Datapulse Technology: going about it the wrong way

By Mak Yuen Teen

On Dec 28, 2017, Datapulse Technology issued an eight-page response to detailed queries from the Singapore Exchange regarding the company’s acquisition of its new Malaysian business, Wayco Manufacturing (the target company), from Way Company (the vendor).

However, the central question remains unanswered. Why was the board in such a hurry that it took just five days to almost completely reconstitute the board (without the involvement of any of the former independent directors) and complete the acquisition? Was there a pre-Christmas sell-off that the board needed to take advantage of? Did it come with free gift-wrapping?

When a company makes a hasty acquisition in a new business, it raises questions about whether the acquisition is arm’s-length and the board has exercised reasonable diligence. The company’s responses give no comfort.

It said it did conduct proper due diligence because the new CEO was a former employee of the target company and familiar with the business. Further, the vendor can be required to buy back 109 per cent of the target company if material adverse events or matters later emerge.

While the new CEO had worked for the target company from 2008 to 2010, how familiar is he with the business today? More importantly, the board has to exercise its own independent judgement about the acquisition. The fact that the CEO has a prior relationship with the target company and the vendor should make the board even more conscious about the need to undertake proper due diligence. Regarding the buyback “warranty”, is there a formal agreement in place spelling out in detail what constitutes “material adverse events” that can trigger a buyback?

There are also questions as to who actually brought the proposed acquisition to the board and whether there is any relationship between the new controlling shareholder and the vendor. Is any director or his associate paid any introducer fees or advisory fees for this acquisition?

The board also said that to its knowledge, the vendor is a profitable company and therefore should be able to meet its buyback obligations if required. The vendor is an exempt private company without financial accounts readily available to the public. Did the board review its financial standing?

ANSWERS NEEDED

The target company’s sales to the vendor made up between 83 and 92 per cent of its total sales over the last five financial years and latest half-year. Further, the vendor made much of its purchases (between 79 and 96 per cent) from the target company. This suggests that the vendor was essentially set up to market the products of the target company.

The overall gross margin for the target company’s sales to the vendor was between 61 and 67 per cent and consistently increasing over the period. However, the prices set for these sales and purchases are like internal transfer prices between the manufacturing and sales divisions of a company and may not necessarily reflect arm’s-length market prices. Once the target company is acquired and separated from the vendor, there is no guarantee that it will be able to achieve such margins. Further, it is possible that sales from the target company were just building up as inventories in the vendor.

Even with such a high gross margin, based on the latest audited accounts of the target company, its net profit margin is a mere 3 per cent. If this is the typical net profit margin, the operating expenses of the target company would represent about 58 to 64 per cent of sales — much higher than the manufacturing costs of the products. Since the whole of the marketing and distribution process is undertaken by the vendor, it is likely that much of the operating expenses are costs charged by the vendor.

Yet, all the board could offer in its response is that the vendor “may still intend to continue to purchase products from the Target Company” and some general statements about exploiting alternative sales and marketing options and a possible future merger/acquisition involving the vendor.

A recent lapse by the company has also raised further concerns about its nominating process for directors and its disclosures, which were already questionable. On Christmas eve night, Datapulse corrected a mistake in the announcement template for Mr Low Beng Tjin filed on Dec 11. Datapulse had earlier stated “to” the question as to whether Mr Low “has ever, to his knowledge, been concerned with the management or conduct, in Singapore or elsewhere, of the affairs of any corporation which has been investigated for a breach of any law or regulatory requirement governing corporations in Singapore or elsewhere”.

However, Mr Low was the lead independent director at China Yongsheng between 2007 and 2016 and the company was reprimanded by SGX in 2009 for breaching its listing rule on timely disclosures in 2008. It was also issued a warning by the Monetary Authority of Singapore in 2011 for failing to disclose material information as required by the SGX Listing Manual.

I had on Dec 21 discovered the error in Mr Low’s appointment template and later made an online posting highlighting possible discrepancies in the appointment template before Datapulse’s clarification.

Did Mr Low provide the answers in the original announcement and did the board review or ensure that the announcement was reviewed for accuracy? Did he disclose the regulatory actions to the board when they were considering his appointment? If he did not, does the board still believe that he is suitable for appointment?

On Dec 26, the family of the former Datapulse chairman and founder issued a requisition notice to the company to convene an EGM to consider the removal of four directors from the board, the appointment of four new directors, and to suspend diversification of its businesses until a complete feasibility study had been carried out and shareholders have had the chance to approve any proposed diversification. Datapulse shareholders should carefully consider the proposed resolutions, attend the EGM and ask questions, and vote their shares accordingly.

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