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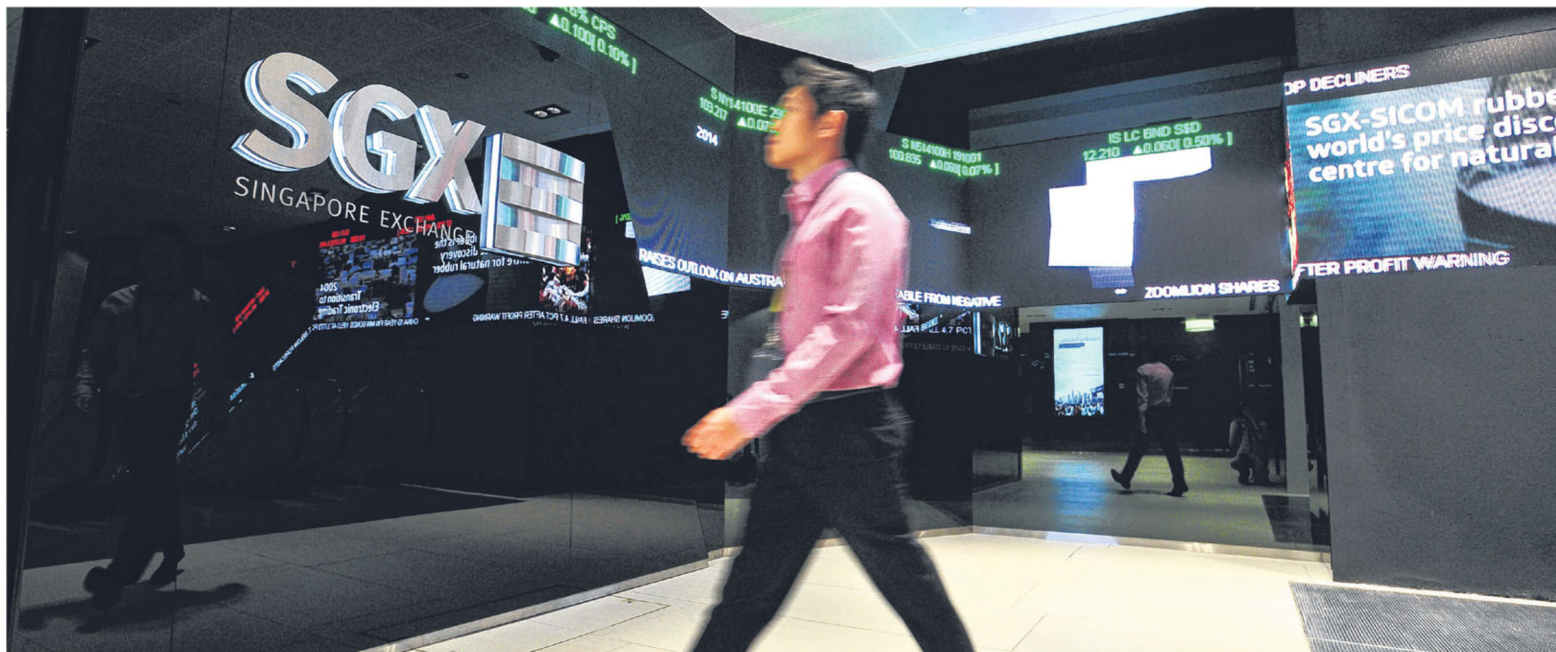

Catalist: A platform for growth firms or ICU for mainboard patients?

The less stringent listing rules on SGX's second board adversely affect investor protection and the quality of the issuers, which could in turn harm its reputation. BY MAK YUEN TEEN AND MARK LAI

CATALIST was established in November 2007 as the successor of Sesdaq, and is one of the two boards of the Singapore Exchange (SGX). Modelled after London's Alternative Investment Market (AIM), its sponsor-based regime is similar to AIM's system of regulation through nominated advisers. Its name reflects its vision of being a platform that catalyses the growth of young companies by giving them access to financing, and hopefully a transfer to the Mainboard. However, over time, the objective of Catalist seems to have changed somewhat as SGX now sees the Catalist board as providing "greater flexibility for a company to raise funds either to implement its growth strategy *or to improve its financials*" (emphasis ours).

The growth in Catalist listings has outstripped the Mainboard particularly over the last five years. Between 2014 and 2018, the percentage of IPOs accounted for by Catalist issuers increased from 60 per cent to 80 per cent, and the percentage of issuers listed on Catalist has increased steadily from 20 per cent to about 29 per cent.

However, these numbers do not necessarily tell the whole story about the success or otherwise of Catalist. Since 2008, only 21 Catalist issuers have transferred to the Mainboard, with only six having done so since 2014. In fact, there are more companies moving from the Mainboard to Catalist, with 24 having done so since 2014, starting from one company in 2014, to eight in each of 2015 and 2016, with another five and two doing so in 2017 and 2018 respectively. Today, about 11 per cent of all Catalist listings are companies that have moved down from the Mainboard.

To be fair, SGX is not alone in having few companies moving from the second board to the Mainboard. In 2017, the Hong Kong Exchange (HKEx) initiated a review of its second board, then called the Growth Enterprise Market (GEM), one of the main reasons being that few GEM companies have transferred to its Main Board.

Following a public consultation, GEM was repositioned as a market for small- and mid-sized companies, its previous name of "Growth Enterprise Market" was changed to simply "GEM", admission requirements were enhanced, and the streamlined process for GEM transfers to the Main Board was removed. A mandatory sponsor requirement for transfer of listing from GEM to the Main Board was also introduced.

Recent Catalist listings have performed poorly. In 2018, 12 out of 15 IPOs were on Catalist and they are trading at an average of negative 22.8 per cent below their IPO price, with 10 being underwater.

MAINBOARD OR CATALIST?

There are certain potential benefits of a Mainboard compared to a Catalist listing. First, CPF funds can only be used for investing in Mainboard companies. Second, Mainboard issuers do not have to appoint a continuing sponsor. Third, a Mainboard listing may have more prestige, better analyst coverage, greater institutional investor interest, and so on.

However, a Catalist listing has its attractions. The admission requirements are less demanding and the listing process faster, with less involvement of SGX in vetting listing applications. Further, the initial and annual listing fees are lower, which may help offset the cost of a continuing sponsor. In addition, the continuing listing rules are less stringent in certain areas, including the absence of a Watch-list, number of Singapore-resident independent directors for foreign issuers, general share issue mandate, share and share option schemes, major transactions, and very substantial transactions or reverse takeovers. These reduce the risk of a mandatory delisting, provide more flexibility, allow companies to execute transactions more speedily, and lower compliance costs.

However, the less stringent rules adversely affect investor protection and the quality of the Catalist board. They may also encourage companies that meet the Mainboard requirements to list or remain on Catalist. Further, Mainboard companies that plan to undertake transactions where the Catalist rules are more liberal, or that are at risk of being placed on the Watch-list, may opt to transfer to Catalist. In fact, SGX has indicated that transferring to Catalist is an option for companies that are on the Watch-list, or at risk of being placed on it.

COMPANIES TRANSFERRING FROM MAINBOARD TO CATALIST

We conducted a study of the companies that transferred from the Mainboard to Catalist between 2015 and 2018. Eight (35 per cent) of the 23 companies that did so were already on the Watch-list at the time of transfer. The remaining 15 companies were at risk of heading to the Watch-list under either the Financial Entry Criteria and/or the Minimum Trading Price (MTP) Criteria. Five other companies not included in the 23 unsuccessfully applied for a transfer, and four of these were already on the Watch-list.

Based on the Singapore Governance and Transparency Index, the transferring companies on average also have poorer corporate governance than other Mainboard and Catalist companies. They are also less profitable than other Mainboard companies, and have lower growth potential than other Mainboard and Catalist firms.

RULES ARBITRAGE?

Not surprisingly, some companies utilised the more liberal Catalist rules after they transferred. Eight companies did not have to seek shareholder approval for major transactions that exceeded the thresholds of the Mainboard rules, two companies made pro-rata issues of shares that exceeded the 50 per cent limit under the Mainboard rules, while one exceeded the limits for share/share option schemes under the Mainboard rules. Other companies that have transferred may also use the more liberal Catalist rules in future.

Transferring to Catalist often did not help the companies, may not be in the best interest of their shareholders, and harm the reputation of Catalist. Twelve of the 23 transferring companies saw their average net income worsen, 15 experienced a further fall in their share price, while the share liquidity of 16 deteriorated. Six companies had all three measures worsen, while only two saw all three measures improving.

Take the case of Transcorp Holdings, which transferred from the Mainboard to Catalist on Oct 20, 2015. While it was not yet on the Watch-list at the time of transfer, it had met the MTP Criteria for the Watch-list that had been introduced in March 2015 (but effective March 2016). In February 2016, its then managing director, 53-year-old Tan Cheng Chuan, who was a controlling shareholder until March 2016, resigned from the company and the board, citing "retirement". On May 9, 2016, Transcorp completed the disposal of several subsidiaries to Mr Tan, within about 10 days after announcing the proposed disposal. If Transcorp had remained on the Mainboard, shareholder approval would have been required given the size of the disposal, but since it was now on Catalist, shareholder approval was not required. Since Mr Tan was no longer considered an "interested person", the transaction was also not an interested person transaction.

In June 2018, Transcorp completed the acquisition of a 10 per cent interest in Motor Megamall Pte Ltd for S$1.5 million. The target was described as a fintech startup company whose main business appears to be providing an online platform for motor vehicle purchasers to obtain financing. Again, shareholder approval was not required only because it was now listed on Catalist.

Following its transfer, Transcorp's average net income worsened and turned negative, its cumulative share return was highly negative and its liquidity deteriorated. At the time of its transfer, Transcorp's share price was 15 cents. Today, it is 1.5 cent. To top it off, it has recently seen a spate of resignations involving independent directors and key officers, including an independent chairman who lasted four months and a chief financial officer who lasted four days.

In the case of Nippecraft, it almost had to be carried across the line. The company had been on the Watch-list since Mar 5, 2014 due to the Financial Entry Criteria, and since Mar 3, 2016 due to the MTP Criteria. Previously, issuers had 24 months to exit the Watch-list, or face delisting. When this was changed to 36 months in March 2016, Nippecraft received an extension of time until Mar 1, 2017 to exit the Watch-list. However, it was still unable to do so. On Feb 27, 2017, it applied for a second extension of time, but this was not granted and it faced delisting on May 11, 2017. However, on June 1, 2017, SGX granted the company an extension to Mar 1, 2018.

In February 2018, Nippecraft announced that it made a net profit before tax of US$97,000 but did not meet the average market capitalisation requirement to exit the Watch-list and therefore proposed to transfer to Catalist. It applied for a further six-month extension to exit the Watch-list. In May 2018, it was granted a final extension to exit the Watch-list by July 1, 2018 and approval-in-principle from SGX for the transfer. On June 8, 2018, it announced that its transfer to Catalist would be effective from June 13, 2018 and that it would be removed from the Watch-lists based on Financial Entry Criteria and MTP Criteria.

Nippecraft's business of producing diaries, notebooks, organisers and stationery has been heavily disrupted. Is giving it so many opportunities to exit the Watch-list and then eventually allowing it to transfer to Catalist good for all shareholders and for the credibility of Catalist?

TIGHTENING THE CRITERIA

To be fair, in January 2016, following concerns raised in the media about poorly-performing Mainboard companies transferring to Catalist, SGX clarified and tightened the criteria for such transfers, especially for loss-making companies. We did find some evidence that companies that transferred after SGX tightened the criteria were on average making lower losses, although it was not clear that their overall quality was better because their share price performance, share liquidity and corporate governance were on average actually worse than those that transferred earlier. However, while more companies that transferred earlier saw their net income, returns, share liquidity and corporate governance worsen, more companies that transferred later saw these measures improve, except for share liquidity which also tends to worsen. We caution that this additional analysis is based on a very small number of companies in each group and therefore the findings may not be conclusive.

TIME FOR A RETHINK?

When we examine how Hong Kong and Malaysia approach the regulation of their Mainboard and second board – GEM in the case of Hong Kong and ACE Market in the case of Malaysia – we found that while admission requirements are understandably less stringent for the second board, continuing listing requirements tend to be equally stringent or even more so.

For example, GEM companies in Hong Kong must produce quarterly reports, while those on the Main Board report on a half-yearly basis. Limits for the general share issue mandate and ratio thresholds for transactions requiring disclosure/shareholder approval are the same for the two boards.

For Malaysia, certain areas such as "watch-list" (called Guidance Note 3 or GN3 companies), adviser and sponsor requirements appear to be stricter for the ACE Market. Further, limits for the general share issue mandate and ratio thresholds for transactions requiring disclosure/shareholder approval are the same for the two boards.

We also did not find provisions for companies to transfer from the Mainboard to the second board in Hong Kong and Malaysia, and our understanding is that such "downgrades" are rare, if allowed at all.

We believe that SGX should reconsider whether Mainboard companies should be allowed to transfer to Catalist at all. Mainboard companies that are on the Watch-list have 36 months to exit it. If they are unable to do so within that time frame, SGX can provide an extension. Allowing companies to transfer to Catalist when they may struggle to exit the Watch-list under these conditions will harm the reputation of Catalist and its attractiveness for true growth companies. Further, if transferring companies tend to have poorer corporate governance, giving them access to more liberal rules on Catalist may be harmful to shareholders. After transfer, directors and management may also feel less pressure to improve the fortunes of the company since there is no more threat of a delisting due to failure to exit the Watch-list, no more deadlines, and no more requirement to provide quarterly updates.

If allowed, transfers should only be on a highly exceptional basis after a thorough review by SGX, and they should remain under close scrutiny by SGX and be required to continue to comply with applicable Mainboard rules at least for a reasonable specified period after their transfer.

A fundamental question is whether differences in continuing listing obligations between the Mainboard and Catalist are justified in the first place, especially since Catalist companies are not necessarily growth companies. As it is, our Mainboard rules in key areas such as general share issue mandate and large transactions are already more liberal than equivalent Mainboard and second board rules in Hong Kong and Malaysia.

Rather than being a platform for growth companies, there is a risk of Catalist becoming an "intensive care unit" for struggling Mainboard companies and a magnet for low-quality firms which may eventually lead to Catalist suffering a cardiac arrest.

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