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Studying some red marks at Raffles Education

Company fails to disclose writs for large amounts long after they were filed and says it wants to sell property at well above valuation with no further details. BY MAK YUEN TEEN

Revenues have been on a general downward trend, while profitability and cash flow have been highly volatile. The plunge in its share price from over S$3 in 2007 to less than S$0.10 reflects the market's view about its prospects. IMAGE: PIXABAY

ON OCT 8, 2021, Raffles Education Corporation (REC) announced that its auditors, BDO LLP, have included an "emphasis of matter" paragraph on a Material Uncertainty Related to Going Concern in the Auditor's Report on the audited financial statements of the group and company for the financial year ended 30 Jun 2021. BDO did not modify its opinion in respect of this matter.

The fact that there is a going-concern issue at REC is not a surprise. Its revenues have been on a general downward trend, while its profitability and cash flow from operations have been highly volatile. The decline in its share price from more than S$3 in 2007 to less than S$0.10 reflects the negative view of the market about its prospects.

Further, Affin Bank in Malaysia had on 27 May 2021 filed writs against its two Malaysian subsidiaries and the company, demanding immediate repayment of a total outstanding amount of RM410 million (S$133 million). Presumably, this is because the group had failed to make timely payments on its loans. The total amount sought in the writs was more than half the market capitalisation of REC just before the announcement.

REC only disclosed the writs more than two months after they were filed. The day following the announcement, the share price fell by nearly 40 per cent to S$0.10. On 13 Oct 2021, it closed at S$0.084. In my view, the late disclosure raises clear questions about compliance with the listing rules and Securities and Futures Act, and the discharge of director duties under the Companies Act.

Bases for directors' view on going concern

In not modifying its opinion, the auditors have relied on the directors' view that it is appropriate to prepare the financial statements on a going concern basis after taking into account a number of factors. The bases for the directors' view are dependent on a number of assumptions which may not eventuate, and some lacked details. SGX queried the company and on 13 Oct 2021, REC published its response to the queries providing more details on some of the bases. I will focus on the two particular areas covered in its response – the settlement with Affin Bank and the proposed sale of its property in Merchant Road.

Regarding the settlement with Affin Bank, REC said that the Group is to repay the settlement amount of RM138.2 million from June 2021 to March 2022, and that the cash flows from other sources are sufficient to repay the settlement amount. It also said that RM58.2 million has already been repaid.

What the company did not highlight are two important terms of its "settlement" which it disclosed in its response to SGX queries on 25 Aug 2021; they are (emphasis mine):

"(e) *subject to compliance by the Borrowers with the payments under the revised monthly repayment schedule*, with regard to the settlement of the balance outstanding debts owed by each of the Borrowers, *Affin Bank shall review the position after 31 Mar 2022. The estimated balance outstanding debts as at 1 Apr 2022 is approximately RM310.9 million*; and

"(f) prior to 31 March 2022, Affin Bank *may request the Borrowers and the Company to furnish Affin Bank with such information and documents required by Affin Bank to ascertain how the outstanding debts would be fully resolved and settled.*"

What will happen after 31 Mar 2022 is uncertain. Even if REC complies with the repayment schedule, Affin Bank will review its position after that. The settlement is in effect only until 31 Mar 2022.

In its response about the planned loan repayments within the next 12 months, REC included S$25.9 million (the balance of RM80 million as of 13 Oct 2021), which is the balance repayable until 31 Mar 2022, and not within the next 12 months. It is possible that after 31 Mar 2022, Affin Bank may demand the repayment of the entire estimated remaining amount of RM310.9 million.

It should also be noted that the total amount owed to Affin Bank based on the settlement is RM449.1 million which the company disclosed on 25 Aug 2021, and not the original amount of RM410 million claimed by Affin Bank in the writs which REC disclosed on 29 July 2021.

Proposed disposal of Merchant Road property

Regarding the group's ability to realise certain of its assets as a basis for the directors' view on going concern, the response specifically mentioned the proposed disposal of the 51 Merchant Road property. The company had previously announced on 16 Aug 2021 that the "guide price for the Proposed Sale is contemplated to be approximately S$200 million". SGX asked the company for an update on the proposed sale and other details.

The company merely replied that the potential sale is ongoing. On 23 Aug 2021, *EdgeProp* ran an article about the proposed sale of this property for S$200 million. It said the expression of exercise was scheduled to close at 2.30 pm on 23 Sep 2021. If this is the case, why is the company unable to provide an update as to whether there are interested buyers and offers?

Although the market valuation of the property as at 30 Jun 2021 was S$150 million, the company has continued to assume that the sales price is S$200 million, when it responded to SGX about the estimated net amount from the sale after the repayment of the mortgage and transaction costs. Is the response appropriate if there is no interested buyer offering S$200 million?

The company reiterated that "without the proposed disposal of the Property and further disposal of other assets, the Group will continue its planned repayment of loans as they fall due over the next 12 months and will continue to operate as a going concern generating positive cash flow".

However, this is one of the bases given by the directors to support their views about the company being able to continue as a going concern. Further, this is at best based on the assumption that Affin Bank will not demand immediate repayment of the entire outstanding amount after 31 Mar 2022 (or even before that if REC fails to comply with the settlement agreement).

When queried about how the potential sale of the property affected the operations of the college in terms of student enrolment and financial performance (as part of the property is used as a college campus), and what will happen to the students and the stream of income from the college, REC merely asserted that it will not affect the college operations as the college will rent other premises upon the sale of the property.

REC did not mention the estimated renovation and rental costs of other premises. Given that revenue from the college was S$10.4 million for the financial year ended 30 Jun 2021, it would suggest there are a sizeable number of students on that campus.

How does the company plan to complete the sale of the property within the financial year (which is one of the bases of the going concern assumption), while also finding new premises, renovating and moving its students to this new campus, all without disrupting operations and affecting student enrolment and financial performance?

It is ironic that the company failed to disclose writs for such large amounts long after they have been filed but disclosed that it proposes to sell the property for well above its valuation, without giving any indications of buyer interest at this price, and remains vague on other bases of its going-concern opinion.

It is like not disclosing when the chickens have already flown the coop, but counting chickens before they are hatched.

The author is a professor (practice) of accounting at NUS Business School and a corporate governance advocate. The views in this article are his personal views.

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