MINORITY SHAREHOLDERS WATCH GROUP

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RISK-AVERSE INVESTORS

WATCH OUT FOR THE RED FLAGS

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THE stock exchange is a risk-return game. The higher the risk, the higher the return and vice versa.

The risk-averse investor may have a low threshold for risks. Below are some of the developments at public-listed companies (PLCs) that investors with low risk appetite should be aware of.

Contention between management and board

It is a red flag when there are accusations thrown by the board against the senior officers e.g., chief executive officer and executive directors. This is sometimes followed up with a suspension of the officer by the board pending investigations.

A forensic auditor may be appointed, or the investigations could be done internally. Let's not forget the letters to the regulators alleging all sorts of wrongdoing and the police reports flying about. Clearly, all is not well.

This may be exacerbated by the officer accusing the board of wrongdoings. The allegations and counter-allegations take centre stage with barbs being thrown at each other.

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> *Ultimately, there may be litigation. The by-product of all this is the loss of focus on running the business of the day. Minority shareholders suffer when public-listed companies' performance suffers.*

Proposed changes to financial period end

Proposed changes to financial period end should be supported by good reasons. One good reason is when there are new acquisitions and there is a desire to make all the companies' period ends coterminous to facilitate the preparation of group accounts.

If there are no good reasons, shareholders will view the change with suspicion.

The questions playing on their mind is; why the sudden need to change the period end? Since they have always been meeting the period ends, are there issues?

Name changes

Again, name changes must have a reason. Acceptable reasons are to communicate a new business direction.

Another reason is to incorporate the name of a takeover or merger party to better reflect the new group structure.

Name changes can also be done to refresh the brand. But when name changes happen too frequently without valid reasons, the market may view such changes suspiciously.

Frequent changes in business direction

Some PLCs change their business direction to what is the "flavour of the day". Often they are too late to operate profitably in the new business due to the long gestation period or high capital expenditure.

Some recent flavours of the day were gloves, microchips and medical equipment.

Unfortunately, oil palm trees need to be planted and take too long to yield. We do not see many PLCs jumping on that bandwagon though some PLCs may have been tempted to diversify into palm oil through acquisition of oil palm estates.

Change of auditors

Changes in auditors tend to be perceived suspiciously if there are no good reasons for such a change.

It is especially suspicious when auditors appointed at an annual general meeting (AGM) walk away before the next AGM — they walk away mid-stream.

There are several valid reasons for the change of auditors.

The audit committee may feel that the current auditors are unable to provide the level of service that the PLC needs.

An example will be a local PLC acquiring many overseas businesses.

The PLC may prefer an auditor who has overseas presence in the countries where the PLCs' operations are located.

This would help tremendously in the preparation of group audited accounts.

Another reason for the change of auditors is disagreement on the fees. We sometimes read of some auditors voluntarily resigning when they could not agree on the audit fees with the PLCs.

On another note, some auditors walk away from PLCs by citing the reason that they do not have enough resources, presumably human resources.

Auditors do not rely heavily on foreign labour and as such should not be impacted by the freeze in foreign labour.

One would have thought that audit human resources would be available given the layoffs that happened during the Covid-19 pandemic. Whatever the reasons, the Audit Oversight Board (AOB) may wish to look at such instances where the auditor walks away citing unavailability of resources.

(To be an external auditor of a PLC, the auditor must be registered with the AOB).

Maybe it is a structural issue that needs to be addressed.

Audit opinion

Anything other than a "clean" audit opinion should be viewed with concern. The most concerning audit opinion is the "material uncertainty as to the going concern" of the PLC.

This casts doubts as to the ability of the PLC to continue as a going concern. Other opinions may be phrased as "emphasis on matter".

Minority shareholders are reminded to read the Key Audit Matters section of the auditor's report where the auditor discusses some of the key challenges they faced during the audit and how they overcame these challenges.

The above is by no means an exhaustive list — which is prompted by some recent events among Malaysian PLCs.

The writer is chief executive officer of Minority Shareholders Watch Group