

Business Valuation from a Regulatory and Corporate Governance Perspective and Approach to Valuation

All investors neither want to pay more for an asset than what it is worth, nor get shortchanged by receiving less than what the asset is worth when disposing of it. Therefore, it is imperative to get the valuation right when companies undertake business acquisitions or disposals.

Some have argued that the transaction value of a business should not be questioned since there is willing buyer who is prepared to pay for it. However, the question is how an investor would know whether the value of the business to be acquired or disposed reflects its fair market value? Although a formal valuation exercise is not the absolute answer to this question, it will assist a decision maker in making an informed decision on the transaction.

When do you need a Valuation?

Regulation on Valuation for Capital Market Transactions

In general, the rules or requirements governing the capital market do not explicitly require a formal valuation except for transactions that fall under Chapter 4 of the Securities Commission's ("SC") Guidelines on the Offering of Equity and Equity-linked Securities ("Equity Guidelines") regarding valuation of assets. Under Chapter 4 of the Equity Guidelines, the SC will assess directly the valuation of identified assets or identified companies that are the subject of –

- an acquisition of assets as part of the listing proposal;
- an acquisition of assets resulting in a significant change in the business direction or policy of a listed company;
- an acquisition of assets from related parties via issuance or proceeds from issuance of equity/equity-linked securities by a listed company;
- an acquisition of assets undertaken as part of a restructuring scheme of a distressed-listed company; or
- a disposal of assets resulting in a significant change in the business direction or policy of a listed company.

In the above case, listed companies must adopt the valuation approved by the SC as the basis for the consideration for the acquisition or disposal.

The identified assets mean –

- development properties including development rights;
- plantation land;
- purpose built commercial or leisure properties,
- plant, machinery and equipment;
- timber concession;
- mining land; and
- any other types of asset which the SC may specify from time to time,

Identified companies mean companies that own or hold the identified assets.

For acquisition of assets other than the identified assets, which is part of a listing proposal; or acquisition of assets financed by issuance of securities; or significant assets disposal, the Equity Guidelines requires the valuation of the assets and the purchase or disposal consideration to be appropriately justified and adequately substantiated. The SC has the right to seek second-opinion valuation on the assets if it considers the valuation is unreasonable or not justifiable. Under such circumstances, listed companies will have to adopt the lower of value for acquisition or higher of value for disposal if second-opinion valuation is sought by the SC. Therefore, a formal valuation exercise will facilitate the applicant or listed company to comply with these requirements although it is not specifically stated in the guidelines.

For acquisition or disposal that breaches the relevant percentage ratios under Chapter 10 of the Listing Requirements of Bursa Malaysia Securities Berhad (“Listing Requirements”) in relation to transactions, listed companies are required to disclose in the announcement or circular, amongst others, the value of the consideration and the basis of how the consideration was arrived at. The Listing Requirements however do not specifically state how this requirement is to be met.

For acquisition from or disposal to a related party where the value of the transaction is equal to or exceeds 5% of any of the percentage ratios under Chapter 10 of the Listing Requirements, an independent adviser is also required to comment whether the transaction is fair and reasonable to the shareholders. While the requirement is silent on how the independent adviser should arrive at its opinion, the independent adviser is expected to perform certain form of valuation to determine whether the value of the transaction is fair and reasonable.

Corporate Governance perspective on Valuation

The board of directors has a fiduciary duty to the shareholders of the company. It is expected of the board of directors, legally and morally, to exercise due care in deliberating and deciding on any transactions undertaken by the company. Therefore, one could argue that it would be appropriate for the board of directors to get a valuation done for a transaction involving acquisition or disposal of assets of the company, especially if the deal is a related party transaction.

By having an independent and professional opinion on the value ascribed by the management for any acquisition or disposal transaction, a check and balance is in place to ensure that the company will not pay more than what they have to or not getting shortchanged. This will not only reflect that the management is transparent but also indicates that it has taken steps to protect the interest of all stakeholders. Of course, in a transaction where it is clearly insignificant or there is a clear market price for it, then a formal valuation may not be necessary.

*This article is part one of two in a series on **Business valuation from a regulatory and corporate governance perspective and approach to valuation**. Look out for ‘**How to value a business?**’ in the next issue of BizDO.*

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