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SGX should consider introducing a process where every action and actor is subjected to close scrutiny once certain red flags become evident. ST FILE PHOTO

When poor governance meets liberal rules

On the Catalist, more liberal rules apply in a number of areas, making for a risky situation for investors when this comes up against poor governance. BY MAK YUEN TEEN

IN APRIL, (my colleague at the National University of Singapore Business School) Richard Tan and I released a report titled "Avoiding potholes in listed companies", published by CPA Australia. The report identified 16 warning signs and red flags in corporate governance, disclosure and reporting that had differentiated 33 companies that had run into serious corporate governance or accounting problems, and comparable companies that had not.

The study also found 14 other companies that had many of the same red flags and may therefore be at risk of suffering the same fate soon (although we did not name them in the published report).

Allied Technologies Holdings was one of them. In the three years leading up to April 2018, it had nine of the 16 warning signs and red flags already present, including the sudden resignation of the audit committee chairman and other independent directors.

Allied also checked a number of boxes on the list of the warning signs in the "business model" and "events/transactions" areas we discussed in the report, such as ad hoc diversification, quick acquisitions in areas unrelated to its existing core business, multiple large transactions below the thresholds for approval by shareholders, and change of control without a mandatory general offer.

Allied is now embroiled in a scandal: JLC Advisors managing partner Ong Su Aun Jeffrey has become uncontactable, and some S$33 million of Allied's funds parked in an escrow account managed by his firm is missing. But trouble was arguably already coming to Allied, given its poor corporate governance and liberal Catalist rules.

Churn in directors and key personnel

In October 2015, Allied's then-chairman and chief executive Hsu Ching Yuh, also the founder and controlling shareholder, requested that the three independent directors (IDs) resign.

The three IDs who replaced the trio (Jake Lam, Woo Say Hock and Yau Woon Fong) had one thing in common – zero experience as directors of listed companies. Yau, then aged 36, became lead ID and audit committee (AC) chairman; in June 2016, he was appointed as an executive director (ED) of AA Group Holdings, but he resigned in December 2018.

Loo Choon Chiaw, one of the IDs who was asked to resign at Allied, had also resigned as an ID from AA Group just a month earlier with two other IDs.

The two IDs and one non-independent non-executive director who replaced them at AA Group had two things in common – they were in their 30s and had no experience as directors of listed companies.

Chua Chee Heng, 35, became lead ID, NC and RC chairman; Charles Chew Yeow Bian, 38, became AC chairman.

Over at Annica Holdings, two of the three IDs on the board also resigned in January 2016. There too, they were replaced by two new IDs with no experience as directors of listed companies – Su Jun Ming, 37, who was appointed lead ID and AC chairman, and Adnan Bin Mansor, 53, who became NC chairman.

Jeffrey Ong, the third incumbent ID, did not resign and later became acting independent chairman – but tendered his resignation by e-mail on May 20, 2019.

Such situations of IDs being replaced as a slate when new shareholders appear make a mockery of the concept of IDs, who are supposed to be independent of major shareholders.

What is worse is that newly-appointed, inexperienced IDs are then supposed to oversee major transactions and safeguard the interests of the company. Unfortunately, this is reminiscent of what happened at Datapulse Technology and other companies.

At AA Group and Allied, turnover of directors and key management continued, with the new directors all eventually stepping down – in AA Group's case, in a matter of months.

Two IDs appointed at Allied in October 2015 resigned in March 2017, and were replaced by Chuang Shaw Peng, 65, and Shih Chih-Lung, 62. Neither had listed-company experience. Chuang resigned in August that year, replaced by Lim Jin Wei.

The company has now disclosed that when the escrow agreement with JLC was approved in October 2017, the board comprised two EDs, Hsu and Soh Weng Kheong, who was deputy managing director, and three IDs – Mr Yau, Mr Shih and Mr Lim. Mr Shih resigned a week after the escrow agreement was approved, and was replaced by Pok Mee Yau. Pok is a JLC partner.

Other warning signs continued to pile up, including the sudden departure of a CFO who left in January 2019 after just two months; other red flags included SGX's queries about a proposed investment, a profit warning and a delay in holding its annual general meeting (AGM) and the announcing of its results.

Liberal Catalist rules

On the Catalist, more liberal rules apply in a number of areas, which are discussed in another report I released this year with (NUS accountancy student) Mark Lai, titled "Where to, Catalist?"

In fact, AA, Annica, Allied and the latest company to have a disappearing chairman, Epicentre, are all listed on Catalist.

They also have the same continuing sponsor, Stamford Corporate Services. Three of these four companies have changed sponsors since their listing on Catalist, with two changing sponsors twice.

We identified a change in sponsor for Catalist companies as a warning sign in our "potholes" report; there will be more on this issue when the report on Catalist sponsors is released later this year.

In our Catalist report, we looked at 23 companies that transferred from the Mainboard to Catalist and expressed concerns about companies doing so in order to take advantage of the more liberal Catalist rules, which are to the detriment of shareholders.

Allied was one of the 23 companies that transferred to Catalist, having done so in May 2017. It was particularly fast and furious in seeking to undertake six transactions under the more liberal rules. Only three companies had transferred later than Allied, and none of the other 22 companies that transferred had sought to use the more liberal rules as much as Allied.

Allied also had relatively poorer corporate governance based on its SGTI score of 46, which was below the medians for all transferring companies, all Mainboard companies and all Catalist companies.

Placements, disposal and investments

At its April 27, 2017 emergency general meeting (EGM) – the same one at which its transfer to Catalist was approved – Allied obtained a general mandate to issue up to 100 per cent of new shares, either on a pro-rata or non-pro rata basis through a special resolution. If it had remained on the Mainboard, it would have been able to issue no more than 20 per cent of new shares on a non-pro rata basis. By Oct 31, 2017, it had utilised the entire mandate through two placement exercises. In July 2018, it made another placement of 420 million shares, amounting to 31 per cent of the enlarged outstanding shares.

It then disposed of a subsidiary in China in December 2017 without the shareholder approval which would have been required under Mainboard rules, given the amount involved.

That same month, it entered into a binding memorandum of understanding (MOU) to invest in 8TravelPay Intelligence & Technology (Shanghai) (8TPS). This was incorporated in China and described as being "principally involved in the business of providing payment and technology solutions to the corporate travel market".

In May 2018, Allied conditionally agreed to subscribe for 10 per cent of the enlarged share capital of 8TPS for US$2.5 million, extend a convertible loan of US$3.5 million which can be converted to a 7 per cent interest in the enlarged share capital, and accept an option to subscribe for a further 8 per cent in the enlarged share capital for US$4 million. In its response to SGX's queries about this transaction, it disclosed that the latest book value and net tangible asset value of 8TPS was just S$18,000. There has been no announcement about completion of this deal yet.

In January 2018, Allied announced that it had entered into another binding MOU to acquire a 51 per cent stake in Asia Box Office (ABO), which it said was worth S$60 million based on the vendor's internal estimates. ABO was incorporated in Singapore in March 2016 and said to be "in the business of operating an e-commerce ticketing solutions platform for venues and event organisers, with focus on sports, entertainment and lifestyle events in South-east Asia and Greater China". It had unaudited net tangible assets of S$265,000 as at June 30, 2017 and unaudited net profit from incorporation until June 30, 2017 of S$165,000. The ABO transaction was completed in April 2018 for S$30 million.

On March 26, 2018, after already announcing its proposed investments in 8TPS and ABO, it obtained shareholders' approval to diversify into e-commerce platforms and digital payment applications at an extraordinary general meeting (EGM).

In June 2018, Allied entered into another binding MOU to acquire a 51 per cent interest in ActivPass Holdings. ActivPass was incorporated in Singapore in July 2016 and is said to provide software solutions within the fitness, wellness and beauty services industries. Allied said that an independent valuation by Baker Tilly Consultancy (Singapore) had "provided an investment value for 100 per cent of the Target's equity to be between S$57,000,000 and S$60,700,000 as at June 30, 2018". This was completed in July 2018 for S$25.2 million, almost totally funded by the 420 million share placement that same month.

If it had remained on the Mainboard, all three investments involving 8TPS, ABO and ActivPass would have required shareholder approval based the amounts involved. Allied proceeded on the basis that none would require shareholder approval based on the Catalist rules.

It duly completed both the ABO and ActivPass transactions without shareholder approval. SGX then belatedly exercised its discretion and directed the sponsor to aggregate these transactions. After aggregation, these two transactions constituted a major transaction under the Catalist rules, and Allied was required to convene an EGM to seek shareholders' ratification of the ActivPass acquisition.

The EGM was to have been held on June 4 – nearly a year after the ActivPass transaction had been completed and money paid. The EGM has since been adjourned, pending the completion of the special audit directed by SGX.

In such situations, how can reliance be placed on the board? What sort of due diligence would have been done for the proposed transactions taking place at such a rapid pace?

In the case of the ABO investment, the CFO who joined in November 2018 and resigned two months later had, subsequent to his resignation, raised concerns with the auditors and the sponsor about the classification of expenses, documentation processes and the ABO audit.

It has now also emerged that Low Si Ren, Kenneth, who became an executive director (ED) of Allied last June 27, has a conflict of interest relating to the ABO transaction that was completed less than three months before he joined.

In April 2019, Allied proposed to acquire Aik Chuan Construction for S$130 million, to be satisfied by S$30 million to S$50 million in cash, and the balance through shares issued at no more than S$0.01. By then, Allied's shares were trading at just S$0.011. After diversifying out of the "machinery" industry into e-commerce and digital payment, it now wanted to get into the construction business.

This transaction was cancelled on May 22, 2019, following the loss of the money in the escrow account.

Changes in ownership

Meanwhile, on the ownership front, it turned out that those new shareholders that Mr Hsu talked about did not emerge until two years later.

It is interesting that Lim Tah Hwa (also known as Lin Tah Hwa), who bought 403 million shares (or a 29.88 per cent stake) between November 2017 and April 2018 at an average cost of over S$0.07, sold off more than 235 million of those shares over a two-day period less than four months later. They were sold at an average price of just over S$0.047 each. Assuming Mr Lim still holds the remaining 168 million shares (since no further changes of interest have been disclosed) – and based on the last reported share price of S$0.011 – he would have a total realised and unrealised loss of more than S$15 million.

The 1.095 billion shares placed out in October 2017 and June 2018 at a total cost to the placees of about S$58.95 million would be worth only about S$12.05 million based on the latest share price.

Three of the four placees who acquired direct interests and became substantial shareholders through the first placement in October 2017, and who still held close to 5 per cent of the shares each after the second placement that same month, did not appear on the list of top 20 shareholders in the 2017 annual report – as would be expected if they still directly held those shares.

Some shareholders who acquired large stakes apparently lost big, while investments at generous valuations have undoubtedly contributed to Allied's share price collapse.

Regulators would no doubt be looking at the share transactions, disposals and investments at Allied as part of their investigations into the disappearance of the S$33 million, and also at events at the other two "A" companies – AA and Annica. It is also important that regulators look into the actions of directors in the various companies to assess if they have breached any duties.

What was happening at Allied – essentially a multi-step reverse takeover (RTO) and a change of control, without triggering the rules governing RTOs and mandatory general offers – has been observed in other companies. The liberal Catalist rules made the transactions easier to undertake, and poor corporate governance made them highly risky.

SGX has introduced a "green lane" with fast-tracked approval for well-behaved companies. It should consider introducing another lane in which every action and actor is subjected to scrutiny once red flags are evident – sort of like a "strip search lane".

The writer is associate professor of accounting at the NUS Business School, where he specialises in corporate governance