things are now, there is certainly nothing cool about the whole episode.

■ The writers are, respectively, a shareholder of Natural Cool Holdings and who has been involved in various corporate governance research projects in Singapore and the region; and an associate professor of accounting at the NUS Business School where he teaches corporate governance and ethics.