Dissecting Sumatec's Cash Call

The Edge

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Sumatec Resources Bhd's share price tanked after the company announced a haircut to wipe out its accumulated losses, followed by a cash call.

The oil and gas counter slid 52.5%, or 31 sen, to 28 sen on Oct 26 – the lowest since May this year — down from its peak of 59 sen in June, despite the rise in the crude oil price. On Oct 21, the company announced a capital reduction exercise that will reduce the par value of its shares to 60 sen from RM1, followed by a one-for-five rights issue.

The deal comes with a sweetener — free detachable warrants. Shareholders will be entitled to three free warrants for every rights share subscribed. The price of the rights issue, which will be pegged at a later date, will not be below 60 sen per rights share given the par value is 60 sen.

Sumatec's share price has regained some lost ground, closing at 34.5 sen last Thursday. Still, with its shares trading substantially below 60 sen on the open market, minority shareholders will probably be wondering whether to subscribe to the rights issue.

One option is that shareholders could leverage on the current low market price by buying up some shares on the open market to offset the dilution caused by the rights issue, instead of subscribing for the rights at 60 sen per share. By doing that, shareholders will not get the free warrants, whose exercise price will not be lower than 60 sen as well (as shares cannot be issued below par value).

But the money saved from purchasing the shares on the open market would probably be enough to acquire the warrants when they are floated on Bursa Malaysia. The warrant price may not be too high, assuming the underlying share price remains depressed.

There have been instances where minority shareholders refused to answer companies' cash calls. The most recent example was AMDB Bhd. Given the low market price, Sumatec may possibly be in such a situation.

However, this may not concern Sumatec's board as its major shareholder, Tekad Mulia Sdn Bhd, is taking up a total of 17 million rights shares, which is equivalent to 46% of the 36.9 million shares that will be issued in the exercise. The company has set a minimum subscription level at 17 million rights shares under the proposed rights issue, which will see it raising RM10.2 million in fresh capital from the cash call.

Tekad Mulia, which holds 25.74% equity interest, is providing an undertaking to subscribe for its entitlement to 8.27 million rights shares. On top of that, Tekad Mulia will also subscribe to as much as 8.72 million unsubscribed rights shares, as laid out in the exercise, to ensure the rights issue takes off.

Based on its entitlement and additional undertaking of 8.72 million shares, Tekad Mulia's shareholding in Sumatec could possibly increase by up to 52.78%. The company's rights issue has raised some eyebrows. The question is that with the par value at 60 sen, its rights issue would also likely be at that price, which is way above its current share price of less than 40 sen.

Shouldn't the company consider a share split to reduce the par value of its shares and bring it closer to the market price? By doing this, it will increase the chances of minority shareholders subscribing to the rights issue.

By the same token, the undertaking of Tekad Mulia to subscribe to the rights issue could be seen as the majority shareholder's confidence in the prospects of Sumatec.

The company itself appears to be repositioning itself. In September, the company announced the disposal of several subsidiaries to a newco — Semua International Sdn Bhd (SISB) — for RM77 million. Sumatec is proposing to be a shareholder of SISB. The other shareholders in the newco are Ethos Capital One Sdn Bhd (ECO), the Employees Provident Fund (EPF) and a management buyout team comprising three individuals.

The subsidiaries to be sold to SISB are Semado Maritime Sdn Bhd, Semua Shipping Sdn Bhd, Semua Chemical Shipping Sdn Bhd and Mini Tanker Chartering Sdn Bhd, collectively referred to as the Semua Group.

Following the exercise, SISB is expected to apply for a listing on Bursa by June 30, 2011. A point to note is that apart from its partnership with the EPF, Sumatec has also teamed up with Ethos Capital One, a local private equity fund which is said to be politically-linked.

Following the announcement of its proposed disposal, Sumatec then bought the entire stake in SISB, which is intended to be the investment holding company of the Semua Group, for RM2. Subsequently, SISB has become a wholly-owned unit of Sumatec.

Another plus point for Sumatec is that it has reported improved earnings since it returned to the black in 4QFY2008 ended Dec 31.

In its latest results for 2QFY2009, it made a net profit of RM2.71 million compared to a net loss of RM3.2 million a year earlier, while revenue rose to RM50.83 million from RM44 million. It says the improvement was mainly due to better margins from its engineering, procurement, construction and commissioning and shipping division.

The company is also confident of an even better performance going forward, based on its existing order book of RM700 million, while project margins are expected to improve due to lower material prices.

According to analysts, more oil and gas contracts are expected to start rolling in, beginning early 2010, if not by the end of this year, and this will likely meam better prospects for Sumatec, given its proximity to the sector.

The company's proposed capital reduction and rights issue is expected to be completed by 1Q2010. But before that, it has to get shareholders approval. Until then, shareholders will have to decide whether they want to buy into Sumatec's growth story, or if they will be better off ignoring the company's cash call, which looks expensive at today's price.