NUS National University of Singapore

Source: *The Business Times*, p19
Date: 3 March 2020

Time for 'fit and proper' tests for directors of listed companies, not just for financial institutions?

The example of DLF Holdings, which has not demonstrated much corporate governance and internal controls since its Catalist listing, raises the question of accountability. BY MAK YUEN TEEN AND CHEW YI HONG

ON Feb 19, 2020, Catalist-listed DLF Holdings announced that it was selling a BMW528iA car, with the number plate "SKN3333R", to Abwin (1994) Pte Ltd, an unrelated third party buyer. The car's certificate of entitlement, originally registered on Nov 29, 2013, has an expiry date of Nov 28, 2023.

The sale of the car for S$72,000, said to be the highest quote from three unrelated third-party prospective purchasers, was to improve cash flow. This small transaction requires disclosure because the car's book value of S$114,322 exceeded 5 per cent of the group's net asset value – in fact, it was 21.2 per cent.

DLF had listed only in July 2018. Having to sell a used car to improve cash flow so soon after its IPO raises a lot of questions and is symbolic of the state the company is in.

A desktop search found a car with the same make and model, and same registration date, listed by the dealer mentioned by the company. It was listed on Feb 19, the date the company announced the disposal.

The dealer's listings showed no other BMWs in the previous three months. The remarks in the listing stated that the previous owner had retained the number plate, suggesting it likely has value.

All the above – same dealer, same model and make, same registration date and valuable number plate – suggest that it is almost certainly the same car.

The car plate, SKN3333R, would indeed have value. In fact, the very exact car registration was listed in 2014 for S$17,000. Other "3333" plates listed today have asking prices of between S$6,333 and S$12,800.

If this is the car in question, does the company still own the number plate? Or did it sell the plate separately and receive the proceeds?

The reason why we raise this issue is because the company has not demonstrated much corporate governance and internal controls since its listing.

LISTING THROUGH PLACEMENT

DLF listed in July 2018 entirely by placement, with 18.5 million shares at S$0.23 each. The controlling shareholders were Manfred Fan Chee Seng, the executive chairman, and Wong Ming Kwong, an executive director and the CEO.

The placement raised S$4.255 million, with S$1.12 million going to PrimePartners Corporate Finance (PPCF), which was the sponsor, issue manager and placement agent. PPCF received an additional S$600,000 through 2,608,700 new shares as part of its management fee for acting as sponsor and issue manager. The net proceeds of S$2.85 million were for general working capital and to fund acquisitions and alliances.

Not surprisingly, the shares rarely traded after listing. For instance, in the six months prior to this article, there were only 6,000 shares traded on the market on two trading days.

And it has been all downhill since listing.

REVERSAL OF FORTUNE

The offer document portrayed a promising mechanical and electrical engineering services and solutions provider with a regional footprint. Its unaudited income statements showed impressive upward trajectories for revenues and profits. Revenues increased by more than 52 per cent between FY2015 and FY2017, gross profit by 100 per cent and profit before tax by 427 per cent. Curiously, despite the significant revenue increase, selling and distribution expenses and administrative expenses shrunk by 70 per cent (from just S$71,594 to S$21,337) and 21 per cent respectively.

Its first half-year results for the period to June 30, 2018 post-listing continued to show strong growth. Despite revenue falling by 6.8 per cent compared to the corresponding previous half-year, gross profit increased by 53 per cent and profit before tax by 144 per cent.

However, the unaudited FY2018 results announced on March 1, 2019 showed a total reversal of fortunes. Revenue fell by 15.2 per cent compared to FY2017, gross profit by 34.2 per cent, and profit before tax from S$3.87 million to a loss of S$960,000 (later adjusted to S$1.02 million loss based on audited accounts in April 2019). Profit after tax dropped from S$3.37 million to a loss of S$1.18 million (loss of S$1.24 million in audited accounts).

A 68 per cent fall in revenue from mechanical and electrical services was largely responsible for the fall in revenues, which the company attributed to the completion of a hospital project and trade tensions between US and China, the latter resulting in reduction of purchases of its products from US customers.

Why did the company not issue a profit warning? While uncertainty in the global economic outlook was listed in the offer document among the long list of risk factors, it did not mention the trade tensions between US and China. The offer document said: "Our business is susceptible to the general economic conditions in Singapore."

In March 2018, the US started imposing tariffs on certain goods. In early April, China imposed tariffs of up to 25 per cent on 128 US products, and the US responded almost immediately with plans for 25 per cent tariffs on US$50 billion of China imports. In other words, the trade war had started several months before DLF's IPO, but it was not specifically mentioned as a risk factor.

The company did not identify any major US customers in its offer document, while its annual report shows two geographical segments of Singapore and Maldives for FY2017 and FY2018. So, what US customers and products is DLF referring to?

FRIENDS BECOMING FOES?

At the AGM on April 30, 2019, the CEO (who was the second-largest shareholder) and the three independent directors were voted out by the largest shareholder, Mr Fan, who himself was voted in with 100 per cent of the votes. The CEO, who was removed as a director, appears to be clearly taken by surprise by the move to oust him, as the share count indicated that he had voted for Mr Fan.

The cessation announcements for the four directors who were voted out all stated there were no unresolved differences and no matter that needs to be brought to the attention of shareholders. The sponsor stated that it was satisfied that there were no other material reasons for their cessation. Did the sponsor interview the directors concerned?

SGX queried the company. Two weeks later, on May 15, the company disclosed in its reply that some shareholders (including Mr Fan) were not satisfied with the performance of the CEO. They also decided to remove the independent directors to restructure the board with the change of management.

So, were the company announcements accurate? Was dissatisfaction of the chairman/largest shareholder with the CEO not a matter that needed to be brought to the attention of shareholders?

On May 30, the company announced the appointment of three new independent directors through a fractured nomination process managed by the sole director left – the largest shareholder and executive chairman.

The financial controller, who was then the most senior finance executive in the company, resigned on July 3 with immediate effect "to pursue other career opportunities". A replacement was announced that same day. The sponsor was satisfied that there were no other material reasons for her cessation. Did the company disclose the cessation promptly, when it first became aware of her intention to leave?

MORE BAD NEWS

About three weeks later, the company issued a profit warning for its 1H2019 results and the results released on Aug 14 were a catastrophe.

Revenue had collapsed 92 per cent to S$740,000 compared to S$9.54 million for the previous corresponding period; gross profit fell from S$3.05 million to a loss of S$220,000; and net profit before tax had fallen from S$2.06 million to a net loss of S$5.62 million.

The fall in revenue was said to be due mainly to the termination of the Maldives project on Feb 5, 2019 – but the company made no announcement about the termination at that time. Does this comply with the continuous disclosure requirement?

Over its 1.5 years on Catalist, DLF has seen three different sets of independent directors; the departures of a CEO, COO, CFO, and two financial controllers; several disclosure lapses; six sets of queries; a notice of compliance; a price fall of 65 per cent (based on IPO price and MGO price); sharply rising pre-IPO revenues and profits followed almost immediately by sharp reversals; and major re-statements to its financial statements.

The day after the 1H2019 result announcement, the financial controller, who joined just over a month earlier, resigned with immediate effect "to pursue other career opportunities", with the sponsor again satisfied with the company's disclosures. The following day, SGX queried the various cessations. "No other material reasons" was the reply. A finance manager who joined less than three months earlier was now in charge of the finance function.

WHAT INTERNAL CONTROLS?

On Aug 30, 2019, the company announced that the chief operating officer had resigned "due to family commitment". His effective cessation date was April 30, and he had already informed the former CEO in October 2018 that he was resigning. Did the company not know that the COO had already left four months earlier, and had served notice six months before that?

SGX queried DLF about the adequacy of its internal controls and steps it will take to strengthen the controls. That is well and good, but will there be accountability?

CHEAP SALE

On Sept 20, 2019, the company suddenly announced that QRC Pte Ltd had agreed to buy 57.16 per cent of the company from Mr Fan and Wong at S$0.0809 per share, which would trigger a mandatory general offer (MGO). This was a 54.5 per cent discount from the one-month VWAP.

Mr Fan and Mr Wong were subjected to a moratorium of six months, with 50 per cent subjected to a further moratorium of another six months. So two months after the moratorium expired, the second-largest shareholder had sold his entire stake, while the largest shareholder had sold nearly half.

SGX queried the huge discount and DLF said that both the balance sheet and income statement had deteriorated significantly. A notice of compliance followed on Sept 26.

On Sept 30, the company appointed a CFO who lasted less than four months. On Nov 13, all three independent directors resigned, replaced by three new ones. Enomoto Hiroyuki, who now owns 64.13 per cent of the shares, nominated the CEO/director of QRC as a non-independent non-executive director. None of them has any experience as a director of listed companies but they were nevertheless assessed by Mr Fan to be suitable to be DLF directors.

This is just the latest instance of listed companies appointing a slate of inexperienced independent directors. Perhaps it is time for "fit and proper" tests for directors of listed companies, not just for financial institutions.

After we had written this article, the company announced its unaudited FY2019 results and disclosed material re-statements to its audited FY2018 financial statements. The termination of the Maldives project, which occurred in February 2019 – more than two months before the audited FY2018 financial statements were authorised for issue – should have been accounted for as an "adjustment event" in preparing the FY2018 financial statements. This also means that revenues had actually fallen 24.2 per cent, as opposed to 15.2 per cent, between FY2017 and FY2018, while profit after tax had fallen from S$3.37 million to a loss of S$5.18 million, rather than a loss of S$1.24 million. The company had already received the "Final Financial Settlement Statement" in March 2019, which included them having to offset S$4 million of trade receivable against S$4 million in compensation to the project owner for the termination. Given that the final settlement was in March 2019, should the company not have disclosed this immediately? Were the auditors aware when they signed off on the FY2018 financial statements?

Over its 1.5 years on Catalist, DLF has seen three different sets of independent directors; the departures of a CEO, COO, CFO, and two financial controllers; several disclosure lapses; six sets of queries; a notice of compliance; a price fall of 65 per cent (based on IPO price and MGO price); sharply rising pre-IPO revenues and profits followed almost immediately by sharp reversals; and major re-statements to its financial statements. And selling a car for S$72,000 to improve its cash flow.

Questions must surely be asked of the sponsor and issuer manager, the reporting accountant and auditor, Foo Kon Tan LLP, and of course the directors and management involved.

One more thing. DLF is selling another car for S$101,000 – but we do not know its number plate.

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