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The Merger of EON Capital Berhad and Hong Leong Bank Berhad

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A Case Study on the Merger of EON Capital Berhad and Hong Leong Bank Berhad

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Case Study Part A

EON Capital Berhad

As the directors of EON Capital Berhad absorbed the meaning of the meeting they just had with Credit Suisse, their independent financial advisor, their dilemma became clear.[1] If they heeded the opinion of Credit Suisse and rejected an all-cash offer from Hong Leong Bank Berhad (HLBB) to acquire all their assets and liabilities for RM7.30 per share, they might be walking away from the highest price their shareholders would ever see. But if they put the offer, which Credit Suisse had opined was "unfair from a financial perspective," to a shareholder vote, they would further strain relations with their largest shareholder, the Hong Kong-based private equity group Primus Partners, and their fellow director, Ng Wing Fai. Either way, they could be opening themselves up to substantial legal liability.

It was May 17, 2010. Earlier in the day, the company had asked Bursa Malaysia to halt trading in its shares pending an announcement the directors expected to make after their meeting about the HLBB's offer. Their announcement did not turn out the way they expected however: "The Board wishes to announce that the Board's meeting was adjourned to a later date pending further clarification from Credit Suisse on [their] Opinion. Accordingly, the Board has also deferred its decision on the Proposed Distribution.[2] An announcement on the details of the Proposed Distribution and [Credit Suisse's] Opinion will be made once such opinion has been clarified and finalised."

It appeared that the takeover, which had been in the works for more than five months, might still have a long way to go before it was finalised.

EON Capital

EON Capital got its start in 1991, when Edaran Otomobil Nasional paid RM94.6 million for a 46.85% stake in Sarawak-based Kong Ming Bank. EON, the distributor of Proton cars, used the renamed EON Bank as its platform to provide loans to car buyers. The growth in car ownership in Malaysia fueled EON Bank's growth throughout the 1990s, during which time it became one of the largest providers of automobile financing in the country's fragmented financial industry.[3]

In 1999, following the Asian financial crisis and in anticipation of increased financial industry competition as a result of Malaysia's membership in the World Trade Organization, Bank Negara Malaysia announced that Malaysia's 55 financial institutions would be merged into six "anchor"

[1] Brief bios of EON Capital's directors are included at **Exhibit 1**.

[2] The "Proposed Distribution" referred to the amount and form of payment to shareholders that EON Capital proposed to make following the sale of its assets and liabilities to HLBB.

[3] "EONCap a sitting target for predators," *The Edge*, January 11, 2010.

banks: Maybank, Bumiputra-Commerce Bank, Multi-Purpose Bank, Perwira-Affin Bank, Public Bank, and Southern Bank. Under BNM's proposed marriages, EON Bank would become part of Maybank. Wishing to maintain independence, shareholder Rin Kei Mei lobbied for anchor bank status for EON Bank. Shareholders from Arab Malaysian Bank, Hong Leong Bank, and RHB Bank did the same. In 2000, these four were added to the list of anchor banks and, along with the original six, began acquiring Malaysia's remaining 45 financial institutions. EON merged with Oriental Bank, Malaysian International Merchant Bankers Bhd (MIMB), and Perkasa Finance in deals totaling nearly RM500 million. In 2002, EON Bank was part of a restructuring exercise with EON Capital, which had become a listed company through a reverse merger with Kedah Cement Holding Bhd. EON Bank, which owned 52% of EON Capital post-restructuring, distributed these shares to its shareholders in 2004. As a result, Malaysia's Employees Provident Fund (EPF) and Malaysia's sovereign wealth fund, Khazanah Nasional Bhd, ended up with 12.89% and 10.00% stakes in EON Capital respectively. DRB-HICOM Bhd was another substantial shareholder, owning 14.81% of EON Capital, which it increased to 20.2% in early 2005.[4]

By this time the Malaysian banking sector, consolidated and growing rapidly, was attracting investor interest domestically and abroad. US-based private equity group, TPG Newbridge Capital Ltd, after obtaining required permission from Bank Negara, held discussions with DRB-HICOM about acquiring its EON Capital stake. No deal was consummated, reportedly because TPG was reluctant to make such a substantial investment without also securing management control.

In early 2008, Primus, which had reportedly been trying to enter the Malaysian financial services sector for a few years, acquired DRB-HICOM's 20.2% stake. Primus paid RM9.55 per share for a total of RM 1.34 billion, which was then approximately 2.16 times EON Capital's book value.[5] A list of EON Capital's substantial shareholders following the Primus acquisition is shown at **Exhibit 2**. EON Capital's recent summary financial statements are shown at **Exhibit 3**.

HLBB

HLBB, like EON Bank, was initially slated to be absorbed by one of the six anchor banks in Malaysia, but also lobbied to maintain its independence. By 2009, it was Malaysia's sixth largest bank, one notch above EON Capital, with assets of RM79 billion. An acquisition of EON Capital would increase its total assets to approximately RM121 billion and move it into fourth place among Malaysia's banks, jumping it over RHB and AmBank.[6] A summary ranking of Malaysia banks by total assets at September 30, 2009, is in **Table 1**.

HLBB's holding company, the Hong Leong Group, and Hong Kong-based Guoco Group, both controlled by Malaysian Quek Leng Chan, had been active investors around East Asia since 2001, when Guoco sold its controlling stake in Hong Kong's Dao Heng Bank for HKD41 billion. In late 2009, Guoco had approximately HKD18 billion and Hong Leong Group had approximately RM23 billion in cash on their balance sheets.

[4] Ibid.
[5] Ibid.
[6] "Quek on the Prowl," The Edge, January 11, 2010.

Table 1				
Malaysian banks by assets and gross loans (as of September 30, 2009)				
Millions of ringgit			Total assets	Gross loans
1	Maybank		317,041	198,783
2	CIMB		228,892	143,193
3	Public Bank		209,043	133,578
4	RHB Cap		110,500	66,950
5	AmBank		92,455	62,451
6	Hong Leong Bank		77,017	35,961
7	EON Capital		44,393	32,139
8	Affin Bank		38,745	22,340
9	Alliance Financial		30,278	20,553
Source: The Edge, January 11, 2010				

Seeing clearly that the banking landscape was changing, HLBB's management believed that increasing the size of its capital base in Malaysia was a strategic imperative. In late 2009, management of the bank approached Bank Negara seeking permission to hold merger talks with EON Capital.

HLBB's recent summary financial statements are shown at **Exhibit 4**.

The 2008/2009 financial crisis

The financial crisis in the United States, triggered in large part by hundreds of billions of dollars of losses from subprime mortgage securities, impacted financial institutions around the globe. In March 2008, investment bank Bear Stearns, seeing its US$18 billion in liquidity pulled out in a single week by nervous investors was forced to merge with J.P. Morgan at US$2.00 per share. That this was later revised to US$10.00 was little comfort to shareholders who had owned Bear stock priced at US$172 per share in January 2007 and US$108/share just six months earlier. In September, during the same weekend that Lehman Brothers filed for bankruptcy, Merrill Lynch was pushed by the Federal Reserve Bank of the United States into a merger with Bank of America. The two remaining top-five investment banks, Goldman Sachs and Morgan Stanley, converted to bank holding companies so they could take advantage of loans available through the Federal Reserve's discount window. Commercial banks like Citigroup (weekly all-time high US$557 on 29/12/2006, to lowest US$10.3 on 6/3/2009), Bank of America (weekly all-time high US$$54.85 on 17/11/2006 to lowest US$3.14 on 6/3/2009), and Wells Fargo (weekly all-time high US$39.8 on 19/9/2008 to lowest US$8.61 on 6/3/2009) all saw their share prices drop dramatically and were pushed in October to take capital injections from the Federal Reserve as were J.P. Morgan (weekly all-time high US$52.63 on 4/5/2007 to lowest US$15.93 on 6/3/2009), Goldman (weekly all-time high US$235.92 on 26/20/2007 to lowest US$53.31 on 21/11/2008) and Morgan Stanley (weekly all-time high US$73.45 on 15/6/2007 to lowest US$9.68 on 10/10/2008).

Europe's banking industry saw a similar decline. The major banks in the UK, France, and Germany all saw substantial reductions in their valuations. And, despite being much better capitalised than they were prior to the 1997/1998 financial crisis, Asian banks were not spared. Around the region the large banks in China, Japan, Hong Kong, Malaysia, and Singapore all saw large drops in their

valuations. Data on selected international banking valuations are included at **Exhibit 5**. An index of Malaysia's banks' market values 2005-2009 is shown in **Exhibit 6**.

Exacerbating the market value decline brought on by losses was the anticipated increase by the Bank for International Settlements of bank capital standards under the Basel III framework.[7] Simply put, many analysts believed that the increases in equity anticipated under Basel III would lead inexorably to smaller ROE and, therefore, permanently lower share prices. While Bank Negara generally urged Malaysia's banks to maintain excess capital following the 1997/1998 financial crisis, some nevertheless expected to have to increase their shareholders' equity and were scrutinising their capital structures carefully in anticipation of meeting higher standards resulting from a more conservative view toward bank capitalisation worldwide.

During 2009, EON Capital attracted unwanted scrutiny on this issue from Bank Negara. When acquiring its initial stake, Primus had indicated to Bank Negara that it would inject new capital of RM655 million in early 2009 with an issue of debt and warrants, part of which would be used to replace a US$225 million EON Capital bond. In the event, the company repaid the bond before raising replacement funds, which caused its capital adequacy ratio to fall below nine percent temporarily and prompted a reprimand from Bank Negara.[8] Primus ultimately failed to come through with the promised cash injection and instead proposed a rights issue, which was not viewed favorably by existing substantial shareholders. It also came to light that part of Primus's initial share purchase had been financed by a loan from Public Bank and that Public Bank effectively held Primus's EON Capital shares as security (**Exhibit 2**). This surprised many industry observers.

For banks everywhere, the slowing of economies worldwide and the new regulations proposed under the Basel III framework suggested that reduced banking valuation would be long-lived.

Relevant regulations in Malaysia

At least two sets of regulatory issues were relevant in any proposed deal between HLBB and EON Capital. Approval would be required from Bank Negara, which kept close oversight of Malaysia's banks and had played a fundamental role in limiting the damage to Malaysia's banking industry caused by the 1997/1998 Asian financial crisis. Prior to a possible acquirer approaching a target bank, or a bank seeking capital approaching new investors, it was customary for interested parties to obtain Bank Negara's approval to begin discussions. Any deal that may be agreed would require BNM's explicit approval to be consummated. Following a change in 2006, banks involved in merger discussions could be permitted to hold talks with more than one party at a time.

[7] The Framework "[set] out higher and better-quality capital, better risk coverage, the introduction of a leverage ratio as a backstop to the risk-based requirement, measures to promote the buildup of capital that can be drawn down in periods of stress, and the introduction of two global liquidity standards." Source: www.bis.org.

[8] Although CAR fell above the regulated requirement of 8%, it was reported that the Central Bank felt that it might not be comfortable enough to cushion against loan losses during a recession, prompting the reprimand. When replacement funds were eventually raised, they were at a higher all-in cost. EON Capital rushed to raise RM410 million through medium-term notes at an effective rate of 7.5 percent, boosting capital adequacy ratio to 12%. However, tier-1 capital kept close to the regulated limit.

The second set of issues that were relevant to a HLBB/EON Capital deal were those relating to its form. Under Malaysia's Companies Act, acceptance of an offer by HLBB to buy the assets (and assume the liabilities) of EON Capital could be passed by a simple majority vote of EON Capital's shareholders following a required recommendation by the company's board of directors. In contrast, HLBB could make an offer directly to EON Capital shareholders to acquire their shares. This transaction would fall under the purview of Bursa Malaysia's Main Market Listing Requirements, Practice Note No. 19 and the Capital Markets and Services Act 2007. Under such an offer HLBB would generally be able to de-list EON Capital once it acquired 75% of its shares and HLBB would be able to compel remaining EON Capital shareholders to sell their shares once it acquired 90%.

HLBB's offer

In December 2009, Rin and Tiong, through their companies,[9] notified the board of EON Capital that they had received Bank Negara's approval to negotiate to sell their shares to HLBB. In early January 2010, the board announced that it would "conduct a strategic review of the EON Bank Group in an effort to create shareholder value." Two weeks later the company announced that it had submitted an application to Bank Negara for approval to commence negotiations with HLBB. It was reported during this time that EON Capital or Ng had made approaches to other possible suitors including Singapore's Temasek Holdings, which owned a 29% stake in Malaysia's Alliance Financial Group.

On January 21, the board received an unsolicited offer from HLBB to acquire all the assets and liabilities of EON Capital for RM4.9 billion, (RM7.10/share). The terms of the offer required that EON Capital make no distributions other than a regular RM0.10 per share dividend declared on 2009 earnings. It also included a deadline of February 4, 2010, and required EON Capital to negotiate exclusively with HLBB throughout the period of the offer.

EON Capital's board hired Goldman Sachs and Ethos & Company to advise them regarding HLBB's offer. On February 2, the board concluded that the offer was too low and resolved not to call an Extraordinary General Meeting to put the matter to a shareholder vote. This prompted Rin, through his company Kualapura (M) Sdn Bhd, to call an Extraordinary General Meeting of his own to vote on a proposal to add eight new directors to EON Capital's existing seven-member board.[10] By law he was required to give 14 days' notice for the EGM, during which time the HLBB offer expired. HLBB refused to extend the offer.

The EGM was held on March 16. Seven of Rin's proposed new directors were elected, winning approximately 70% of the 90% of the shares that voted. Within days, four of EON Capital's original director group, including Chairman Syed Anwar Jamalullail resigned.

On March 30, the new board received another unsolicited offer from HLBB, also at RM7.10 per share. On April 1, following some discussion, HLBB increased its offer to RM7.30, though the terms of the new offer permitted EON Capital to make no distributions to shareholders, a change from the original

[9] Lintang Emas Sdn Bhd, R H Development Corporation Sdn Bhd, and Kualapura (M) Sdn Bhd.

[10] Under Malaysia's company law, any shareholder who owns at least 10% of a company's shares has the right to call a shareholder meeting.

offer, which permitted its 10 sen dividend. The offer was set to expire on April 12 and again required EON Capital to negotiate exclusively with HLBB, among other customary conditions.[11] The following day the EON Capital board informed Bursa Malaysia that it would put the offer to a shareholder vote, but that it had requested HLBB to consider offering EON Capital shareholders a choice between their current all-cash offer and one that would include some element of HLBB equity.

In May, following extensions of the offer deadline by HLBB, the board retained Credit Suisse as its independent financial adviser to provide an opinion from a financial point of view on the fairness of the offer. Credit Suisse undertook a detailed analysis of the offer, comparing it to the historical market price of EON Capital's shares, evaluation of other major banks in Malaysia, prices paid in earlier banking M&A deals done in Malaysia, and the intrinsic value of EON Capital reflecting its growth, projected profitability, capital structure and cost of capital. The Credit Suisse report is shown at **Exhibit 7**.

Credit Suisse's opinion was succinct: "Based on the above, we are of the opinion that that Offer is not fair and not reasonable from a financial perspective."[12]

* * * * * * *

[11] A summary of the conditions of HLBB's offer is available at **Exhibit 7** as part of Credit Suisse's opinion letter.
[12] Source: Credit Suisse "Opinion Letter" to EON Capital's Board of Directors dated June 11, 2010.

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Case Study Part B

EON Capital Berhad

On May 20, 2010, the Board of Directors of EON Capital, following a five-hour meeting, made the announcement shown in Exhibit 8 to Bursa Malaysia.

Malaysia's StarBizWeek summarised the announcement:

> *The EON Capital Bhd (EON Cap) board will table the all-cash RM5.06bil, or RM7.30 per share, takeover offer from Hong Leong Bank Bhd (HLB) to shareholders at an upcoming EGM despite the disapproval of its independent financial adviser (IFA) as it is "in the best interests" of the financial group, it said.*
>
> *The decision was made on Thursday after a board meeting which lasted more than five hours.*
>
> *EON Cap told Bursa Malaysia yesterday that the board came to its decision after considering the opinions of IFA Credit Suisse Securities (M) Sdn Bhd, another of its advisers, Goldman Sachs (S) Pte Ltd and also after consideration of relevant aspects of the offer.*
>
> *It did not provide the date of the EGM but said it would be convened in due course.*
>
> *"The board has proposed to distribute the proceeds from the proposed disposal back to the shareholders of EON Cap via a proposed special dividend and a proposed capital repayment exercise," the company said.*
>
> *In its statement, EON Cap said that among other reasons, it considered the proposed disposal in the best interests of the company in view of the growing drive towards consolidation in the banking sector and increasing competition in the landscape.*
>
> *It also said the liquidity of its stock had been relatively low, which meant that it may not be easy for shareholders to realise their investments on the open market.*
>
> *"The implementation of Basel III could also subject the group to further uncertainties in the longer term which may broadly require the group to hold more capital and liquidity, strengthen its capital buffers and be subject to greater regulatory supervision," it said.*
>
> *In the absence of an alternative bidder, the board viewed the offer by Tan Sri Quek Leng Chan's HLB as "serious and credible", it added.*
>
> *Director Ng Wing Fai, who represents EON Cap's largest shareholder Primus Pacific Partners Ltd with its 20.2% stake, expressed his disagreement in the statement, saying that the proposed disposal was not in the best interests of the company.*
>
> *Ng's views would be included in a circular to be sent to shareholders, EON Cap said.*
>
> *Primus' resistance is not surprising. Analysts have said given that Primus had purchased its EON Cap shares at RM9.55 each in February 2008, accepting the HLB offer would crystalise its losses.*

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The merger and acquisition of EON Capital Berhad by HLBB was fully and legally vested effective the 1st of July 2011.

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