

MINORITY SHAREHOLDER WATCH GROUP  
 BADAN PENGAWAS PEMEGANG SAHAM MINORITI BERHAD  
 (Incorporated in Malaysia – Company No. 524989-M)

The Edge Malaysia – Monday July 23, 2018 (Part 1)

# SHOULD SHAHRIL GET SO MUCH?

STORIES BY JOSE BARROCK  
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United Overseas Bank as stated in the company's latest annual report.

Sapura Energy chairman Datuk Hamzah Bakar points out that the EPF is aware of the covenant and the consequences of removing Shahril.

"This is perplexing to me. They wanted to oust the board. Have they got a team to replace the existing one? Who is going to run the company?" independent director Gee Siew Yong asks in an interview with *The Edge*.

Asked whether it was aware of the covenant and its conditions, the provident fund, in an email reply, says, "The EPF had repeatedly raised concerns relating to the corporate governance practices of Sapura Energy, in an effort to align EPF's interest as a shareholder in its investee companies' management.

"The EPF is of the view that the remuneration of senior executives should be linked to the company's performance. Boards of PLCs have a fiduciary duty to ensure that their shareholders' interests are protected.

"As a signatory to the Malaysian Code for Institutional Investors, the EPF is committed to the agenda of promoting strong governance practices in Corporate Malaysia, and expects the same to be practised by all its investee companies. Adherence to good corporate governance by EPF's investee companies would lead to sustainable long-term value creation for the EPF's 14 million members by extension."

Commenting on the EPF's criticism at the AGM, Hamzah says, "The tone was surprising but the subject matter was not. They have raised it before and we have answered it before."

The EPF, which held an 11.46% stake in Sapura Energy in January, ceased to be a substantial shareholder in May.

Its board representative, Tunku Alizakri Raja Muhammad Alias, resigned in end-January, but he is understood to have been privy to the information regarding the covenant that is tied to Shahril's pay package and to have voted for it, according to Sapura Energy executives.

**MSWG not happy as well**

Apart from the EPF, the Minority Shareholders Watch Group (MSWG) also pelled

TABLE 1  
 Earnings summary (RM mil)

FYE END	2017	2018	2019E	2020F	2021F
Revenue	7,651.3	5,895.0	6,332.5	8,487.1	9,635.5
EBITDA	2,688.4	1,502.8	1,174.8	1,372.5	1,399.3
EBITDA margin (%)	35.12	5.5	18.6	16.2	14.5
Pre-tax Profit	385.2	(2,323.6)	0.926	6.5	370.7
Reported Net Profit	208.3	(2,503.5)	(133.3)	98.5	179.5
Core Net Profit	400.3	(299.8)	(133.3)	98.5	179.5
Core EPS (sen)	6.7	(5.0)	(2.2)	1.6	3.0
Core EPS growth (%)	(60.3)	<-100	(55.7)	<-100	82.3
Core PER (x)	9.5	(12.7)	(28.7)	38.8	21.3
DPS (sen)	1.0	0.0	0.0	0.0	0.0
Dividend Yield (%)	1.6	0.0	0.0	0.0	0.0

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the Sapura Energy board with questions, and clearly meant business.

Asked if it was aware of the covenant binding Shahril, MSWG, in an email reply, says, "During an engagement between the Institutional Investors Council, MSWG and the board and management of Sapura Energy on May 21, 2018, the chairman of Sapura Energy (Hamzah) mentioned that one of the reasons for Tan Sri's (Shahril) high remuneration was due to the fact that there was a covenant on his shareholding by financial institutions.

"We were told that the covenant was one of the reasons for Tan Sri's high remuneration. We were told that in the abovementioned meeting, and this was reiterated at the AGM.

"MSWG is of the view that remuneration should not be tied to such covenants. Remuneration should be in line with the performance of the company and benchmarked against other companies in the industry, both locally and internationally.

"More importantly, the board should ensure there is an alignment of interest between management and shareholders."

Asked if MSWG was aware that if Shahril was removed as president and CEO, it would

Sapura Energy Bhd president and CEO Tan Sri Shahril Shamuddin seemed his usual self last Thursday at the company's office in Publika in Mont Kiara, Kuala Lumpur. However, the same could not be said of the other top brass after the company held its annual general meeting the day before.

Shahril, who took home RM55 million in bonus payments and RM16.56 million in salary and other emoluments in FY2018, has come under the scrutiny of shareholders, including the Employees Provident Fund (EPF).

Excluding an intellectual property rights payment of RM43.4 million, Shahril's compensation amounted to RM71.92 million in FY2018, when Sapura Energy incurred a net loss of RM2.5 billion on revenue of RM5.89 billion. The loss was mainly attributed to a RM2.1 billion impairment provision for the company's drilling segment.

At the AGM at the KL Convention Centre, the EPF representative apparently said the minority shareholders had seen the downside of the group's financial performance and impairment but not the downside of Shahril's remuneration package. He indicated that the retirement fund would vote against all directors due for reappointment at the AGM, including Shahril.

However, the bid to remove Shahril failed. He received 81.71% of the votes to remain as president and CEO. The other resolutions were likewise passed.

But any move to oust Shahril from the board would have dire consequences. Sapura Energy's 14 bankers have a covenant on a RM16 billion refinancing package put together in 2014 that requires Shahril to maintain his shareholding above 10% and remain as CEO, failing which the loan will default.

The 14 principal bankers are ABN AMRO Bank, AmBank Bhd, CIMB Bank Bhd, Citibank, Export-Import Bank of Malaysia Bhd, First Abu Dhabi Bank, ING Bank, Maylayan Banking Bhd, Mizuho Bank, RHB Bank Bhd, Standard Chartered Bank, Sumitomo Mitsui Banking Corp, MUFG Bank Ltd and

cause a default of the company's RM16 billion debt, the watchdog says, "This was alluded to at the AGM. The way we understood it, if Tan Sri leaves the company, it would trigger a default. As we are not privy to the covenant documentation, we cannot comment further on the finer details of the conditions of default of the covenant.

"We did not vote against his re-election or call for his removal. It was the other directors, especially the independent directors on the board, who we hold accountable for Tan Sri's remuneration.

"As such, we recommended to the shareholders to vote against the re-election of the two independent directors. This was to indicate our seriousness in wanting the board to show commitment to addressing the issue, which has been the concern of shareholders for the past few years. Even though all resolutions were passed, we believe a strong message has been sent to the board to seriously consider and review the remuneration package," MSWG says.

**Is Shahril being paid too much?**

Some quarters are of the view that Shahril's compensation should not be tied to such a



# 'I have no issues with the EPF ... it is their right to do what they want'

Tan Sri Shahril Shamsuddin, the president and CEO of Sapura Energy Bhd, was in a lively mood when met at his office last week.

The annual general meeting, he says, was 'disappointing', but he is unperturbed, with alot to do. The Employees Provident Fund (EPF) and Minority Shareholders Watch Group (MSWG) opposed some of the company's resolutions and made public their displeasure. But how much of an impact will that have on the direction of the company?

In an interview with The Edge, Shahril shares some of his thoughts on the outlook for the company, and what transpired at the AGM. Here is an excerpt from the interview.

## **The Edge: Are the local institutions selling your stock?**

**Tan Sri Shahril Shamsuddin:** But the foreign institutions are buying ... Usually we won't have this issue. Look at my board — Tan Sri Hamid Bugeo, MACC (Malaysian Anti-Corruption Commission) adviser, state secretary of Sarawak, chairman of Petros (Petroleum Sarawak Bhd) — we have people of impeccable standing.

(Mohamed) Rashid (Mohamed Ghazali), risk, at PwC, Gee Siew Yong — everyone knows the government puts her everywhere as she is a smart cookie! Datuk, Muhammad Noor Hamid, he is a gas expert ...

The share price went from RM11.50 to 40 sen ... what do you want the management to do? You can take the capitalist route, which I totally respect. Capitalist shareholders will say, okay ... lose money, understand the environment, sell your shares and walk, but don't talk bad about the company.

## **Aren't you concerned about shareholders selling shares?**

I am totally fine with that. It's your right, it's your money.

## **It was asked if profits were to pick up, would your salary rise as well?**

He (the EPF representative) is a shareholder, so he has a right to whack me, but it's all

covenant. Others think his compensation should not be lumped with his remuneration package.

The covenant, others have bluntly said, enables Shahril to hold the board and shareholders to ransom as he has to helm the company or risk a default.

Nevertheless, the board is solidly behind Shahril. From a cost perspective, Hamzah's view is that paying a RM55 million bonus to Shahril is less than having to secure a bank guarantee. This is as important as his ability to grow the company.

"It depends on who you ask. Ask an entrepreneur and he will tell you it's fair compensation ... with the covenant and all. Ask a shareholder or a common man and he will tell you it's immoral," says a market watcher.

conjecture. But when we were making RM18 billion, my salary was the same.

## **There were questions as to why you are being compensated when you have not sold any shares.**

If I sold the shares, it (the share price) would be at 10 sen.

## **Could it be that shareholders are upset that though the share price has fallen and they have suffered losses, you are still getting the same pay?**

But who caused the share price to fall? When there are more sellers than buyers, the share price will fall.

## **How much do you think it (the share price) would be if not for the heavy selling?**

At least 10% to 20% above net book value.

(Sapura Energy's net asset per share as at end-April was RM1.58.)

## **Do you think the massive impairments gave a bad surprise to shareholders last year? If I remember correctly, there were two rounds of impairments. The first caused the share price to fall to about RM1, then the second caused it to fall to below RM1.**

No ... the selling caused the share price to fall. If you say it's because of the impairments, it would be below 60 sen now. It actually went up after the impairments.

You see, impairment is a discipline the management must have, and it's a rule — you have to mark to market ... although I know in two years, things will pick up, I could have used all the technical arguments against writing off. But I have to err on the side of prudence.

## **Actually, Sapura Energy's impairments came later when compared with others in the industry. Why?**

We couldn't (do them earlier) because we still had contracts, I actually wanted to do them earlier. The first impairment involved our oil assets; the second, our service rigs and vessels. The rigs and vessels had long-term contracts that did not really end. And they could not obtain new contracts, so we impaired them.

Secondly, rates were already corning down. A chunk of the vessel cost will be depreciated. When I write off, the depreciable amount will shrink, which means I will be more profitable at a lower rate for the corning contracts.

We took the conservative position, it's going to be down for longer. We wanted to be more competitive, therefore we argued with the auditors, we wanted to cut.

## **Have you had any issues with the EPF?**

I have no issues with the EPF. It is their own assessment, their own valuation, their right to do what they want.

We brief them twice a year, and we explain everything (including remuneration packages)

... (we tell) all the major shareholders every quarter the strategy.

## **You have an upcoming IPO (initial public offering). Does the EPF's reaction at the AGM worry you?**

No, it's a story of there being more buyers than shares to sell.

## **Tan Sri, some people have asked how much more you are paid compared to (Tan Sri) Wan Zulkiflee (Wan Ariffin), Petronas' president and CEO.**

Wan Zuli sits in a company that has the right to the oil in Malaysia. I have to go and find and pay for it. I have to risk it. Wan Zuli is a dear friend of mine. One is an entrepreneur ... you cannot compare an entrepreneur to the CEO of an institution that has skin in the game.

## **Is your operating environment still as difficult?**

This is the result of work for the past three years. We can address Southeast Asia, India ... we can address Australia, we can address Caspian, we can get Mexico, Brazil, East and West Africa. From just RM38 billion, we have grown to a market opportunity of RM350 billion.

This RM350 billion is the market we can look at now, but could not look at before.

In order to achieve this, we had to do structural changes, we had to change our processes, we had to expand, develop global centres, put in systems — all the things that needed to be done, all these were KPIs (key performance indicators) along the way.

You cannot just say, 'I want to go there', without putting in the logistics, the processes. It's a lot like going to war — you need to strategise and be very clear on the route you want to (use to) attack the market.

We decided we had to increase our top line: in order to increase our top line, we had to increase our footprint. To do the footprint, we needed to continue to develop the platform and the architecture.

The board conditions the management to do the right thing.

## **So what did you do?**

We had our traditional markets, but the board said we could not go on giving the same ones (markets), so we won an EPC (engineering, procurement and construction) contract. Then, in the US ... in the US, we can do fundamental design in pipeline construction. That is the very top end of engineering, a company called Peritus.

We used that company for the design portion, to bid in Romania for a US\$1.5 billion contract.

Other evidence — in the Middle East, we said we would take (jobs). This year, we won something there. We won a US\$4 billion bid in Saudi — two contracts.

In the Middle East, to win, you have to go through a process. In that process, we have had to bid against five giants — McDermott,

LNT, Technip, Saipem, Subsea Seven. They value you on, judge you on engineering capabilities, fabrication capabilities, installation capabilities, and project management track record.

In Saudi (Arabia), Marjan, there are some jobs where only four (companies) are invited, and we are one of them ... US\$800 million. We were invited ... Those are the kinds of things we have done to qualify ourselves, to get access to this market.

If you look at the Romanian tender, you are only allowed to bid after a technical evaluation. We are in the top three — Eni, Technip and ourselves. Now, we have to go for an interview and scrutiny in the US at the head office of Exxon ... a 50% shareholder with OMV ... We have already penetrated Europe.

This is what we have done. Others have been shrinking over the past three years but we have expanded.

In 2017, we only had RM2.5 billion in bids for the year. In 2018, at this time, we are already at RM5.8 billion. If we get all our prospects, there is another RM8.2 billion, which is about RM14 billion already. We won't win it all but we will be back to pre-collapse levels. (Sapura Energy's current order book stands at RM16.7 billion.)

If I said three years ago I wanted to build a global company, who would have believed me?

## **There is talk that your pay, your compensation for the covenant should be reflected differently in your annual report. And it should not be part of your remuneration package.**

I don't know these things. I am straight. My board is very strict and transparent. But a bank guarantee for RM16 billion at 1% is RM160 million ... so was the board out of line?

## **On the listing of your exploration and production (E&P) business, there is a question on the prospects of the parent company after carving out a choice asset.**

There's a RM16 billion order book but mainly in E&C (engineering and construction), but we will have a chunk in an E&P company but the debt comes down.

## **There are quite a few companies you could list, right?**

Yes. My biggest problem now is (high) debts. When I reduce my debts, (more) revenue will go straight to my bottom line.

## **There are two things that shareholders would like to know — the impairment cycle and likelihood of a cash call.**

This is up to you to interpret. A cash call is always an option.

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ery's refinancing say the move to tie Shahril up via a covenant is common.

"It's understandable ... We would like him (Shahril) to have his skin in the game as well," says one of the bankers.

Another says when dealing with companies run by entrepreneurs, it is the norm for banks to ensure that the driving force behind them does not leave.

In March 2014, Sapura Energy signed a RM16.5 billion (US\$5 billion) refinancing club deal with 13 local, regional and international banks.

A month before that, Tan Sri Mokhzani Mahathir, the son of Prime Minister Tun Dr Mahathir Mohamed, sold a block of 190.3 million shares at RM4.30 apiece, or almost RM820 million. He was seen to have made a timely

exit as crude oil prices collapsed in October that year, sinking to US\$50 a year later.

Sapura Energy was then known as Sapurakencana Petroleum Bhd following the merger between Shahril's SapuraCrest Petroleum Bhd and Mokhzani's Kencana Petroleum Bhd in July 2011.

In November last year, Mokhzani ceased to be a substantial shareholder of Sapura Energy after disposing of 605 million shares or a 10.1% stake, held under Khasera Baru Ltd, at between RM1.42 and RM1.49. The relationship between him and Shahril was said to be strained.

Mokhzani and his partner Datuk Yeow Kheng Chew relinquished their executive board positions in November 2013 and resigned in March 2015. **E**



# 'We put our own reputations on the line'

ANNUAL REPORT

Sapura Energy Bhd chairman and non-independent non-executive director Datuk Hamzah Bakar, who doubles as the chairman of the board remuneration committee, and independent non-executive director Gee Siew Yong, who is the chairman of the board audit committee, sat down with The Edge to discuss the events at the company's annual general meeting last Wednesday. At the AGM, some shareholders questioned the board on several issues, including president and CEO Tan Sri Shahril Shamsuddin's pay package of RM7192 million in FY2018 and an additional RM43.4 million he took home from an intellectual property rights payment. Here is an excerpt from the interview.

## The Edge: Were you surprised by the eventful AGM?

**Datuk Hamzah Bakar:** They chose to ignore some points ... for example the fact that when we pay a bonus, the board wants to make sure that the result is indisputable; we take the decision on the bonus after we approve the audited accounts.

Therefore, the bonus for performance in FY2017 (ended Jan 31, 2017) was paid in April 2017. We can't put it in the FY2017 accounts, so we put it in the FY2018 accounts. But unluckily for us, we suffered a loss in 2018. So it looks like we paid a bonus when we made losses.

It just so happens that in 2017, we made profits. It (the bonus) is not just (based on) financial results). We have business development, we have cost savings, strategy, restructuring, business opportunities, new contracts won and so forth. All those count ... so, it's unfortunate.

The other element that nobody wants to acknowledge although we have told them, is the long-term incentive plan. Say for 2017, we paid 50% of the allocated amount, the rest is in the following two years. If the following two years are loss-making, you still have to pay. The rationale for deferring is so that he (Shahril) stays.

**Gee Siew Yong:** The whole purpose of an LTP (long-term incentive plan) is to make sure that staff, not just Tan Sri (Shahril) but all those who are eligible, have a longer-term view of the company. They earn it, they get granted, according to the criteria that are set, but they don't even receive it until over three years.

But because of this rollover – I wouldn't even call it unfortunate – we have tried to explain this but if (shareholders) choose not to understand, what can we do?

These are the facts we have articulated when queried, so it's not like you (shareholders) were told yesterday. They have raised it, and we just said 'noted and did nothing'. That is not quite an accurate picture.

## Are these explanations done on a regular basis?

**Hamzah:** Last year, they (the EPF) raised this issue at the AGM and we explained. We made it a point to explain clearly.

The other point is that when we go to the banks, they look at the company. We spend a lot of money buying assets to expand the business, and they recognise this company (Sapura Energy) right from the beginning. It is moved by an entrepreneur ... so I think they believe that if the entrepreneur is not there, they may not get their money back, as the company may go under.



Gee (top) and Hamzah

So they (the banks) insist that the CEO, the mover, give his personal undertaking not to run away, basically, not to give up his management position. The other part is not to sell his shares to below 10%, and he has to remain a director of the company.

So, without these, the loan would be breached. If it was me, I wouldn't (take such a risk) ... Shahril doesn't have 51% (of Sapura Energy), he has only 17%, so to give an undertaking for the benefit of the rest of the shareholders is a bit much to ask.

So the alternative, if he (Shahril) doesn't want to give a personal undertaking, is for a company to get a bank guarantee; if you look around, the lowest may be 1% basis, so imagine our loan of RM16 billion, 1% is RM160 million and that is for every year the loan is outstanding.

But the cost to him (Shahril), when he made that commitment, the price of Sapura Energy's shares was about RM4 plus. Let's say RM4, so he couldn't sell 10% for RM4; 10% is 600 million shares. Let's say we take a price a few months ago, before one of the institutional shareholders started selling the shares, say at RM1, so he lost RM3 per share, multiplied by 600 million, it is RM1.8 billion. So, we have to take that into consideration.

## One of the issues brought up is that you are not an independent director...

**Hamzah:** It's technical ... when Sapura bought Crest Petroleum a long time ago, I became the nominee of Sapura on the board, and the chairman. Because I was a nominee of a major shareholder, I cannot be independent.

## So, you believe Tan Sri Shahril's salary and remuneration are fair?

**Hamzah:** They are fair, given all the factors we have to take into account.

## Why are the covenant and his (Shahril's) guarantee of the debts not recorded in the annual report?

**Hamzah:** The covenant is supposed to be confidential. But we explained it to the institutional

investors, we explained it last year at the AGM, we explained it at the meeting with institutional shareholders.

They (institutional investors) say it (covenant) is normal (laughs). How could it be normal? I wouldn't do it.

It's easy to look at the profits of the company and just jump to conclusions: oh, the company is not making profits, so his salary is exorbitant ... but there are other KPIs.

## But then, how much salary would he (Shahril) draw when the times are good? This, we hear, was brought up by some shareholders. They asked, if I'm not mistaken, if it would be RM200 million to RM300 million...

**Gee:** We – I speak as an independent director – have our own fiduciary duties, and we have a structure within Sapura Energy that respects that; so even if he is going to be paid RM200 million to RM300 million, it has got to go through the due process. We have a remuneration committee, we have independent directors on the board, we all have to be convinced first. It's not like when the oil price goes up, it's automatic (he gets higher pay).

In the corporate environment, the rules and regulations are quite strict. There are many things we can't say in the annual report for it would be (tantamount to) forecasting but there are things we, the board monitor and we as a board, know, and the board consists of mostly independent directors. We know our fiduciary duties, we know our limitations, we abide by the rules of the exchange. We didn't just pluck the figure – RM55 million. There was a basis (at arriving at the figure) and that went through our corporate governance process.

**Hamzah:** The board did not pluck the number from thin air.

**Gee:** In 2014, which is FY2015, oil remained at US\$100 until October. That year we made a profit after tax of RM1.4 billion, and Tan Sri was not paid a lot more. It didn't triple to RM200 million to RM300 million.

## The EPF had board representation on Sapura Energy. Does it mean the EPF has also approved the remuneration package?

**Gee:** He retired at the end of the financial year but he was there during the deliberation, all deliberated and voted for. The quorum was made up of those who were not executive directors, Tan Sri and also his brother. In this case, there were seven directors, all together, the chairman (who represents the EPF), and all deliberated for, no one abstained and no one voted against.

Some noise was made but there were other shareholders while the MSWG (Minority Shareholders Watch Group) says it represents the minority shareholders. We, the independent directors, represent all shareholders. We put our own reputations on the line.

**Hamzah:** A lot of the investors were more worried about the company making profits and paying dividends; no violent reactions to compensation. They understood that an entrepreneur running the business gets paid ... just bring in the profits and pay dividends.

## How does it work? His pay was above RM80 million from 2014 to 2017. In FY2018, it fell to about RM71 million. So, why the drop?

**Gee:** The KPIs. We had a lost-time injury; that was a percentage of the KPIs. The board sets the KPIs up front and there are lots of categories. You have KPIs for stakeholder management, KPIs for health and safety, KPIs for the P&L ... it is a weightage of all the categories and there are lots and lots of them.

## Would you say that Tan Sri has achieved his

## KPIs in a satisfactory manner over the past five years?

**Gee:** Yes. We have a methodology that is transparent and quite rigorous. And it is consistently applied.

## Is it an issue that there are no dividends?

**Gee:** They (the shareholders) understand...

**Some feel that maybe he should not get such a high salary but suffer with the other shareholders...**

**Gee:** What do you mean by suffer?

## The share price being battered and no dividends paid...

**Gee:** No dividends is across the board, and we can understand. But this company, at this time, cannot pay a dividend, but when we can, we try to. When we look at our results, we go through them with management ... one of the items on the agenda is, are we paying a dividend? And the explanations come ... it's not like we ignore the shareholders and don't think of dividends. **Hamzah:** It is prudent financial management. Over the past few years, all the growth trajectory, the acquisitions, were made without any cash call to the shareholders. There is no dilution, which is how the company was built. We built the business without taking money from the shareholders.

**Gee:** All the bank borrowings have been put into the company for real physical assets.

**Over the past 10 months, it seems as though there have been unpleasant surprises to shareholders one after another. The massive impairment, then another round ... the share price falls off the cliff, then at the AGM, you had the issue of high salaries. These have made shareholders unhappy...**

**Hamzah:** We have to mark to market. Impairing the assets allows us to recalibrate the depreciation charges, which is a component of the day rate. So, it is to the advantage of the company to do it ... also, it is something that accounting standards require.

If we were not responsible, management can come out with a thousand reasons not to impair, and we won't have the losses and we would look good ... but it's not good for the company, but good for the CEO. If and when things improve, the asset value will increase, and it will be time for us to write back.

## Some wonder if there is a huge hole covered by all these impairments?

**Gee:** We have audited accounts, we have due process, we have quarterly results, we did impairments twice because it is our process, but think of our total assets, look at our balance sheet, and this RM2 billion relates to our rigs.

For all segments, our revenue is still higher than our costs, so we are still bringing in cash. We only show a loss because of paper depreciation ... we have always been Ebitda-positive, every single year in every single segment.

## Could you elaborate on the intellectual property payments?

**Gee:** There is always an annual review of benefits and services rendered, albeit, the bundle of services would repeat. Brand Finance and PwC looked at the intellectual property but PwC, from a tax perspective. But both did not come out with the same figure as they have different methodologies of calculating. But we used the lower of the two.

The intellectual property fees were presented and approved. How it works is that if Sapura Energy does not want to pay annual fees, they can pay a one-off US\$230 million to take the brand off Sapura.