MSWG
MINORITY SHAREHOLDERS WATCH GROUP
BADAN PENGAWAS PEMEGANG SAHAM MINORITI BERHAD
(Incorporated in Malaysia . Registration No. 200001022382 (524989-M))

The Observer

27.10.2023

❖ Some reflections on an ESOS

Stock-based compensation such as employee share option schemes (ESOS) is widely used to reward, motivate and retain directors and employees for their contributions to a company's performance. Proponents believe stock options can effectively align the interests of managers, employees and shareholders.

At the same time, opponents argue that the mechanism of ESOS is flawed and highly contentious. They argue that executives can make a fortune from options when shares go up in value. But when share prices fall, investors lose out while executives are no worse off as they can choose not to exercise the options.

Worse still, the incentive to keep share prices moving upward so that options stay in the money may encourage some executives to focus exclusively on the near term and ignore shareholders' longer-term interests. Options can even tempt top managers to manipulate numbers to meet short-term targets. If so, that hardly reinforces the link between top managers and shareholders.

ESOS options granted, then impairments and provisions made

The ESOS of a local listed company serves as an interesting case study.

In December 2022, the Company granted close to 50 million new ESOS options to eligible directors and employees at 38 sen per share. About 80% of the new ESOS options were granted to its chief executive officer/executive director. Another 4% to the other five directors including four independent and non-executive directors.

Six months later, the Company announced massive impairment with hundreds of millions impaired and provisioned from its balance sheet in the last quarter of its 18-month financial period ended 30 April 2023 (FPE2023). This resulted in hundreds of millions of losses recorded during the financial period.

The sum included a one-off provision for potential liability due to delays in existing projects and impairments for outstanding receivables and intangible assets for key projects which the Board attributed to disruptions caused by the COVID-19 pandemic.

The Company announced the change of its financial year end from 30 October 2022 to 30 April 2023 in early January 2023 to ‘allow for better availability of resources and improvement management of audit and annual reporting.’

Notably, this was the first time it was in the red since it went public over a decade ago. In its Annual Report 2023, the Board stressed that the impairments and provisions were 'timely and pragmatic to reflect the Company's financial position'.

Assets are tested for impairment on a regular basis to prevent overstatement on the balance sheet. Assets such as receivables, intangibles and fixed assets are more likely to be subject to impairment. When an asset's value is written down (impaired) on the balance sheet, a loss is recorded in the income statement.

Timing opportunism or pure coincidence

Its annual report stated that all the eligible directors and employees fully accepted the ESOS options by the end of January 2023. Some directors exercised their options at 38 sen per share during the FPE2023. These ESOS options were without a vesting period.

The temporal proximity between the grant of ESOS options and impairments raises questions on whether the Board and Options Committee were aware of the possibility of impairments when they assessed the eligibility of employees and directors when granting the ESOS options.

It is good practice to disclose to shareholders the criteria and KPIs used to grant options to directors and key employees.

To be fair, the Options Committee could have been unaware of the imminent impairment when it granted the ESOS options, especially given the resignation of the external auditor. Its former external auditor resigned on 24 October 2022 due to 'disagreement on unreasonable audit fees.' A new external auditor was appointed six months later.

MSWG queried the Board on the above during the Company's AGM. The Board clarified that no concern of subsequent impairments was raised to the Board before granting the ESOS options to its directors and employees. The ESOS was granted in December 2022, and the impairment assessment had yet to be performed at that time.

The allocation of ESOS was at the discretion of the Options Committee based on the standard criteria set under by-laws, and the Audit Committee subsequently verified the list of recipients.

The Options Committee comprised its former chairman, the CEO and an employee. Generally, the directors involved would abstain from the deliberation of their own remuneration at committee and board levels.

The past, present and future

In fact, concerns abounded months back over its financial health given its stretched balance sheet, rising contract assets and intangible assets, and persistently negative operating cash flow.

As crises loomed, its share prices were beaten to a multi-year low. At one point, shares of the Company changed hands at 27.5 sen in mid-2022 before recovering to 90 sen currently.

Amid these concerns, the CEO of the Company reassured the investing public that these concerns had arisen from a general misunderstanding of its business model. The negative cash flow was attributed to its concession-based projects which require intensive capital expenditure upfront.

Investors were told that the cash flow would turn positive once the concession assets were completed and subsequently would generate stable and reliable income in the years to come. Besides, the Company was confident that no additional capital was required to complete its existing projects,

Notwithstanding the repeated assurances, the commercial operation dates of its key projects were again deferred. As it faced the cash crunch issue, shares were placed out to new shareholders, with revamps ensuing at the board and management level.

Records showed that four of six directors who received the ESOS options left the Board after the revamps. Then, huge impairments and provisions were announced; the rest is history.

It is worth noting that the impairments and provisions are non-cash and potentially reversible, subject to ongoing negotiations of receivables and reduced liquidated ascertained damages, should delayed projects commence operations earlier than expected.

Impairments and provisions should be provided to accurately reflect a company's financial position; board and management should always be prudent in their estimations and judgments. This means being more cautious and conservative to mitigate any major risks that would affect the business.

Ultimately, significant impairments of assets have a negative effect on the balance sheet and dampen investors' confidence in a company. At the end of the day, shareholders are on the receiving end of these negative developments.

It may seem that the CEO had profited tremendously from the exercise of ESOS options at a price that is far lower than the market price amid massive losses posted by the Company. However, credit is also due for the efforts in steering the Company out of recent crises and a subsequent recovery in share price within a year.

It appears the dust has settled for the Company after experiencing a challenging year. For now, it is on track to complete its remaining key projects and is starting to recognise incomes from some concession assets.

New investors who invested in the Company since last year might reap abundant returns with a strong recovery in share price. However, for long-term shareholders, their investing journey is nothing short of a roller coaster ride with volatile share price performance and the absence of dividends in recent years.

Lim Cian Yai
Manager, Corporate Monitoring

MSWG AGM/EGM Weekly Watch 30 October – 3 November 2023

For this week, the following are the AGMs/EGMs of companies in the Minority Shareholders Watch Group's (MSWG) watch list.

The summary of points of interest is highlighted here, while the details of the questions to the companies can be obtained via MSWG's website at www.mswg.org.my.

Date & Time	Company	Quick-take
30.10.23 (Mon) 02.30 pm	Hong Leong Bank Berhad (AGM)	In FY2023, HLB achieved a total income of RM5.686 billion, marking a 1.6% y-o-y increase, while net profit reached a record RM3.818 billion, showing an encouraging 16.1% improvement compared to the previous year. The robust performance was underpinned by healthy loan growth of 8% during the year, attributed to increased business activities in mortgages, auto loans, SMEs and commercial banking.
30.10.23 (Mon) 02.30 pm	Pensonic Holdings Berhad (AGM)	The Group turned lossmaking with a net loss of RM4.0 million in FY2023 (FY2022: net profit of RM13.1 million), in line with lower revenue of RM273.2 million from RM325.0 million a year ago. The decline in revenue was attributed to subdued discretionary consumer spending, persistent inflationary pressures and rising material costs. Approximately 70% of the Group's total revenue was derived locally. The Group is taking proactive measures to diversify its revenue streams and explore new growth opportunities.
31.10.23 (Tue) 10.00 am	KUB Malaysia Berhad (AGM)	In FY2023, the Group achieved a 41% increase in net profit to RM33.9 million (FY2022: RM24.1 million) despite posting a lower revenue of RM488.9 million during the year (FY2022: RM548.0 million). The increase in net profit was driven in part by the recognition of a gain on

		the fair value of its investment in KUB Sepadu Sdn Bhd, totalling RM13.4 million, and a more than 100% jump in the profitability of the LPG division.
31.10.23 (Tue) 10.30 am	Hong Leong Financial Group Berhad (AGM)	HLFG recorded a pre-tax profit of RM5.1 billion, an increase of 5.4% y-o-y, and a net profit of RM2.79 billion, an increase of 13.8% y-o-y in FY2023. The improved performance was attributed to higher contributions from the commercial banking division (under Hong Leong Bank) and the insurance division, while the investment banking division recorded lower contributions. The commercial banking segment contributed over 90% of the Group's profit.
01.11.23 (Wed) 10.30 am	Hong Leong Industries Berhad (AGM)	The Group's revenue y-o-y increased 39%, marking a record high revenue of RM3.4 billion (FY2022: RM2.5 billion) in FY2023. Its pre-tax profit improved significantly by 36% y-o-y to RM512 million from RM377 million in FY2022. Higher sales of motorcycles contributed to the higher revenue and profit. As part of the Group's ongoing strategy to rationalise and streamline its businesses, the Group entered into a definitive agreement to sell its non-core fibre cement products business in FY2023.
02.11.23 (Thur) 10.00 am	IOI Properties Group Berhad (AGM)	Among IOI Properties' three core business segments, the hospitality and leisure recorded the greatest jump in revenue of 85% in FY2023, followed by the property investment segment at 35%. The property investment segment saw higher recurring leasing income with the commencement of operations at IOI City Mall Phase 2, which added 1 million sq ft to its net lettable area (NLA) in Q1FY2023. The Group achieved a robust pre-tax profit of RM1.62 billion, marking a remarkable 47% y-o-y increase, while its net profit reached RM1.40 billion, showing an impressive 104% y-o-y growth.

		These substantial increases in both PBT and PAT were primarily driven by significant fair value gains on its investment properties. This success is intricately linked to the completion of IOI City Mall Phase 2, which seamlessly integrated its operations with the existing mall.
02.11.23 (Thur) 02.30 pm	TMC Life Sciences Berhad (AGM)	The Group recorded revenue and pre-tax profit of RM311.4 million and RM40.9 million, representing increases of 28% and 27%, respectively compared to the previous financial year. The higher revenue was mainly due to increased patient loads arising from the additional operating capacity at Thomson Hospital Kota Damansara ("THKD") during the financial year. THKD added 15 beds during the financial year, bringing the total bed count to 314 beds as of 30 June 2023.

One of the points of interest to be raised:	
Company	**Points/Issues to Be Raised**
Hong Leong Bank Berhad (AGM)	Notwithstanding a 27% y-o-y increase in the gross impaired loans, advances and financing (LAF) to RM1.04 billion from RM819.75 million in FY2022 (page 226 of AR2023), HLB's loan loss provision was up marginally at RM1.76 billion (FY2022: RM1.74 billion), resulting in a significantly lower loan impairment coverage (LIC) ratio of 168.8%, compared to 212% and 247% in FY2022 and FY2021. a) What stance does the Bank take in providing impairment for potential loan loss moving forward? Was the lower LIC ratio suggesting that the Bank now adopts a less conservative approach in providing provisions for doubtful loans, compared to the high level of buffer provided during the COVID-19 pandemic? b) Was the uptick in gross impaired LAF primarily driven by the expiry of the Payment Relief Assistance Plan (PRAP)? What is the risk of impairments of the RM1.4 billion amount under PRAP?
Pensonic Holdings Berhad (AGM)	The Group reported a loss before tax of RM2.5 million, compared to a profit before tax of RM14.8 million in the previous year. The lower revenue impacted on the overall financial performance, leading to the loss. (Page 10 Annual Report 2023) The administrative expenses increased by 7.5% to RM29.8 million as compared to the previous year (Page 60 of Annual Report 2023)

	Has the Group set targets for reducing fixed costs in FY2024 to improve its bottom line? If so, please elaborate on the targets in addition to the cost control strategies mentioned on page 12 of the Annual Report 2023.
KUB Malaysia Berhad (AGM)	As at 30 June 2023, KUB held cash and cash equivalents of RM405.6 million against total borrowings of RM41.1 million. This made KUB a net cash company with net cash amounting to RM364.5 million, or equivalent to 65.5 sen per share based on total issued shares of 556.46 million shares (Pages 75, 76 of AR2023) As a comparison, the shares of KUB are traded at 55 sen as of 10 October 2023. The cash and cash equivalents made up 62.6% of KUB's total assets of RM647.5 million. It was mentioned in the last AGM that KUB planned to conserve as much cash as possible as KUB was exploring several organic and inorganic expansion opportunities. a) Please elaborate on the possible directions for KUB's expansion. b) Will KUB consider short-term investments which generate better yield of return than bank interest while exploring expansion opportunities?
Hong Leong Financial Group Berhad (AGM)	For FY2023, the New Business Embedded Value (NBEV) of Hong Leong Assurance Berhad (HLA) was lower at RM178 million compared to RM200 million in the previous year, attributed to lower new business regular premium (NBRP) from agency and bancassurance channels. a) Moving on, HLA will focus on building a productive and professional agency to improve the distribution of its products. What are the strengths and weaknesses identified among HLA's agency force? b) What is the retention rate of HLA's customers and the average policy size per customer? What is the propensity of existing customers to renew their policies? On average, what is the cost of acquiring a new customer versus retaining an existing customer? c) As HLA's agency force is gradually pivoting towards distributing more protection products, resulting in higher protection and lower savings premium mix ratio of 38:62 versus 24:76 in FY2022 (page 29 of AR2023). Why does the agency force shift its focus to distribute more protection products? What does this mean to HLA in terms of margin and profitability? If such a trend persists, would this result in higher claims ratio moving forward?
Hong Leong Industries Berhad (AGM)	The Group had a provision for slow moving inventories of RM6.1 million for FYE2023 as opposed to a reversal of provision of slow-

	moving inventories of RM9.3 million in FYE2022. (Note 24, page 164 of AR2023) How much of these slow-moving inventories are attributed to motorcycles and tiles? What has caused these inventories to be slow moving? What are the measures to be taken by the Group to deal with these slow-moving inventories?
IOI Properties Group Berhad (AGM)	The property development business segment achieved a significant reduction of RM637.88 million in FY2023, representing 21% of the Group's FY2022 total inventory balance of completed properties. This brings the total outstanding inventory as at 30 June 2023 to RM2.41 billion. (Page 72 of IAR) a) What is the Group's targeted reduction of the inventory of completed properties in FY 2024 in terms of units and value? b) How did the Group manage to bring down the completed properties inventories by 21% in FY 2023? c) Please provide a breakdown of the completed properties sold in FY 2023 by the location of the property projects in terms of units and values respectively.
TMC Life Sciences Berhad (AGM)	As at 30 June 2023, the trade receivables which have been past due or impaired amounted to RM21.2 million (FY2022: RM13.2 million), representing 51% of the trade receivables. (As at 30 June 2022: 44%) (Page 167 of Annual Report 2023) a) What are the reasons for the increasing rate of trade receivables which have been past due or impaired? b) What are the Group strategies and targets set to improve the credit control and trade receivables recovery, along with the growing revenue? c) How much of the impaired trade receivables have been recovered to-date?

MSWG TEAM

Devanesan Evanson, Chief Executive Officer (devanesan@mswg.org.my)
Rita Foo, Head, Corporate Monitoring (rita.foo@mswg.org.my)
Norhisam Sidek, Manager, Corporate Monitoring (norhisam@mswg.org.my)
Lee Chee Meng, Manager, Corporate Monitoring (chee.meng@mswg.org.my)
Elaine Choo Yi Ling, Manager, Corporate Monitoring (elaine.choo@mswg.org.my)
Lim Cian Yai, Manager, Corporate Monitoring (cianyai@mswg.org.my)
Ooi Beng Hooi, Manager, Corporate Monitoring (ooi.benghooi@mswg.org.my)
Jackson Tan, Manager, Corporate Monitoring (jackson@mswg.org.my)
Nur Amirah Amirudin, Manager, Corporate Monitoring (nuramirah@mswg.org.my)
Yan Lai Kuan, Manager, Corporate Monitoring (yan.laikuan@mswg.org.my)
Lam Jun Ket, Manager, Corporate Monitoring (lam.junket@mswg.org.my)

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• *With regard to the companies mentioned, MSWG holds a minimum number of shares in all* the companies covered in this newsletter.

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