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Making the most of things

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IN 1996, on a Saturday afternoon in the month of October, Malayan Banking Bhd's managing director Datuk Amirsham Aziz was in his office after the bank's annual general meeting. In walks Tan Sri Rashid Hussain, then a 20 per cent shareholder of Development & Commercial Bank (D&C), with a proposition. Armed with Bank Negara Malaysia's (BNM's) approval, Rashid told Amirsham of his intention to acquire Kwong Yik Bank Bhd (KYB).

'The Maybank MD was surprised ... he nearly fell off his chair,' say officials familiar with the deal. 'Just hours earlier, he had brushed off suggestions by a hoard of local and foreign journalists that KYB is to be hived off to Rashid.'

The deal was finally clinched at RM2.8 billion. It was Malaysia's first major bank merger. It is also the deal that is taking a toll on the 'deal-maker extraordinaire'.

Rashid bought KYB when Malaysia was riding the crest of economic growth. His acquisition of KYB was at 3.2 times the book value. Today, banks are being sold at a book value of 1.5 times or even less in some cases.

The acquisition of KYB was done via Rashid's flagship corporate vehicle, Rashid Hussain Bhd (RHB). The company paid Maybank RM2.2 billion for its 75 per cent stake in KYB. In addition, RHB had to fork out another RM740 million for the mandatory general offer exercise.

The end result? RHB being saddled with a RM2.8 billion bill. The mitigating factor is that the bill is shared, to a certain extent, by Malaysian Resources Corporation Bhd (MRCB) which bought a 27 per cent stake into RHB at RM15.80 per share. The acquisition was funded via shares and cash of RM550 million.

After the acquisition of KYB, Rashid unveiled the newly-restructured D&C Bank, renamed RHB Bank, in June 1997. The interest of Rashid and his family in the ultimate holding company, RHB, was close to 30 per cent while MRCB became the second largest partner with 27 per cent. That was not the end of the restructuring story.

Barely had the dust settled when Malaysia was hit by the currency crisis. Like many other corporate figures, Rashid felt the whiplash, which still continues to reverberate around his group today. There was another round of restructuring at the end of 1998. This time, Rashid had to take a haircut to save his financial institution. His personal stake in RHB was diluted to 23.9 per cent while MRCB's interest was reduced to 22.7 per cent.

To many in the corporate circle, The acquisition of KYB was the catalyst which sent Rashid into a tail spin. But try telling that to him. 'I have no regrets,' the banker tells Malaysian Business. 'This is what investment opportunities are all about. If you make a wrong call, you have to live by it and make it right. There are no choices in life.'

The dilution of Rashid's stake at RHB saw additional shareholders coming in at the RHB level. The Employees Provident Fund (EPF) emerged with a 9.3 per cent stake and the Pension Fund (Kumpulan Wang Amanah Pencen) with 16.8 per cent. (See chart on RHB Group structure.)

At the RHB Bank level, Khazanah Nasional took a 30 per cent stake for RM725.4 million cash. The proceeds were utilised to reduce debts at the RHB Capital Bhd (RHB Cap) level. The debts of RHB Cap and the ultimate parent company, RHB, are mainly due to exposure to RHB Equities Sdn Bhd, a company involved in the financing activities of corporate and high net-

worth clients. RHB Equities' exposure is large compared to other companies in the stockbroking industry.

According to Rating Agency Malaysia Bhd (RAM), as of June last year, RHB Equities had a deficit in shareholders funds of RM561.8 million. Its total external borrowings amounted to RM168 million while the amount owed to the holding company (RHB Cap) and ultimate holding company (RHB) amounted to RM1.58 billion. 'While the external borrowings have been fully repaid, we are concerned that the inter-company advances by RHB Cap may not be fully recoverable although we note that the group has already taken substantial provisions to account for the shortfall in collateral and potential protracted process in recovering from clients,' says RAM in a recent report.

RHB Cap's debts stood at RM870 million as at the end of the financial year (FY) ended June 1999, a gearing figure which RAM describes as manageable at 0.3 times. At the time of writing, the gearing is said to be less than RM500 million.

While RHB Cap's debts are manageable, sadly, the same cannot be said about the debts at the RHB level. At the end of FY1999, the debts of RHB remained at RM2.8 billion, which is a cause for concern. The major components of the debts are RM800-million and US\$ 200-million bond issues. Both are due in June 2002. 'The US dollar bond holders would be seeking to redeem their papers by the middle of next year,' says a head of research.

Besides the redemption of bonds, there are several other issues that the RHB Group needs to address if it is to go forward. Among them:

- \* a loan of RM300 million at the RHB Cap level which needs to be paid. According to sources, the loan is a short-term loan that was originally dished out by the EPF. It is said that the group borrowed from a foreign bank to repay EPF. The loan is said to be due soon,

- \* the exercise price of both the tranches of RHB warrants are out of money. The exercise price of the first tranche, issued in 1997, is RM15 while the exercise price of the second tranche, issued in 1999, is RM4.35. At the very least, the exercise price of the first tranche needs to be adjusted if there is any hope of conversion by warrant holders. The proceeds from the exercise of the warrants are vital to redeem the bonds, and

- \* the settlement of RM1.4 billion Irredeemable Non-Cumulative Convertible Preference Shares (INCPS) at the RHB Bank level. The INCPS were issued to Danamodal Nasional in place of a loan given to Sime Bank.

To compound the problem, RHB's intrinsic structure denies RHB Cap or RHB any access to the cashflow of its banking subsidiaries. Consequently, the income generating ability of RHB Cap and RHB is under severe constraints.

'It is being choked. Being a holding company of a bank, RHB Cap's source of income is via dividend payment by the financial institutions under it. The story is about the same for RHB,' says an analyst. 'RHB is still bleeding from its venture in Vision City, leaving dividend income from RHB Cap as its major source of revenue.'

In 1999, RHB Bank was the major source of dividend income for RHB Cap followed by the merchant bank, RHB Sakura Bhd. (See pie chart on RHB Cap's dividend contributors).

Considering the weight of debt obligations and choked cashflow for the immediate and ultimate holding companies, analysts feel the RHB Group is ripe for an exercise to maximise its assets. 'It is possible that the group undertakes a restructuring exercise to unlock value,' says Franklin Tan of OCBC Research.

The best asset of the RHB Group at the moment is the bank. One possibility being bandied about by analysts is RHB Sakura being sold to RHB Bank. In fact, a few months ago, the share price of RHB Sakura surged

on speculation of corporate developments surrounding the stock. A sale of RHB Sakura to RHB Bank will indirectly result in the backdoor listing of RHB Bank. Rashid owns about 72 per cent of RHB Sakura via RHB Cap and his privately held company, Panduan Cekal Sdn Bhd. 'The sale of RHB Sakura to RHB Bank will unlock cash to RHB Cap which can be utilised to repay the RM300 million loan. It will also solve the INCPS problem,' says an analyst.

According to the terms and conditions, there will be a mandatory conversion of the INCPS should RHB Bank be listed on the stock exchange. It is learnt that Danamodal is also anxious to cash out and a listing of RHB Bank will provide them with the avenue.

As for the bonds maturing in June 2002, the group does not have much of a choice except to revise down the exercise price to induce more warrant holders to convert their papers.

Rashid declined to comment on suggestions of an impending corporate exercise of the group.

One snag that could arise from the possible listing of the bank is that RHB Cap will lose its allure as the holding company of an anchor bank. Investors wanting exposure to the banking unit within the RHB Group will place their money with the listed arm of the bank directly instead of RHB Cap. Recently, Public Bank proposed to shift its commercial banking operations to Hock Hua Bank and the move was not well received.

In RHB's case, if the jewel, which is RHB Bank, makes a backdoor listing via RHB Sakura, then RHB Cap could possibly feel the heat. But knowing Rashid and how he built his group into the country's third largest financial outfit, he will have something up his sleeves to ensure none of his listed companies turn out to be dead-wood.

For instance, associates close to Rashid say the tenacity he showed in waging a silent battle to ensure RHB Bank got anchor status underlines his determination in building up the group as a universal banking outfit. Under the original BNM driven merger plan, RHB Bank was not accorded anchor status. It was to be swallowed by the much smaller Multi-Purpose Bank.

The official reason for RHB not being accorded anchor status was that it was a recipient of financial aid from Danamodal. But investors and bankers in town felt that the reason was flimsy and speculations mounted that there could be something more to it.

Like most other corporate chieftains, the 54-year-old stockbroker-turned-banker owed a large part of his rise in fortunes to the New Economic Policy. Even way back in 1978, Rashid was identified as one of the few Bumiputeras with an affinity for financial services. Starting off as a fund manager for Bumiputera Merchant Bank, Rashid quickly rose to establish his name as a dealmaker.

Thus, for a man who had already established himself as one of the only two prominent Bumiputera bankers in town (the other being Tan Sri Azman Hashim of the Arab-Malaysian Group), it was hard to believe that he could soon be out of the sector altogether.

All looked lost for Rashid until one fine Sunday on Oct 3, 1999. While giving a talk to students at Malaysia Hall in London, Prime Minister Datuk Seri Dr Mahathir Mohamad revealed that he was re-thinking the BNM driven merger plan. Eventually, the number of anchor banks increased from six to 10. RHB Bank was among the additional four accorded anchor status.

When the official seal of approval was given, the RHB Group took a one-page advertisement in major newspapers thanking the government for granting the group anchor status. 'The granting of anchor status to RHB Group does not mean anything ... it is just a vagary of life,' says a Finance Ministry official. 'It is just that a decision was made to let

market forces decide on the mergers of banks and RHB Bank was given approval (for anchor bank status).'

Prior to the merger with Sime Bank, the risk weighted capital adequacy ratio (RWCAR) of RHB Bank was well above 10.5 per cent. Although the minimum requirement is 8.5 per cent, BNM likes to see banks maintain a ratio above 10.5 per cent. RHB Bank had to seek help from Danamodal after its merger with Sime Bank.

To his detractors, Rashid took a calculated gamble by acquiring Sime Bank and consequently, had to pay a price. But Rashid's sympathisers feel that the banker was obliged to take up Sime Bank as nobody else wanted it at that time. 'That is why the deal was structured in a way that protected Rashid himself,' he says.

Put briefly, RHB Bank acquired a 'clean' Sime Bank with downside risk capped to a minimum level. As part of the arrangement brokered by BNM, the crystallisation of any contingent liability of Sime and its officers will be indemnified by the central bank. Also, any new non-performing loan that may materialise during the one-year period after the takeover until December 1999 will be removed from RHB Bank's books.

On hindsight, RHB Bank's investment in Sime Bank has brought it a fair share of benefits. Sime Bank's predominant position in lending to the retail and small and medium-sized industries changed the loans portfolio of RHB Bank. Previously, the portfolio was skewed more towards the manufacturing sector and financing of corporate loans.

After a bad call on KYB, Rashid the deal-maker had made some amends in the last two years to rectify his mistakes. He has propped up the group's risk management practices. Gone are the carefree days when margin financing was easily available and contra losses were allowed to accumulate. Credit control, especially at the securities arm, is tight. Any contra losses over 15 days is fully provided for unless it is covered by the remisier's deposit.

But for all he has done, Rashid still has a few more crucial hurdles to cross. He has to address the gearing problem at the ultimate holding company level before one can truly say he has actually rode the storm.

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