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SC CORPORATE CASE STUDY SERIES

The Merger of CIMB Bank Berhad and Southern Bank Berhad

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A Case Study on the Merger of CIMB Bank Berhad and Southern Bank Berhad

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Bumiputra-Commerce Holdings Berhad and Southern Bank Berhad

A Case Study and Lessons from a Hostile Take-over and Merger

Bumiputra-Commerce Holdings Berhad said in October 2005;

> "…had received approval from the Central Bank to make an offer for Southern Bank Berhad…."

Southern Bank Berhad said in January 2006;

> "After an extensive period of negotiations of almost three months, Southern Bank has not received from CIMB Group (the operating arm of Bumiputra-Commerce Holdings Berhad) a formal offer of the price, structure and value proposition relating to the proposed merger… the board is of the view that further prolonged discussions would not be in the best interests of Southern Bank and its shareholders and other stakeholders, including its customers… and it would immediately seek a near-term merger alternative that was in the best interests of its shareholders and stakeholders. …."

Bumiputra-Commerce Holdings Berhad responded within minutes of SBB's announcement:

> "While Bumiputra-Commerce is disappointed with the unilateral decision of Southern Bank's Board, Bumiputra-Commerce intends to continue discussions with shareholders of Southern Bank who remain interested in a merger . . . ."

Thus began one of the most intense and closely watched hostile takeover and merger case, the first of its kind in the Malaysian banking industry, replete with an array of defensive strategies, the involvement of prominent shareholder personalities and even regulators, and which spawned numerous copycat takeover routes[1] in the country in the years to come which eventually led to the amendments to Bursa Malaysia's Listing Requirements on Privatisation of Listed Companies via Disposal of Assets.

[1] While there are M&As involving public companies structured in a similar way in the past, CIMB's acquisition of SBB is widely seen as the pioneering deal of this nature, referred to in the industry as the "assets and liabilities route".

To recap, let us look at the major players involved in this significant case in corporate Malaysia.

Bumiputra-Commerce Holdings Berhad

Formerly known as Commerce-Asset Holdings Berhad, Bumiputra-Commerce Holdings Berhad (BCHB) was the listed vehicle for the CIMB Group, Malaysia's second largest financial services group. It was listed on the Main Board of Bursa Malaysia, the country's stock exchange in 1987. BCHB's main focus was maximising its capabilities to achieve sustainable progress.

BCHB had gone through an internal restructuring process which had resulted in the transformation of the company. Before this, its operating entities in the financial services sector operated largely on a stand-alone basis. However, from late 2004 onwards, it began to consolidate all its operations under CIMB Group to form a universal bank anchored by CIMB, South East Asia's largest investment bank. By end-2004, BCHB was the 11th largest company by market capitalisation amounting to RM12.7 billion. One year later, it had grown to the eighth largest company by market capitalisation amounting to RM15.7 billion and by end-2006, it was the seventh largest. The restructuring exercise was completed in January 2006 and marked the birth of the new CIMB Group, a universal bank. Encapsulating investment banking, consumer banking, asset management and Islamic products and services, CIMB Group stood on the threshold of making its mark on the Malaysian financial landscape.

Southern Bank Berhad

Southern Bank Berhad (SBB) was founded as Southern Banking Limited in Penang in 1965. It was a public limited liability company, incorporated and domiciled in Malaysia, and listed on the Main Board of Bursa Malaysia. It was the ninth largest lender and one of the ten anchor banks in Malaysia. SBB was principally engaged in all aspects of the banking business and the provision of related services, which also included Islamic banking services. With over four decades of banking experience and an unbroken track record of consistent profitability, SBB had positioned itself for leadership in niche markets such as retail banking, wealth management and SME financing where it had the greatest competitive advantage. Its primary strength laid in its very strong consumer finance franchise.

For its financial year ended 2005, SBB had recorded a profit before tax of RM799.1 million, generating a basic earnings per share (EPS) of 40.1 sen and a fully diluted EPS of 38.3 sen[2]. As at the same date, it had a total assets base of RM25.1 billion with loans amounting to RM16.3 billion compared to deposits of RM14.6 billion. In 2004, SBB ranked first among the banks in pre-provision profit, second in net interest margins, third in dividend yield and fourth in total returns.

SBB itself had completed a total of nine mergers and acquisitions with the acquisition of Ban Hin Lee Bank, three finance companies (United Merchant Finance, Perdana Finance and Cempaka Finance), two asset management companies (BHLB Pacific Trust and BHLB Asset), Mohaiyani Securities, the minorities of shareholders in SBB Securities and an investment bank (Perdana Merchant Bank).

CIMB

Commerce International Merchant Bankers Berhad (CIMB) came into existence in 1986 with the renaming of Pertanian Baring Sanwa Multinational Berhad as a result of Bank of Commerce Berhad replacing Bank Pertanian as the controlling shareholder.

CIMB Group is the operating entity of BCHB and is Malaysia's second largest financial services group. Anchored by CIMB Investment Bank, CIMB Group had undertook a series of mergers and acquisitions to the tune of RM12.8 billion to transform itself into a universal bank and was officially launched on 7 September 2006. Following an internal restructuring exercise to transfer all of BCHB's operating entities to CIMB Group, the universal bank now comprises five major business divisions - consumer banking, investment banking, treasury, asset management and insurance. The Banker named CIMB Group as "bank of the year for Malaysia" in 2006. Within the CIMB Group, its consumer banking arm is CIMB Bank.

The key individuals in this deal included several prominent personalities, namely, CIMB Group chief executive Datuk Seri Nazir Razak[3], SBB chief executive officer Tan Sri Tan Teong Hean, businessmen Tan Sri Chua Ma Yu, Tan Sri Khoo Kay Peng, Datuk Syed Mohd Yusof Syed Nasir and DYMM Sultan Sharafuddin Idris Shah.

[2] The basic EPS was calculated by dividing the net profit for the financial year by the weighted average number of ordinary shares in issue, excluding the weighted average number of treasury shares held by the bank. The diluted EPS was calculated by dividing the net profit for the financial year by the weighted average number of ordinary shares in issue adjusted for shares issuable by virtue of the exercise of warrants.

[3] In 2004, Datuk Seri Nazir was named the winner of the Malaysia's CEO of the year award organised by Business Times and American Express Global Corporate Services. He was also named as one of the "25 Stars of Asia" by Business Week magazine and one of the World Economic Forum's "Young Global Leaders".

THE SCENARIO

As part of the transformation of the Malaysian banking sector under the central bank's Financial Sector Master Plan to further develop the Malaysian banking sector and to prepare for the opening up of the industry to greater foreign participation, the banking industry saw many changes in the first decade of the new millennium. The drive towards consolidation of the industry from the then large number of financial players was particularly cogent given the impending liberalisation of the sector when foreign banks would be permitted to establish a greater presence locally. Accordingly, the banking sector had seen the number of banks shrinking from 54 prior to the Asian financial crisis to 10 anchor banks by 2000 but, since then, marriages had been hard to negotiate. Consolidation among the banks were seen as necessary in order to survive, as in 2007, Malaysia, in order to fulfil its World Trade Organization commitments, would have to permit the foreign banks operating in the country, such as Citigroup and HSBC, to set up as many as four additional branches each.

CIMB Group had ambitious plans to become not only a significant domestic universal[4] bank but also aimed to be a regional banking group offering the full range of banking activities from retail to investment advisory. Set on an aggressive expansion plan, acquisition of existing banking businesses seemed the fastest route to meet its ambition than to grow organically. It already had a strong commercial banking presence and investment advisory business but lacked a foothold in the retail banking sector. In 2004, the bank had acquired Commerce Trust Berhad and Commerce Asset Fund Managers Berhad which led to the formation of CIMB-Principal, its asset management arm. This was followed by expansion into the stockbroking business a year later through the RM551.41 million acquisition of Singapore-based GK Goh. Through this deal and a tie-up with Indonesia's seventh largest bank, Bank Niaga Tbk, CIMB had announced its regional ambition way ahead of any other domestic bank. A merger with SBB would leave CIMB with around USD30 billion in assets, a fraction of the USD105 billion held by South East Asia's biggest bank, Singapore's DBS, and still less than its main domestic rival, Malayan Banking Bhd.

To better understand the CIMB Group DNA, it may be worthwhile to also take a look at its lineage. The bank itself was formed from an amalgamation of numerous entities including Bank Bumiputera Malaysia Berhad, United Asian Bank Berhad, Pertanian Baring Sanwa Multinational Berhad and Bank of Commerce Berhad. With its diverse lineage, the bank was endowed with an entrepreneurial spirit and uniquely positioned to blaze innovative trails.

[4] Under Bank Negara Malaysia's Financial Sector Master Plan, there are three categories of banks: large regional banks, universal Malaysian banks, and niche banks.

A case of an ardent suitor and a reluctant bride …

The tussle between CIMB and SBB began in late 2005 and culminated with a successful RM6.7 billion takeover deal the following year. But it was not without its fair share of drama.

There is no smoke without a fire… rumours started floating in the market in September 2005 that BCHB wanted to make an offer for SBB. The veracity of this rumour was confirmed when a month later, on 21 October, BCHB (then known as CAHB) announced that it had obtained the approval from the Minister of Finance through the central bank, Bank Negara Malaysia (BNM), to start merger discussions with the shareholders of SBB.

Why SBB? Among the many local banks BCHB considered, it found SBB's "consumer banking business appealed most'' and its other businesses complemented what BCHB had. "When you go first, you have the opportunity to choose from everything that is still out there. The proposed merger with SBB is a major boost. It will accelerate the transformation of CIMB's consumer banking operations and allow us to export consumer banking as we want to be a regional player,'' CIMB Group chief executive Datuk Seri Nazir Razak had said, adding that this landmark deal would trigger the second wave of banking mergers in the country. "We felt small," said Datuk Seri Nazir Razak, adding that the merger would enable CIMB's banking business to have a single customer limit of around RM2 billion, compared with only RM300 million then.

"The restructuring is also partly defensive," as the next phase of bank consolidation would come sooner rather than later. "The move to explore a merger with SBB is consistent with our strategy of being proactive in banking consolidation to strengthen ourselves to compete post further liberalisation and deregulation of the Malaysian market. Preparing for further consolidation was one of the primary objectives of the CIMB-BCB integration. We think that SBB would complement our existing businesses very well. They have good mass affluent retail and SME[5] franchises while we are strong in treasury, corporate and investment banking. We are optimistic about the potential combination of management talent. Our customer bases are also quite different while our two asset management companies could combine to become the largest domestic private asset manager," said Datuk Seri Nazir Razak. Due cognizance was taken that although the negotiation process would bring a temporary element of uncertainty for its shareholders, the Group would only conclude a deal that could convincingly add to shareholders' value.

[5] Small and Medium-sized Enterprises. The official definition of SME is defined by the National SME Development Council based on either the number of employees or the annual sales turnover based on a matrix of type of venture and category.

Ironically, SBB's chief executive officer Tan Sri Tan himself had said in an interview, "…our job is to make ourselves more attractive to our stakeholders, that means our shareholders, customers and employees. By making ourselves more attractive, we attract more people, more interest... that's a basic benchmark of success."

Analysts were in agreement that a merger would bolster BCHB's[6] position as the country's second largest bank in terms of assets and fill some of the missing parts in the BCHB banking group. It was widely held that although the BCHB Group's strength was in commercial and investment banking and it had a growing asset management business, it was weak in some areas such as SMEs and credit card business. A merger with SBB would allow it to not only to bolster its consumer banking arm, but also gain significant inroads in asset management, SME banking business and credit cards.

A protracted and testy courtship ensued…

As in any takeover or acquisition deals, the initial step an acquirer would take would be to seek out the views and obtain the acquiescence of the major shareholders. CAHB had informed Bursa Malaysia that it would begin discussions with DYMM Sultan Sharafuddin Idris Shah, Dato' Syed Mohd Yusof bin Tun Syed Nasir and other shareholders of SBB for a possible merger of the businesses. However, things were not all smooth sailing as not all SBB shareholders were in agreement - two major SBB shareholders, DYMM Sultan Sharafuddin Idris Shah and Dato' Syed Yusof favoured the merger whilst Tan Sri Tan, who was also a substantial shareholder and the architect of the bank's growth, did not.

DYMM Sultan Sharafuddin and Dato' Syed Yusof who each controlled 23.3 per cent and 23.6 per cent of SBB through direct and indirect stakes had made it known that they wanted to exit the bank. Together with Tan Sri Tan, they controlled Ramuda, a private company that owned 32 per cent of Killinghall (Malaysia) Bhd, SBB's single largest shareholder, on a diluted basis. However, SBB's other shareholders, namely, Tan Sri Tan who controlled 23.6 per cent through direct and indirect holdings, the Yeap family (1.5 per cent) and Straits Trading did not want to exit. OCBC itself held a 4.4 per cent stake in SBB while its 32 per cent owned Singapore-listed The Straits Trading Company held a 19.7 per cent stake in Killinghall, which in turn owned the largest direct stake of 16.8 per cent in SBB.

[6] Due to the change in name of CAHB to BCHB and later on to CIMB Group Holding, the former two names are used interchangeably in this study as they refer to the same entity.

Whilst BCHB was still in talks with the major shareholders of SBB for a possible acquisition, a new shareholder entered the fray. In November 2005, Tan Sri Khoo Kay Peng came to the aid of the embattled Tan Sri Tan, buying a 4.3 per cent stake in SBB's parent company, Killinghall, through MUI Properties for RM18.4 million. It was surmised that with the entry of Tan Sri Khoo, interests close to Tan Sri Tan may control close to 20 per cent of Killinghall. Tan Sri Khoo's entry appeared to be a calculated move to shore up support for an old friend. In fact, he was the person who led Tan Sri Tan into the banking fraternity by selling more than 20 per cent of SBB to Tan-controlled Killinghall back in 1984. The entry of Tan Sri Khoo demonstrated Tan Sri Tan's determination to put up a fight against CIMB. This was despite the market betting the odds being stacked against him for two reasons: one, the deal makes sense and two; CIMB is a powerful government-linked company.

Meanwhile, Tan Sri Tan's wife, Puan Sri Lim Siew Lay, had been increasing her stake in the bank's single largest shareholder, Killinghall. This appeared to be a move by Tan Sri Tan and his family to consolidate their position as whoever was in control of Killinghall essentially controlled the bank. Puan Sri Lim had bought 1.15 million shares on 27 October 2005, raising her stake in Killinghall to 14.38 million shares or 7.55 per cent. Consequently, the share price of Killinghall surged upwards. Puan Sri Lim had also acquired 267,400 irredeemable convertible unsecured loan stocks (ICULS) at RM1 each. This move could be interpreted as either a defensive one or an opportunistic one as Puan Sri Lim appeared to be buying ahead of a potential bid from BCHB.

Since BCHB's takeover intentions became clear, SBB itself had shored up its defences by buying its own shares[7] from the market, and thus making it more difficult for any party to mount a hostile takeover. Since 29 June 2005, the bank had actively bought back its shares, which subsequently took on a more aggressive stance. This move served to defend itself against a potential takeover as much as it was to support its share price. Indeed, during the period of the buyback, SBB's share price edged up to RM4.20 - its highest close in almost six years - after it bought back 1.47 million shares for RM6 million (or between RM4 and RM4.20 each). On other occasions, SBB's buyback too had sent SBB share price spiralling upwards and could even account for slightly more than half of SBB shares transacted volume on a given day. The impact of SBB's action also generated strong interest in SBB-related counters including SBB foreign and SBB warrants[8].

[7] The SBB shares bought back were held as treasury shares in accordance with Section 67A subsection 3(A)(b) of the Companies Act, 1965 and have no rights to voting, dividends and participation in other distribution.

[8] The price-earning (PE) ratio for SBB was on an upward trend from its historical range of 8-10 times to 12.6 times by the second quarter of 2005, 13.8 times by the third quarter of 2005 and 18.8 times by the fourth quarter of 2005. Interestingly, the PE ratio for CIMB too rose from its historical range of 12-15 times to 18.6 times by the fourth quarter of 2005, almost mirroring SBB's PE ratio. The ratios of these two banks were higher than those of their counterparts in the banking sector during the same period such as Maybank (16.2 times), Public Bank (14.2 times), RHB (12.9 times), Hong Leong Bank (16.1 times) and EON Bank (11.9 times).

By end-August 2005, SBB had accumulated at least 24.89 million of its own shares and kept up the active buyback. By law[9], it was allowed to buy back up to 145 million shares, or 10 per cent of the company. These shares acquired under the share buyback scheme were precluded from voting in the event of a takeover bid - a move that effectively raised Tan Sri Tan's voting interests in the bank.

For the year 2005, SBB had bought back a total of 55,323,400 SBB shares from the open market at an average price of RM3.61 per share[10]. The total consideration paid for the SBB shares, including transaction costs was RM199,914,697. None of the treasury shares held were resold or cancelled.

What is your opinion on the use of share buyback strategy in the face of a hostile takeover? Is the corollary effect of pushing up the share price acceptable? What about the share purchase in Killinghall ahead of a takeover?

An interesting observation to note here is that SBB had practised a very generous dividend policy. In 2005, it paid out a total of almost half a billion ringgit (RM401.5 million) in dividends although these partly covered two financial years. The details of the dividend payout are as follows:

(i) A special interim dividend of 10% less 28% tax in respect of the previous financial year amounting to RM104,233,137 on 8 April 2005;

[9] As per the Bursa Malaysia Securities Berhad Listing Requirements for the Main Market, a listed corporation must not purchase its own shares or hold any of its own shares as treasury shares if these results in the aggregate of the shares purchased or held exceeding 10% of its issued and paid-up capital.

[10] SBB Share Buy-back for 2005

Month	No. of shares bought	Lowest price paid (RM)	Highest price paid (RM)	Average price paid (RM)	Total consideration (RM)
June	801,800	3.16	3.22	3.19	2,559,629
July	8,573,200	3.18	3.44	3.33	28,594,263
August	8,853,100	3.38	3.62	3.51	31,154,220
September	16,301,200	3.46	3.60	3.55	57,889,557
October	10,470,200	3.36	4.02	3.66	38,429,202
November	8,925,300	3.84	4.20	3.99	35,686,823
December	1,398,600	3.90	4.06	4.00	5,601,003
Total	55,323,400	3.16	4.06	3.61	199,914,697

(ii) A final dividend of 7% less 28% tax in respect of the previous financial year amounting to RM72,963,196 on 8 July 8 2005;

(iii) A first interim dividend of 10% less 28% tax in respect of the current financial year amounting to RM105,678,645 on 14 October 2005; and

(iv) A second interim dividend of 5% less 28% tax in respect of the current financial year amounting to RM52,576,656 on 30 December 2005.

The bank had also declared a special interim dividend of 5% (gross), comprising 3.3% tax exempt dividend and 1.7% non-tax exempt dividend less 28% tax amounting to RM66,063,323 in respect of its current financial year based on its issued and fully paid-up capital of 1,460,285,649 ordinary shares of RM1.00 each.

In addition to the measures taken by SBB to fortify itself, it also announced its intention to acquire Singapore insurer Asia General Holdings Limited (AGHL), a move seen as making any takeover bids for SBB becoming more expensive. Its intended purchase of AGHL would cost it SGD$918.8 million and saddle SBB with debts which would deter any takeover bids. Market talk was that the proposed acquisition was a little expensive considering that a local insurer was acquired around the same time for one time book value. SBB, however, explained that the acquisition would be the way forward in its cross-border growth and regional expansion as it would be strategic and transformational. The bank maintained that it had consistently pursued a customer-focused strategy in value creation and that should its quest to achieve this objective made the bank a more difficult target to acquire by others, it was purely incidental.

This proposed acquisition was seen by some as a poison pill. When asked on the use of poison pills as a defensive strategy, Tan Sri Tan had this to say "We don't do things like that. We really like our business. Public Bank also bid for Asia Life Assurance, a subsidiary of the Asia General group. Some say this is the most profitable part of the group. Why did SBB buy the entire group instead of just the more profitable part? Buying the whole group will buy us four licences - two in Singapore and two in Malaysia - in addition to a whole host of undervalued assets which will give us the option to either cash out at a higher value or to use as building blocks to further add or unlock value. Bancassurance and Allfinanz will also provide synergistic benefits and additional earnings growth. Asia General is SBB's significant move to go regional. Asia General Holdings maps well with our segmentation and customer-focused strategies. For the SBB Group, our skills are scaleable into the region and the high economic growth markets in China and the Asean region are attractive. Asia General provides the necessary stepping stone for SBB Group's regional ambitions[11]."

[11] SBB's plans to acquire AGHL were eventually aborted when Bank Negara Malaysia rejected its application to acquire the insurer, attributed to concerns over SBB's risk exposure to AGHL and that it could end up with a hugh chunk of real estate and a dilution of its net tangible assets. The central bank said that it may consider an alternative proposal that involved the acquisition of just the life insurance business of AGHL. In its appeal against the central bank's decision, SBB had included a proposal to restructure the bank itself so that its banking and insurance business, following the AGHL's acquisition, would be held separately by a financial holding

Do you agree that this is a poison pill and how successful would it be had it gone through?

There were also talks in the market that Maybank was interested in "marrying" SBB. However, this turned out to be just talks after Maybank itself denied that it was in negotiations with SBB.

After months of talk, a formal offer was finally made by BCHB on 13 February 2006 to purchase the shares of SBB for RM6.34 billion at a value of RM4.15 per share. In fact, two separate offers were made: one was a direct offer of RM4.15 to all SBB shareholders and a second offer was to SBB's Board of Directors - proposing RM4.08 a share in cash for the operation, which valued the lender at RM6.17 billion.

On the very next day, SBB announced that its Board had unanimously rejected the BCHB offer because it "fundamentally undervalues" the bank. It also claimed the offer did not comply with the country's takeover and merger regulations and it rejected a call to hold a shareholders' meeting to vote on the offer. The question of validity of BCHB's offer was clarified by the SC soon after in a statement confirming that the terms and conditions of BCHB's offer did not breach the Malaysian Code of Takeovers and Mergers 1998.

At that point, it looked like the deal was dead. But mergers were needed in the sector to survive. Realising this, Tan Sri Tan conceded that it was no longer sensible for the bank to remain independent and proceeded to look for an alternative merger partner. "Consolidation of banks in Malaysia is unavoidable; the only question is who and when," said the bank. There was one obstacle though. At that time, Bank Negara Malaysia did not allow banks seeking merger partners to enter into simultaneous negotiations with several suitors. This placed BCHB in an advantageous position.

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company. SBB revealed that the central bank then wanted "certainty over the implementation of the financial holding company with detailed conditions that would have to be met". "The central bank also asked for various details including the shareholding and corporate structure of the bank after the acquisition, an indication of shareholder support for the purchase and measures SBB would take to cut its exposure to Asia General's non-financial sector assets."

Undaunted by the rejection, BCHB assumed a more aggressive stance and took on the Board of SBB. On 23 February 2006, Killinghall and Dato' Huang Chang Hsun, holders in aggregate of not less than 10 per cent of the paid-up capital of SBB called for an Extraordinary General Meeting (EGM) to be held on 29 February 2006 to remove four existing SBB directors and to appoint four new directors in their place. The four existing directors of SBB who were suggested to be removed were Tengku Zaitun binti Tengku Mahadi, Datuk Nicholas Spiro Zefferys, Ian Craig Buchanan and Dr Sieh Lee Mei Ling, while the new directors that were suggested to be appointed were Dato' Mohammed Adnan bin Mohammed Shuaib, Tan Sri Kua Sian Kooi, Dato' Huang Sin Cheng and Ahmad Rize bin Basir.

To counter Killinghall's move, Puan Sri Lim Siew Lay, who is also a director of Killinghall, filed a suit against Killinghall's Board challenging the validity of holding an EGM to remove SBB's directors. Nevertheless, the EGM proceeded. However, at the EGM, a procedural motion was tabled to adjourn the EGM on the removal of the four directors to a date no earlier than 15 May 2006. It was further motioned that an EGM for the removal of the four directors will not need to be convened if the SBB Board convenes an EGM to consider the proposed business disposal before 15 May 2006.

In the end, what swung the deal around was The Straits Trading Company selling its block in Killinghall to Tan Sri Chua Ma Yu, a party friendly to BCHB. Together with the other substantial SBB shareholders, namely, DYMM Sultan Sharafuddin and Dato' Syed Yusof who had at that point already disassociated themselves with Tan Sri Tan, Tan Sri Chua entered into discussions with BCHB to give their nod to the deal.

On 13 March 2006, BCHB upped its offer for SBB to RM6.7 billion. Specifically, BCHB sweetened the deal to RM4.30 per share, up about 4% from the initial hostile offer of RM4.15. After private talks between Datuk Seri Nazir and Tan Sri Tan, the directors of SBB agreed to accept the revised higher offer. With this, there was no longer any urgency to remove the four SBB directors.

Following the approval of shareholders at an Extraordinary General Meeting held on 5 May 2006, SBB entered into a Sale of Business Agreement for the disposal of its entire assets and liabilities to BCHB on 31 May 2006. Separately on the same day, BCHB launched a voluntary conditional offer for the shares and warrants of SBB not already owned by BCHB at a price of RM4.30 per share or a combination of cash and redeemable convertible unsecured loan stock (RCULS) equivalent to RM4.30 per share, and RM2.56 per warrant.

Under the deal, SBB shareholders would also receive a gross dividend of 5 sen per share[12]. In addition, SBB would set aside RM50 million for loyalty and severance payments to its

[12] The salient terms of the BCHB's initial proposals and revised proposals are summarised in **Exhibit 1**.

directors and staff. Out of the RM50 million, ex-gratia payments of RM20 million was paid to Tan Sri Tan as the Chief Executive of SBB, and RM500,000 each to the three independent directors namely, Nicholas Spiro Zefferys, Sieh Lee Mei Ling and Ian Craig Buchanan. Interestingly, these three directors were the ones sought to be removed by Killinghall earlier.

And therefore, after months of heated negotiations over Malaysia's largest banking takeover, BCHB and SBB jointly announced the proposed merger, saying that they now have unanimous support from the Boards of Directors of both BCHB and SBB, "as well as endorsement from substantial shareholders of Southern Bank" for the proposed acquisition by BCHB.

Under the plan, the voluntary general offer was expected to be completed in late May, after which BCHB would merge SBB with its existing business and eventually delist the bank. Post-acquisition, BCHB would inject the entire business of SBB into the CIMB Group and the flagship bank would be known as CIMB Bank. Tan Sri Tan would quit his post at SBB post-merger and Datuk Seri Nazir Razak would be the captain of the ship even though Tan Sri Tan had been offered an advisory role for two years.

The RM6.7 billion takeover of SBB was a test of Datuk Seri Nazir's negotiating skills. At the time, he was living in a home belonging to Tan Sri Tan. "I could be the first person to launch a hostile takeover against a company that belonged to his landlord," Datuk Seri Nazir Razak had said. On the trigger for the turning point from the earlier hostility from SBB, Datuk Seri Nazir Razak had this to say: "(I believe) it is the four-hour, one-on-one meeting between Tan and I, just the two of us. We spent a lot of time together; I tried to convince him that I am not as bad looking as he thought and he asked for more dowry. And then the deal was done."

The merger resulted in a larger group with assets of over RM152 billion and narrowed the gap between the country's largest bank, Malayan Banking Berhad, which had assets of RM192 billion. Post-merger, CIMB Group remained the country's second biggest lender. "This proposed merger and acquisition is strategic and consistent with our priority agenda of transforming our consumer banking franchise," said Datuk Seri Nazir Razak of the deal. "It augurs well for the future as it gives us the lead in the long anticipated next round of banking consolidation, positioning the BCHB Group even stronger in terms of diversity and scale with total assets increasing from RM121 billion to RM152 billion." The acquisition was expected to bolster BCHB Group's consumer banking, given that SBB had a client list of wealthy individuals and small businesses, which would help it compete against Maybank.

At the press conference announcing the deal, Tan Sri Tan Teong Hean said: "Today, we are at the centre of the largest, most public takeover in Malaysian history with ripples that will be felt in corporate Malaysia. Developments here will trigger a second wave of consolidation in the financial sector as the industry prepares for a new age of fierce global competition when Malaysia opens its doors to further market liberalisation."

Commerce International Merchant Bankers Bhd and JPMorgan acted as advisors for BCHB, while Goldman Sachs acted as the advisor for SBB in the deal.

As the offer was a combination of cash (RM3.22) and RCULS at RM1.04 each, SBB shareholders were also given the choice of participating in the larger merged entity via the conversion of the RCULS. It was said that those who did take the RCULS would have nothing to complain about considering how well the share price of CIMB (what BCHB morphed into) had done since then.

However, there was no consensus on whether the price offered for SBB shares was good compared with the share price of SBB over the last three years. It was contended that for the same period, most companies listed on Bursa Malaysia were under-valued, even in terms of simple net tangible assets basis.

Notably, this deal was the first-ever business disposal coupled with a general offer in corporate Malaysia. The rationale behind BCHB's move to put forward a general offer for SBB's shares and warrants was evidently to expedite payment of the offer consideration which arose from the business disposal[13]. Should BCHB had failed to trigger a compulsory acquisition, the shareholders who declined the general offer will instead realise their investments in SBB via a proposed capital reduction exercise, whereby a payment of approximately RM4.30 per share would be distributed to shareholders assuming that the costs to be incurred by the exercise are negligible. A capital reduction exercise though is subject to further approvals from relevant authorities and shareholders could face delays in receiving the proceeds generated from the asset disposal exercise.

(i) *Do you agree that the valuation and offer made for the SBB shares under (a) the initial offer and (b) the revised offer were fair?*
(ii) *Was SBB's Board of Directors right when they claimed that the initial offer did not comply with the country's takeover and merger rules*?
(iii) *Was the under-valuation of shares listed on Bursa Malaysia detrimental to shareholders in a case of a takeover?*
(iv) *What are the concerns for minority shareholders under the Assets Disposal Route?*

BCHB was expected to pay for much of the acquisition using its own cash although it was speculated that some of it could be debt-funded. Analysts said BCHB could raise up to RM4 billion in hybrid or senior debt to help fund the offer.

[13] A diagrammatic illustration of the revised proposals is depicted in **Exhibit 2**.

BCHB shares, which had risen 7.9% in 2006, rose 15 sen, or 2.5%, to RM6.15 before they were halted from trading on March 13 ahead of the merger announcement. It was the stock's biggest gain since 6 February 2006. On the same day, SBB shares added 4 sen, or 1%, to RM4.20 before their trading was suspended.

Can this be interpreted as evidence of perfect market information in the Malaysian stock market?

On the other hand, the impact on Killinghall's share price was the opposite. A foreign equity research house, Standard & Poors (S&P), had estimated that the intrinsic value of each Killinghall share was around RM4.10 based on BCHB's revised offer. However, the market had surprisingly not taken the news too well. On the contrary, the share price of Killinghall had nosedived to a low of RM3.42 from its high of RM4.20, an 18.6% plunge. What could have triggered such a fall in the share price of Killinghall, given that there was still a 10.5% upside to its estimated intrinsic value by S&P?

If the fall was due to merely profit-taking activities, then there was opportunity to accumulate the stock for a potential distribution of the SBB sale proceeds back to the shareholders (via say, a special dividend or a capital distribution exercise), something the market was expecting SBB to do. However, if the cash was used for something else, then the market was likely to respond negatively unless any potential new asset injection or investments were really enticing. It was reported that even if Killinghall were to pocket a huge sum of RM1.2 billion cash, or RM4.28 per Killinghall share on a fully diluted basis upon completion of the CIMB-SBB merger, the company would possibly not opt to give back the entire cash to shareholders and possibly delist itself. In addition, there were news reports that the company could actually use the cash to look for a new viable business instead of it being injected into the company. Without a clear announcement from SBB, the wait had created uncertainties in the share price. Some investors were also worried that an injection could well involve related-party assets, which were frowned upon by shareholders. All these would dampen sentiment for the stock, which had rallied from RM2.00 in the past six months.

The lesson here is that in the financial world today, any new business must be acceptable not just to the management but also to the market and shareholders as well or else it could be seen as destroying rather than building up shareholder value.

*Was there value creation, as seen through the eyes of investors, based on the share prices of CIMB and SBB in **Exhibit 11** and the financial statements of SBB in **Exhibit 3** and CIMB in **Exhibit 4**?*

Much had been said about the interlocking of politics and business in corporate affairs. Indeed, this deal had attracted its fair share of comments in this regard. Under the banking laws in Malaysia, specifically, the Banking and Financial Institutions Act 1989, the prior approval of the Minister of Finance through BNM is required before an interested party can negotiate to purchase more than 5 per cent of the shares of any financial institution. As CIMB is managed by a brother of the then Deputy Prime Minister, it was imperative that the application of the rules by BNM must not only be fair but seen to be fair. However, BNM's rejection of SBB's proposal to acquire Asia General was seen as biased by some quarters.

Did the Central Bank act and was perceived to have acted in an impartial manner?

And they lived happily ever after, or did they…?

Subsequent to the takeover and merger, CIMB announced the following events for the first quarter of 2007:

(a) CIMB-SBB merger

- On 18 March 2007, the Group merged the operating platforms of the legacy SBB and CIMB Bank. The massive IT and operations challenge was completed one month ahead of schedule. All ex-SBB branches and products had assumed the CIMB brand and the CIMB-SBB merger was effectively completed, and the Group was then able to fully concentrate on synergy maximization from the merger.
- In terms of synergy, the Group had identified about RM23.7 million of pre-tax profit from the synergy between SBB and CIMB in 1Q07.
- About RM60 million was expensed in 1Q07 for merger related costs. About 68% of total CIMB-SBB merger costs had been expensed and the remaining RM50 million is expected to be amortized over the next 3-5 years.

(b) Completion of sale of asset management businesses

- BCHB Group completed the sale of 40% of SBB Asset Management and SBB Mutual to Principal Group. A gain of RM87 million was recognised in 1Q07.

(c) Announcement of disposal of insurance businesses

- On 5th January, the Group announced the proposed sale of 49% of its Life and Takaful insurance businesses to Aviva and 100% of its General insurance to Allianz for a total consideration of RM990 million. Upon completion of the sale by third quarter 2007, about RM650 million will be recognised as profit by the Group.

It turned out SBB had overstated its 2005 assets by RM160 million, CIMB's holding company announced in 2007. It said that its auditors, Pricewaterhouse Coopers LLP (PwC), had discovered ``inappropriate accounting" for some of the bank's 2005 transactions, including derivatives valuations, not writing down in full the collateral value and wrongly writing back specific provisions made on certain foreclosed properties relating to non-performing loans aged seven years and above and non-expensing of certain costs incurred. "The exercise currently undertaken by PwC is to establish whether Southern's 2005 financial statements show a true and fair view of its state of affairs as at that date in light of the findings from our subsequent due diligence review and completion audit."

Datuk Seri Nazir Razak expressed frustration with SBB's financial statements, claiming that SBB had been "relatively imprudent in provisioning[14] and its historical earnings were inflated consequently". Although he was apparently aware of this at the time of the merger, Datuk Seri Nazir said he had not anticipated the extent of the provisions against bad loans that would eventually be required. "I was disappointed at the fancy accounting that was practiced at SBB," he was quoted as saying, "like the way bonuses were accrued on a one-year-lag basis and the consulting fees being capitalised".

CIMB Group, for the first half of financial year 2006, had to make hefty provisions and additional adjustments of RM592 million in SBB's accounts after the due-diligence review and audit, resulting in an acquisition goodwill of RM4.34 billion. That casted a shadow over Malaysia's largest ever corporate merger. Though CIMB said PwC's review would have no financial impact on BCHB, it had hinted that CIMB Group could decide to "seek legal redress in the future", in particular against Deloitte Kassim Chan over audit work on SBB. However, it said it did not plan to bring action against SBB's Board of Directors as it could not find any evidence of fraud.

What should be done by the accounting fraternity arising from this case to improve auditors' professionalism and credibility? And what could be done by the regulators to ensure that auditors perform up to expectations?

[14] SBB made general provision of 1.5% of total loans while CIMB provided at 1.7%.

IMPACT ON MERGERS AND ACQUISITIONS IN MALAYSIA

Since the CIMB-SBB merger in 2006, a number of mergers and acquisitions have taken place replicating the route taken in the CIMB-SBB case, that is, via the acquisition of assets or "assets and liabilities" route (or "Assets Disposal Route") as it is known in industry jargon. In value terms, these deals topped RM40 billion and involved some of the country's largest banking, plantation and power generation assets. Other examples of take-overs and acquisitions that have used the "Asset Disposal" route since then included MMC Corp Bhd's acquisition of Malakoff Bhd's assets, the Synergy Drive Bhd's takeover of the merged Kumpulan Guthrie Berhad, Golden Hope Berhad and Sime Darby Berhad and the takeover of EON Capital Bhd by Hong Leong Bank Bhd.

Despite supposedly being easier to buy the assets of companies with only a simple majority of shareholders' support, some of these deals were still difficult to pull through. It had been said that these deals would likely never have been concluded if they needed the higher shareholder approval threshold of more than 75 per cent, which is a requirement in all the other avenues in taking companies private.

It is a widely held view that a disparity in the shareholder approval thresholds in respect of the routes available for the privatisation of a listed company would give rise to the concern that potential acquirers may privatise a listed company via the least stringent mode which, in turn, provides a lesser level of protection to shareholders. Certainly, the take-over of listed companies via the "Asset Disposal" route have raised concerns that the minority shareholders may be forced to sell-out by a small number of substantial shareholders who hold sufficient shares to attain the simple majority required under Section 132C of the Companies Act even though the prices offered may not be fair or reasonable. Therefore, placing a higher threshold of shareholder approval in respect of an asset disposal may plug the "loophole" in the law and compel the acquirer to offer a price that will be sufficiently attractive to persuade a larger number of shareholders to support the disposal.

To recap, under Section 132C of the Companies Act 1965, a company may dispose of all or substantially all of its assets with the approval of a simple majority (i.e. more than 50 per cent) of its shareholders present and voting at the company's general meeting. The "Asset Disposal" route has been used to privatise and indirectly, take-over a listed company whereby the acquirer, with the approval of the holders of a simple majority of the voting shares of a listed company, acquires the assets of the latter, and followed by the delisting of the listed company as it no longer has the level of operations to maintain its listing status on Bursa Malaysia.

In contrast, under the Malaysian Code on Take-Overs and Mergers 1998 ("Code")[15], the threshold to take-over a company and de-list it is higher at 90% acceptance of shares outstanding which are not held by the acquirer, in order for the acquirer to undertake a compulsory acquisition for the remaining voting shares of the target company.

On the other hand, proponents of the "Asset Disposal" route hold the view that this route is preferred as otherwise, the value creating mergers and acquisitions will be prevented, to the detriment of the Malaysian capital market. Take-overs via the "Asset Disposal" route is said to be in line with the principle of shareholder democracy, and has resulted in the creation of bigger (and arguably, better) companies. It is also argued that providing minorities with the right to veto an asset disposal will allow incumbents or those who can acquire a veto-block of shares to hold the rest of the shareholders to ransom. This would result in the opposite of shareholder democracy, with the minority controlling the majority. In addition, various common law jurisdictions such as Singapore, London and Australia, still permit the disposal of assets via the "Asset Disposal" route to be effected by a simple majority vote. Therefore, it is argued that there should not be an impetus to streamline Malaysia's rules to be in line with jurisdictions that have chosen to tighten their rules.

The Securities Commission of Malaysia (SC) and Bursa Malaysia Securities Berhad (Bursa Malaysia) holds the view that in a situation where a listed company disposes all or substantially all of its assets that would tantamount to an intention to delist. Hence, the rights of the minority shareholders will be affected. Therefore, as part of its continuous efforts to enhance investor protection, ensure parity of regulation, and promote a healthier capital market, the SC and Bursa Malaysia had, on 19 March 2010, issued a joint public consultation paper (No. 3/2010) on Proposed Amendments to Bursa Malaysia Securities Berhad Listing Requirements on Privatisation of Listed Companies via Disposal of Assets spelling out the rationale for the rule change and the proposed method[16]. While not many may be aware then of the intricacies and impact of this proposal, the issues are widespread and have a bearing on the Malaysian capital market.

[15] Since this 2006 CIMB-SBB merger exercise, significant amendments were made to the legislations. Subsequently, the Capital Market and Services Act 2007 (CMSA) and the Malaysian Code on Take-Overs and Mergers 2010 were introduced and fundamentally inherited the similar provision on threshold limit under the 1998 Malaysian Code on Take-Overs and Merger.

[16] The Amendments to Bursa Malaysia Securities Berhad ("Bursa Malaysia") Main Market Listing Requirements ("Main LR") in relation to Privatisation of Listed Companies via Disposal of Assets have been effected through and applies to all announcements on new Asset Disposal proposals made on and after 28th January 2011.

The key amendments are:

(a) requiring the appointment of a main adviser and independent;

(b) requiring a general meeting to be convened and shareholder approval of at least 75% in value of the shareholders present and voting either in person or by proxy at the meeting to be obtained for such Major Disposal;

(c) prescribing the roles of the main adviser and Independent adviser in a Major Disposal; and

(d) prescribing the additional specific information to be included in the announcement and circular in a Major Disposal.

In addition, the appointment of an independent adviser is to advise whether the disposal is fair and reasonable and whether the shareholders should vote in favour of the transaction.

The amendments also require a company that is planning to dispose of its assets to concurrently acquire another asset which complies with the relevant SC guidelines and Listing Requirements. If the company does not intend to acquire a new asset, the acquirer is required to make an "exit offer" to acquire all the voting shares in the listed company in accordance with the Code. This exit offer must be made concurrently with the acquirer's offer to acquire the listed company's assets.

The proposed amendments are in line with several other jurisdictions which have tightened their rules on the "Asset Disposal" route. Thailand and New Zealand have increased the approval threshold for such a transaction to at least 75% of the shareholders present and voting. In addition to the 75% threshold, Hong Kong also requires that votes cast against the disposal must not exceed 10%. It is to be noted that none of these jurisdictions have included the requirement for approval of at least 50% in number of shareholders present and voting, as proposed in the consultation paper.

PROTECTION OF MINORITY RIGHTS

The Malaysian Code on Take-overs and Mergers 2010 which came into effect on 15 December 2010 expressly allows for voluntary offers with a higher acceptance threshold to be carried out. This means that offerors can make their take-over conditional upon achieving 90% acceptances, for example, which would effectively give the offeror total control over the target company considering that the laws allow for any party with 90% acceptances to compulsorily purchase the balance 10% of shares. This change in rule is significant as it erodes the justification used by parties who prefer to use the less onerous assets and liabilities takeover route on the basis that it offers better certainty that the deal will be done.

The amendments have been lauded by the Minority Shareholder Watchdog Group[17] and other players in the Malaysian capital market as the interests of minority[18] shareholders will be better protected.

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[17] The Minority Shareholder Watchdog Group was established as a government initiative in the year 2000 as part of a broader capital market framework to protect the interests of minority shareholders through shareholder activism. It is one avenue of market discipline to encourage good governance amongst public listed companies with the objective of raising shareholder value over time.

[18] The Capital Markets and Services Act 2007 ("CMSA"), elaborates in Section 223 of the CMSA, that shareholders are treated equally and that the interest of minority shareholders are protected in the various scenarios in which takeover and mergers may be effected. The Malaysian Code on Take-overs and Mergers 2010 is read together with the rulings pursuant to this Act.