

Hyper Drive

Despite strong reservations by certain parties, the mammoth Kumpulan Guthrie-Sime Darby-Golden Hope merger seems almost a *fait accompli*. What remains to be seen is how the new company will perform. ■ By Prathaban V

THE sheer magnitude of it all would make other corporate tie-ups look like child's play.

According to the merger script, plantation giants Kumpulan Guthrie Bhd, Sime Darby Bhd and Golden Hope Plantations Bhd will be merged as one entity under Synergy Drive Sdn Bhd.

This would create the world's largest oil palm plantation group with a market capitalisation of over RM39 billion, controlling about 5-6% of global palm oil output and supply. The total merger deal itself is said to be valued at RM33 billion, the largest of its kind in Asia.

According to Credit Suisse, once merged, Synergy Drive would have total cash of over RM4.2 billion and debts of RM6.8 billion.

If there is any doubt that the parties are oblivious to this fact, one needs only understand that this isn't a plan conjured overnight. In fact, as far back as 2003, talks of merging the three plantation companies were already making their rounds among the investing community.

Kumpulan Guthrie, Sime Darby and Golden Hope are all owned by the same entity – Permodalan Nasional Bhd (PNB) – which in turn is a government-related



investment arm to help Bumiputeras get a slice of the country's corporate share pie via unit trusts.

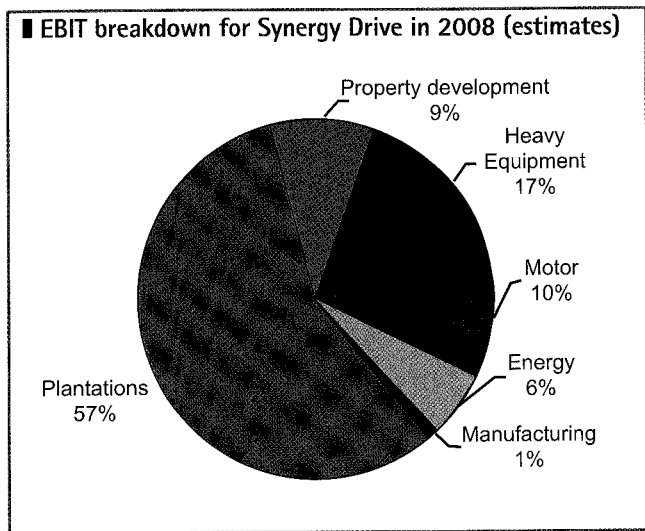
The main thrust of the merger is to rationalise business groups in similar sectors to make them into larger, more efficient and more influential market players. Admittedly, the only new feature

in this merger proposal, albeit somewhat controversial to some, is the entrance of CIMB Investment Bank Bhd's special-purpose vehicle, Synergy Drive. Post merger, PNB could end up with at least 45% of Synergy Drive, making it the single-largest shareholder in the company.

Herein lies the complexity and difficulty for Synergy Drive and PNB. Merging the three giants will not be a walk in the park. To begin with, it isn't just the merger of three plantation companies. In addition to the main companies, another five listed entities would also be merged. They are Kumpulan Guthrie's Guthrie Ropel Bhd and Highlands & Lowlands Bhd; Golden Hope's Mentakab Rubber Company (M) Bhd; and Sime Darby's Sime Engineering Services Bhd and Sime UEP Properties Bhd. The sixth subsidiary, Negara Properties Bhd, where Golden Hope has a 63% stake, is to be merged at a later date.

A fact missed by some is that all the companies are involved in diverse business sectors. They include plantation (both oil palm and rubber), property development, construction, engineering and even the auto industry.

This adds to the complexity of the merger



Source: Credit Suisse estimates

process. For instance, Sime Darby is really more of a conglomerate than a plantation company. To call this merger a 'plantation mega merger' can be misleading. Put plainly, this is a monster of a merger on a scale that has yet to be comprehended by the investing community.

'This is a challenging and daunting task not only to the most competent CEO but also to an effective and diverse Board backed up by capable management team,' admits Abdul Wahab Jaafar Sidek, CEO of the Minority Shareholder Watchdog Group (MSWG).

Despite the challenge, surprisingly MSWG has expressed its support for the merger. 'The merger will also attract new investors, particularly foreigners looking to invest in large stable conglomerates with strong earnings base and stock liquidity,' says Abdul Wahab. 'We support the proposed merger as it has significant upside potential in terms of greater value creation from economies of scale and synergies. The continued expansion of property development, energy and utilities, automotive and heavy equipment businesses will add to the bottomline of the merged entity.'

He explains that group revenue can be improved from having a global presence and branding advantage to facilitate growth and expansion.

Hostile merger

By all appearances, this looks to be a hostile merger, where the parties involved

Seri Abdullah Ahman Badawi, sits on top of PNB's board of directors. PNB's chairman Tan Sri Ahmad Sarji is also a member of the board of trustees. In this situation, it is not difficult to comprehend the strength of resolve attached to the merger proposal.

'It will be very difficult for PNB to reject the proposal as the deal has the support of PNB's board of trustees, which is led by the Prime Minister. If all goes well, Synergy Drive will be listed by the end of October 2007,' says Credit Suisse.

Key players in the deal are of course the chief executives of the three main companies – Datuk Abdul Wahab Maskan of Kumpulan Guthrie; Datuk Sabri Ahmad of Golden Hope and Datuk Ahmad Zubir Murshid of the Sime Darby Group; Tan Sri Hamad Kama Piah of PNB and of course CIMB, which is the adviser of Synergy Drive.

Of the personalities, two key figures emerge as key in seeing the deal through – Hamad and Ahmad Zubir, the later being named as CEO-designate of Synergy Drive pending the successful closure of the merger.

On Jan 24, the companies signed into place the first step towards the long merger journey. It seemed hurried, as just a week earlier, PNB appeared to have had some reservations about signing the sale of business agreement. Apparently the concern was over the sale of all assets of the three companies to Synergy Drive as a first step. In return, Synergy Drive would

are given a Hobson's choice. 'It is by all means a hostile merger, as the management of each of the PNB companies was not aware of the (merger) proposal,' reads an equity research paper issued by Credit Suisse in December.

Even PNB may have little say in the merger. The Yayasan Pelaburan Bumiputera's board of trustees, chaired by Prime Minister Datuk

issue redeemable convertible preference shares (PCPS) at RM5.25 apiece in the company to Kumpulan Guthrie, Sime Darby and Golden Hope's shareholders. The three would then have to call for extraordinary general meetings (EGMs) to get shareholders' approval.

The contention was that if the assets were 'transferred' to Synergy Drive but the shareholders later disapproved of the EGM resolutions, the three main companies would end up with shell companies. However, after some high-level talks in Putrajaya, the issues were resolved and the deal inked. The whole episode showed the resolve of Putrajaya and Synergy Drive to see the merger through.

So far, it is all systems go and the merger will go through despite some dissenting voices from the minority shareholders.

Voices of dissent

While most analysts appear optimistic about creating the world's largest oil palm company and being able to influence (or stabilise) global crude palm oil prices, there are some crucial questions yet to be answered.

Firstly, since PNB is already the substantial shareholder of Kumpulan Guthrie (64.7%), Golden Hope (52%) and Sime Darby (41%), what can it do to a merged entity that it can't already do now? This seems puzzling as there are few good answers to the question.

Some are quick to point that improved operations and an efficient production system would be the consequence of the merger.

But this does not convince former Group CEO of Kumpulan Guthrie, Tan Sri Abdul Khalid Ibrahim. According to him, if PNB is able to manage the plantation companies better, it would already have overtaken other rivals in the palm oil sector, namely IOI Corporation Bhd and Kuala Lumpur-Kepong Bhd (KLK).

Spirit of listing rules ignored?

Secondly, the fact that this has all the characteristics of a related-party transaction, and yet PNB and the three main companies in the merger deal will be allowed to vote in the EGMs, escapes the notice of the market regulators, says one merchant banker who prefers to remain anonymous.

'This is clearly a related-party transaction. PNB's board of trustees had knowledge of it from the start. Despite this, PNB says it is a merger process initiated by an external party – Synergy Drive,' says the merchant banker.

Abdul Khalid also agrees that it is 'impossible for PNB not to know about the merger'. 'I am quite sure PNB knows. The three CEOs (of Kumpulan Guthrie, Sime Darby and Golden Hope) are all nominated by PNB. The boards of directors of these three companies are mainly represented by PNB. All the three chairmen of Sime Darby, Golden Hope and Guthrie are board members of PNB,' he emphasises.

PNB, contacted for its views, declined to comment saying it felt it would be more prudent to wait for the EGMs. The meetings are expected to be held in mid-June.

Transparency and accountability are again issues that emerge. 'As the merger is being proposed by CIMB, PNB as the major shareholder will be allowed to vote. In this eventuality, greater transparency and accountability must prevail in the interest of minority shareholders and other stakeholders,' says MSWG's Abdul Wahab.

Some minority shareholders are unhappy about how the merger is being managed. If it is indeed a related-party transaction, PNB along with Kumpulan Guthrie, Sime Darby and Golden Hope

should not be allowed to vote under Bursa Malaysia's listing rules.

In such a situation, this would place the whole merger proposal in the hands of minority shareholders. But it looks like this is precisely what the players are trying to avoid, to eliminate elements of uncertainty which could potentially scuttle the whole merger.

Technically, Synergy Drive is an external party. However, the merchant banker points out that it is not buying any voting shares of the three companies in question. 'Synergy is merely buying whole assets of the three companies, and thus avoids triggering a mandatory general offer (MGO) to their shareholders,' he says.

But critics say PNB and Synergy Drive are ignoring the spirit of rules regarding related-party transactions to ensure the passage of the merger resolution at the respective company EGMs.

'While there are opportunities for investment bankers to bring forward proposals to be considered by the board of directors which may create value and ultimately ensure benefits to shareholders, there is obviously a need for the regulatory authorities to look critically at the rules governing related party transactions to ensure that the spirit behind these rules is upheld,' says MSWG.

This merger will pass

Last year, investment bankers were very busy with merger and acquisition (M&A) activities. It was reported that four out of the five biggest M&A deals in 2006 involved Malaysian companies. Last year, a total of 683 deals worth RM117 million were announced. According to data firm Dealogic, CIMB Bhd ranked second in Asia in terms of the value of deals announced, with a total worth of over US\$680 million.

Putting all the factors together, the Kumpulan Guthrie-Sime Darby-Golden Hope merger will be even more complex than the Southern Bank Bhd-CIMB Group merger last year. But the one thing certain is that it will not go the way of the abandoned News Straits Times Press Bhd-Utusan Melayu (M) Bhd merger early this year.

This merger will not be a sputtering journey, but a smooth one. In fact, it is almost a done deal. What remains to be seen is how Synergy Drive will perform once it is listed in October this year.

'Minority shareholders may not have the muscle to stop the proposed merger but nevertheless the major shareholders voting for it have to ensure that all shareholders are treated fairly,' says MSWG's Abdul Wahab.

'Merger Makes No Economic Sense'

Malaysian Business, catches up with former Kumpulan Guthrie head Tan Sri Abdul Khalid Ibrahim, who is also Parti Keadilan Rakyat Treasurer, for his take on the proposed Kumpulan Guthrie-Sime Darby-Golden Hope merger.

AS former chief executive of Kumpulan Guthrie Bhd, Tan Sri Abdul Khalid Ibrahim is still very aware of developments in the local plantations industry. He joined Guthrie in 1994 as its Group CEO and was also formerly Permodalan Nasional Bhd (PNB)'s CEO.

In December 2003, Khalid left Guthrie after his contract to head Guthrie was not renewed by the PNB board. The episode set a chain of events that led to a suit being

filed by Abdul Khalid against PNB. He claims that PNB has reneged on its offer to allow him to buy an additional 13% stake, over and above the 7% he already has, in Kumpulan Guthrie.

'The case is still in the courts and I am waiting for an outcome,' Abdul Khalid told *Malaysian Business* editor Charles Raj and section editor Prathaban V.

While he was in very good spirits, he did not attempt to hide his belief and disappointment that minority

shareholder voices would be muted during the EGMs to be held.

What is your opinion on the rationale for the merger exercise?

I have conflicting views, especially on the vision of the merger and its process. While I agree that mergers and acquisitions are part and parcel of the capital markets, this merger is initiated by an 'outsider', who is basically an investment banker, using the name of Synergy Drive.



Abdul Khalid: All economies of scale have their limit

The question is whether the merger is in the interest of these three companies (the three plantation companies). Is it in the interest of the nation? The argument, to me, is not very convincing. Of course investment bankers have a role to play in looking for undervalued assets that can be merged to create better value (for shareholders). At the same time, their main task is to look at financial (value), to pick the right business opportunity and charge a reasonable commission on the work done. That's how I see it. The total merger (plan) does not really make economic sense.

Firstly, the argument for the plantation merger is because there is a need to form a mega plantation group in order to develop economies of scale, especially in lowering the cost of crude palm oil production. To me, the argument does not hold water because, like in all economies of scale, there are also limits. For the plantation industry, the limit of size in being effective and having good economic management should be around less than 5,000 hectares.

Now, what does this mean? It means that most plantation companies can produce crude palm oil at a size of around RM850 to RM900 per tonne. So

they are what you would call a most reasonable producer. That can be done when a company has about 5,000 hectares (of plantation). But if you increase this to, say, 200,000 hectares, will the cost drop to below RM800 per tonne? No. In fact, the cost could be higher. If you increase it to one million hectares, will the cost of producing CPO be below RM900 per tonne? Again no. This is because there is already an optimum size (for the production of CPO).

But some industry observers have done studies and report that there will cost savings in terms of procurement, for instance. Is this a reasonable argument for the merger?

These industry observers are not (oil palm) planters. Probably the best-managed plantation company is IOI Corporation. Why don't we (PNB plantation companies) merge with them? They are the best in terms of production cost per hectare.

So if this argument is the vision for the merger, this is what we (PNB) should be doing. We can

probably produce better as it is a sensible argument.

The problem is that we appear to be fixing the logic of (economies of scale) only to these three companies but not to the whole oil palm industry in Malaysia. So they are giving arguments as it suits them. It is not a strategic argument.

Thirdly, most of these plantations are in diverse areas. This is true especially for big plantation companies, where they have ventured overseas into countries like Indonesia. But if they are to be merged as one unit, they can face restrictions. In Indonesia, for example, there is a ruling that the ownership of plantation land in any single province should not exceed 20,000ha. Thus, once the three companies are merged and they happen to own larger than 20,000ha in a province, they will have to sell the asset to comply with the law.

So if you have three plantation companies in from Malaysia, acting independently, they may be able to open 60,000ha in any Indonesian province...

But that is rather hypothetical. Can it actually happen?

Yes... some of them may have to sell. The Indonesian Government has recently commented that, with the merger, one group may control more than 20,000ha in a province. With that the argument about expanding your plantation area in Indonesia is moot. So what is the case here?

Do the three plantation companies know about this Indonesian policy?

They know. They really should know as it is part and parcel of the plantation industry. So why talk about expansion if there is a possibility of reducing land in Indonesia. That's why I have a mixed reaction to the merger exercise, as they appear not to have thought through all these factors.

So what will you do?

Well, I have written to the board of PNB and Guthrie, Golden Hope and Sime Darby, reminding them that this merger should not be done without getting the consent of the minority shareholders.

You consider yourself a minority shareholder?

Yes, I am a minority shareholder of Guthrie. Currently my total stake is about 7-8%.

Doesn't that make you a substantial shareholder...

(Laughs)...but the structure of the merger process does not allow the minorities to have a say. According to the merger process now, if a mere 50% plus one shareholder accept the merger offer by Synergy Drive, the deal goes through.

The whole voting process is a foregone conclusion and it is a mockery (of the spirit of checks and balances).

The important factor here is that, if you are not part of the merger proposal, you then become independent. This would

Is there an alternative way out?

Yes, by using a third party which is independent.

So you are not entirely opposed to the merger, but disagree with the way it is conducted?

Yes! Of course on the conceptualisation level, it is not very logical. If I had my way, I would invite IOI Corp to join in.

But would it not dilute the Bumiputera interests?

If that were the case, PNB should not be selling at all. The argument by PNB is that the value is more important than the percentage stake it holds in companies.

If that is the case, then merging with IOI makes sense! Thus there are flaws in the vision and the merger process. If you

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enable them to vote in all the (extraordinary general meetings) resolutions. But this is a big merger, and PNB does not know about it? The soon-to-be merged companies represents at least about RM15 billion of all PNB assets.

But perhaps the decision was made at PNB's board of trustees level and PNB had no knowledge of it?

But the chairman of PNB is also a member of the board of trustees...

But as it is, the Securities Commission, the MSWG and Bursa Malaysia and the institutions of ethics and corporate governance should step in and say that this does not make sense. The 'cleanest' way of deciding the merger is for PNB not to vote. Let the minority shareholders vote (to decide).

I wrote a letter to all the independent directors of the companies to be vigilant and to take care of the rights of the minority shareholders.

are going to build a reputable capital market in Malaysia, you need to do it in the right manner. Here the Government's role becomes very important. If investors think there is always an invisible hand driving the capital market, then the valuation of the shares in the market will be discounted to accommodate the uncertainty.

Will you be taking any action?

I am in touch with other minority shareholders and we are waiting for the full details of the merger proposal. I have not decided yet what action to take. But I reserve my position and my rights.

Can the minority shareholders potentially throw a spanner in the works?

No, they can't. But maybe I can but I don't want the other minorities to get involved. My existing lawsuits against PNB are a potential flashpoint. **mb**