

A FINANCIAL SURVEY OF ACQUISITIONS IN MALAYSIA 1980-1986

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ABSTRACT

This paper reports on a financial survey of acquisitions by public listed companies in Malaysia during the period 1980 to 1986. It analyses the characteristics of companies involved in the acquisitions, the reasons for acquisitions, the methods of valuation used in determining the price of the acquisitions and the modes of payment used in the acquisitions. The survey found that most of the acquisitions resulted in controlling power over the acquired companies, diversification was the most common reason for acquisitions, asset approach was the main method used for valuation, and the issuance of ordinary shares was the most common mode of payment.

ABSTRAK

Kertas ini melaporkan suatu tinjauan kewangan tentang pengambilalihan di Malaysia untuk tempoh 1980 hingga 1986. Tinjauan ini menganalisis ciri-ciri syarikat yang terlibat dalam pengambilalihan, sebab-sebab berlakunya pengambilalihan, kaedah-kaedah peniliran yang digunakan untuk menentukan harga pengambilalihan, dan cara-cara pembayaran yang digunakan di dalam pengambilalihan. Hasil kajian ini menunjukkan bahawa kebanyakan pengambilalihan telah menghasilkan penguasaan terhadap syarikat yang dibeli, mempelbagaian merupakan alasan utama pengambilalihan, pendekatan aset adalah kaedah utama yang digunakan di dalam peniliran, dan terbitan saham biasa adalah kaedah pembayaran yang paling utama digunakan.

INTRODUCTION

The term acquisition is used to describe any transaction in which a buyer acquires all or a part of the assets and business of a seller, or all or a part of the stock or other securities of a seller (see Scharf, 1971). Within the general terms of acquisition, there are more specific forms of transactions, such as a merger, a consolidation, an asset acquisition, and a stock acquisition. A merger is a combination of two companies where one loses its corporate existence, and the surviving company acquires both the assets and the liabilities of the merged company. A consolidation is a combination of two companies whereby an entirely new company is formed. Both the old companies cease to exist and their existing shares are exchanged for shares in the new company. An asset acquisition is an acquisition in which the buyer acquires all or a part of the assets and the business of the seller. Whereas a stock acquisition is an acquisition in which all or a part of the outstanding stock of the seller is acquired from the stockholders of the seller.

The first two forms of the transactions are normally referred to as "merger". The second two forms of the transactions are referred

to as "take-over", where the acquiring company acquires control over the assets of the target company, either directly or indirectly through control of either the voting rights or the management of the latter.

For the purpose of this paper the term acquisition is used to include both merger and take-over.

REASONS FOR ACQUISITION

Acquisition is a recognized method of expanding a company. Dale (1973) cites five main rationale of growth by acquisitions, which include lengthening the product line, gaining shares in market not previously supplied, enlarging a firm's capacity to supply old markets, diversifying interest, and gaining access to further process or distribution facilities.

Most of the stated reasons are other than financial, but, according to Hamid (1983), the benefits will in turn lead to financial growth which is often reflected in increased earnings per share and rate of return on shareholders fund. According to Dale also, generally the purely financial gains are merely a consequence of an acquisition and not a reason for affecting it. Newbould and Jackson (1973) were of the opinion that seeking for growth by means of take-over is not so much of financial rationale but is a fundamental piece of the management ethos. The management ethos is the disposition which distinguishes managers.

VALUATION OF ACQUISITION

The next important aspect in acquisition is valuation of the business to be acquired. The acquiring company must have some basis in setting the maximum price to be offered. Generally, a business will have different values to different buyers due to the differing reactions it will have with those buyers' existing business. However, there is a theoretical basis of valuing a business. Investment analysts use a theoretically ascertainable "right price", which is based upon the interest rate obtainable in the long term on capital invested at a given level of risk. This interest is then used to discount the distributable cash that a company is expected to generate in the future. However, it is generally impossible to make a satisfactory valuation of a going concern without a complete appraisal of tangible resources. Such appraisal is necessary to the qualitative study of earnings power essential to the measurement of the fair present value of future income.

Theoretically there are three main methods of valuing a potential acquisition (see Scharf 1971), namely the asset approach, the market price of the shares approach, and the earnings approach. In the asset approach, valuation is based on the assets owned by the company to be acquired. The asset values could be taken at net book

value, net realisable value, replacement cost, or market value. The market price approach uses the price of share which can be ascertained from the listed price or agreed price by buyer and seller in an actual arms length transaction. In the earnings approach, the projected future earnings of the potential acquisition are discounted to a present value using the company's required rate of return as a discounting factor. In addition a multiple of those earnings can also be used to arrive at the price.

The above three approaches will provide the acquiring firm with a yardstick to set the maximum and the minimum price that it would pay. Nevertheless, the price that is finally decided may be less or more than the value determined by any of the above approaches. The difference between the final price and the determined value is either a discount or premium to the acquired company.

PAYING FOR ACQUISITION

Are all acquisition made for cash? According to Kasten (1973) the method of payment for an acquisition is influenced to some extent by management philosophy or style. Basically, the three main methods of payment are the cash bid, issuance of notes or debentures, and issuance of new equity shares. The choice of methods to be used by the acquiring company depends on the impairment effect it has on the balance sheet for future financing activities.

OBJECTIVE OF THE SURVEY

The objective of this survey is to analyse the nature of acquisitions by the publicly listed companies in Malaysia. The main focus of this survey includes:-

- 1/ The characteristics of companies involved in the acquisitions.
- 2/ The reasons for acquisitions.
- 3/ The methods of valuation used in determining the price of the acquisitions.
- 4/ The forms of payment used for the acquisitions.

METHODOLOGY

The survey was carried out to cover all the acquisition transactions that took place during the period 1980 to 1986. However, only data from 188 transactions which represent 52 percent of the total acquisitions are usable. These transactions involved 85 acquiring companies representing 40 percent of the total acquiring companies during that period. These transactions cover all the different types of industry

including companies from the industrial field and the non-industrial fields such as finance, hotel, properties, mining and plantations.

The list of all acquisitions for the period 1980 to 1986 was prepared based on the information obtained from the *Kuala Lumpur Stock Exchange Companies Handbook*. References were then made to the *Kuala Lumpur Stock Exchange Investor's Digest* to determine the announcement date of the acquisitions. This is necessary to facilitate the collection of data from the individual company's file kept at the Kuala Lumpur Stock Exchange library. Data was then collected from (a) circulars to shareholders in relation to the acquisition of the particular company, and (b) company's annual reports.

FINDINGS

The following are the findings of the survey which are divided into characteristics of companies involved in the acquisition, reasons for acquisition, methods of valuation, and modes of payment used.

Characteristics of Companies Involved in the Acquisition The acquisitions were analysed in terms of the sectoral classification of the companies, size of the companies, listing status of the acquired firms, and the percentage of interest acquired.

Sectoral Classification Table 1 shows the sectoral classification of the acquiring and the acquired companies.

TABLE 1 Sectoral Classification of the Acquiring and the Acquired Companies

Sectoral Classification	Acquiring > < Company		Acquired > < Company	
	Number	Percent	Number	Percent
Industrial	95	50.5	49	26.1
Finance	19	10.1	20	10.6
Hotel	8	4.3	11	5.9
Properties	33	17.6	75	39.9
Mining	7	3.7	1	0.5
Plantation	26	13.8	32	17.0
Total	188	100.0	188	100.0

Note: The data in both columns of acquiring and acquired companies represent number of acquisition transactions. An acquiring company can have more than one transaction.

About 51 percent of the acquiring companies were from the industrial sector and most of the acquired companies (40 percent) were in the property sector.

Size of the Companies The size of the companies was measured by either the amount of issued capital or net tangible assets of the companies.

The number and percentage of companies involved in the acquisitions during the period covered by the study according to the size of issued capital was shown in Table 2. About 79 percent of the acquiring companies had issued capital more than \$10 million. About 77 percent of the acquired companies had issued capital less than or equal to \$10 million, and about 61 percent of them were between \$1 million to \$10 million.

TABLE 2. Size of Issued Capital

Size (million)	Acquiring Firm		Acquiring Firm	
	Number	Percent	Number	Percent
\$0.5	2	1.1	15	8.0
0.5-0.9	3	1.6	15	8.0
1-10	34	18.1	114	60.6
11-20	34	18.1	14	7.4
21-30	28	14.9	10	5.3
31-40	13	6.9	4	2.1
41-50	13	6.9	1	0.5
> 50	61	32.4	15	8.0
Total	188	100.0	188	100.0

The number and percentage of firms involved in the acquisitions according to the size of net tangible assets are shown in Table 3. In terms of the net tangible assets, about 80 percent of the acquiring companies had net tangible assets more than \$10 million. About 62 percent of the acquired companies had net tangible assets less than or equal to \$10 million and about 51 percent of them were between \$1 million to \$10 million.

Listing Status of the Acquired Firms From Table 9, we note that 90 percent of acquired firms were not publicly listed. This means that for valuation purposes, market value of the share of the acquired company may not be a suitable basis in determining the purchase consideration for the acquisition. Further discussion on this will be made later under the topic of methods of valuation.

Percentage of Interest Acquired The result of the study also reflects the pattern of the acquisition in terms of percentage of interest

acquired. As shown in Table 4, most of the acquisitions (74 percent) involved the purchase of the entire shares of the acquired companies. Only about 9 percent were acquisitions for less than 51 percent of the issued capital of the acquired companies. This means that most acquisitions in Malaysia resulted in controlling power over the acquired companies either in the form of parent and subsidiary relationship, merger, or takeover

TABLE 3. Size of Net Tangible Assets

Size (million)	Acquiring Firm		Acquiring Firm	
	Number	Percent	Number	Percent
\$0.5	5	3.0	10	6.2
0.5-0.9	2	1.2	8	5.0
1-10	26	15.8	82	50.9
11-20	14	8.5	26	16.1
21-30	26	15.7	9	5.6
31-40	16	9.7	3	1.9
41-50	13	7.9	3	1.9
> 50	63	38.2	20	12.4
Not Available	23	-	27	-
Total	188	100.0	188	100.0

TABLE 4. The Number and Percentage of the Acquisitions According to the Percentage of Interest Acquired

Percentage of Interest Acquired	Number	Percent
25	8	4.2
26 - 50	9	4.8
51 - 75	19	10.1
76 - 99	13	6.9
100	139	73.9
Total	188	100.0

REASONS FOR ACQUISITIONS

Even though many reasons for acquisition have been proposed, the following five reasons are the most common ones, [see Dale 1973], namely,

1. lengthening of the product lines;
2. gaining the facilities in markets not previously supplied;
3. enlarging a firm's capacity to supply old markets;
4. diversifying interest; and
5. gaining access to further process or distribution facilities.

The result of this survey (see Table 5) reveals that the most common reason for acquisition is for diversifying interest. About 52 percent of the acquisitions reflected this characteristic. Even though diversification promotes corporate growth, in diversifying into a new kind of activity, the acquiring company inherently accepts the risks of undertaking activity in which it is less competent than in its present one. However, the acquiring company should accept this risk if the company is certain that the potential rewards are substantially better than that available from continuing to do more of what it knows best.

Other reasons, that is lengthening the product line, gaining facilities in markets not previously supplied, enlarging a firm's capacity to supply old markets and gaining access to further process or distribution facilities are only true for 5 percent, 1 percent, 6 percent and 2 percent of the acquisitions respectively. However, the reasons for the 34 percent of the acquisitions cannot be determined.

TABLE 5. Reasons for Acquisition

Reasons	Number	Percent
Lengthening of the product line	9	4.8
Gaining the facilities in market not previously supplied	2	1.1
Enlarging a firm's capacity to supply old markets	12	6.4
Diversifying interest	98	52.1
Gaining access to further process or distribution facilities	3	1.6
Not Available	64	34.0
Total	188	100.0

METHODS OF VALUATION

The survey found that valuation for acquisitions was mainly based on the asset approach, which represents about 52 percent of the acquisitions. Table 6 gives the details of the findings on the methods of valuation.

TABLE 6. Valuation Approaches

Method/Approach	Number	Percent
Asset Only	98	52.1
Earnings Only	14	7.4
Market value Only	8	4.3
Combination of Asset and earnings	51	27.1
Combination of Asset, earnings and market value	2	1.1
Not Available	15	8.0
Total	188	100

The market value approach appears to be used only in a few acquisition transactions (about 4 percent). It can be concluded that the method of valuation used for most acquisition in Malaysia for the period 1980 to 1986 was the asset basis. There are several possible explanations:-

1. Most of the acquired companies (40 percent) were from the property sector. The value of this type of companies very much depends on the value of their properties or investments underlying their business.

2. About 90 percent of the acquired firms were not listed. These type of firms normally have more reliable information on their assets than on their earnings. Therefore the asset approach was the most appropriate basis of valuing these firms.

TABLE 7 The Ratio of Acquisition Price to the Net Tangible Assets of Acquired Firm

Price/Net Tangible Assets (NTA)	Number	Percent
0.5 - 0.9	24	12.8
1 - 5	103	54.8
6 - 10	14	7.4
10	9	4.8
Not available	38	20.2
Total	188	100.0

TABLE 8 Valuation Method by Sector

	IND		FIN		HOTEL		PROP		MINING		PLANT		TOTAL	
	#	%	#	%	#	%	#	%	#	%	#	%	#	%
Asset only	19	19.4	12	12.2	5	5.1	45	45.9			17	17.3	98	100
Earnings only	6	42.9	2	14.3			4	28.6			2	14.3	14	100
Market value only	6	75.0	-	-	-	-	-	-			2	25.0	8	100
Combination of asset & earnings	12	23.5	5	9.8	5	9.8	20	39.2	1	2.0	8	15.7	51	100
Combination of asset, earnings & market value	2	100											2	100
Not available	4	26.7	1	6.7	1	6.7	6	40.0			3	20.0	15	100
Total	49		20		11		75		1		32		188	

A comparison between the net tangible assets of the acquired companies and the purchase price of the acquisition will give an indication whether the purchase price paid is at least the value of the net tangible assets. The results of the comparison which were based on the ratio of the acquisition price to the net tangible assets of the acquired firm are shown in Table 7.

Based on the information from Table 7, about 55 percent of the acquisitions involved a purchase price between 1 to 5 times of the net tangible assets. Overall, about 67 percent of the acquisitions involved purchase price equal to or greater than the net tangible assets.

Although the asset approach was the most commonly used for valuing acquisitions, the earnings potential of the company was still being considered, as it is an important factor in determining the value of the acquired company. About 27 percent of the acquisitions used both asset and earnings approach.

Further analysis also showed that from the total transactions which used asset as the valuation basis, 46 percent of them involved acquisitions of companies in the property sector. The results of the analysis are presented in Table 8.

Also, the results of an analysis (see Table 9) shows that the asset approach and the earnings approach were mainly used to value the non-listed companies. The main approach for valuing the listed companies was the market value of their shares.

TABLE 9. Relationship of Listing Status of the Acquired Companies and the Valuation Method

	Listed		Not Listed		Total	
	Number	Percent	Number	Percent	Number	Percent
Asset only			98	100.0	98	100
Earnings only			14	100.0	14	100
Market value only	8	100.0			8	100
Combination of Asset and earnings	4	7.8	47	92.2	51	100
Combination of Asset, earnings and market value	2	100.0			2	100
Not available	4	26.7	11	73.3	15	100
Total	18		170		188	

MODES OF PAYMENT

Table 10 summarizes the modes of payment for acquisitions during 1980 to 1986. Cash as a mode of payment, accounted for only about 18 percent of the acquisitions. Among the companies which resorted to cash financing, 57 percent of them raised the funds by borrowing from financial institutions and the remaining 43 percent used their own cash surplus. The issuance of ordinary shares appeared to be the most common mode of payment (68 percent) of the acquisitions. However, this mode of payment may dilute control of the acquiring companies.

Sometimes, acquisition leads to a reverse takeover (i.e., as a result of a company acquiring another company on a share exchange basis, control of the acquiring company passes over to the shareholder of the acquired company). From the survey, only about 5 cases (3 percent) of the acquisitions were reverse takeovers. Each of these cases involved issuance of shares to the acquired company, which subsequently comprised by more than 50 percent of the total issued capital of the acquiring company, including the new issues for the acquisition.

There were, however, payments made through a combination of cash and issuance of shares. About 14 percent of the acquisitions used such method.

Another method sometimes used for the settlement of acquisition price are the issuance of loan stock or preference shares. From the survey, only one acquisition transaction or about 1 percent used issuance of convertible loan stock as the mode of payment.

TABLE 10. Mode of Payment

Mode of payment	Number	Percent
All cash	33	17.5
All common stock	127	67.6
Combination of cash and stock	27	14.4
Convertible loan stock	1	0.5
Total	188	100.0

CONCLUSIONS

From the discussion on the findings of the survey, several significant points were noted about acquisitions in Malaysia during the period 1980 to 1986. The majority of the acquiring firms were in the indus-

trial sector, which acquired mostly firms of the property sector and almost all of the acquired firms were not publicly listed. The survey found that most of the acquisitions involved purchase of the entire issued capital of the acquired firm. It was also noted that for most acquisitions, the common reason for making such decision was for diversifying interest. The obvious pattern was to diversify the activities of firms in the industrial sector into activities in the property sector. The valuation of the acquired firms was mainly based on the value of the assets. This valuation method is the most suitable approach particularly when the acquired firms are not publicly listed and they are in the property sector. Lastly, the most common mode of payment for the acquisitions was through the issuance of ordinary shares.

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