CHAPTER SIX

THE PROSPECT OF MERGING BETWEEN CCM AND EON FINANCE

Chapter Six

6.1 The Prospect of Merging between CCM and EON Finance BHD

6.1.1 Background

The mergers of the two finance companies within DRB - Hicom group-Credit Corporation (M) Berhad (CCM) and the EON Fnance Berhad - would pave the way for the entity to be a stronghold in the motor vehicle finance market. CCM and EON finance has 50% and 60% market share in Proton vehicle financing. Proton sold 300,000 units locally in 1997. However, due to recent economic slowdown and tight liquidity, its sales drops about 30% in 1998. Most of the Proton cars were financed by CCM and EON finance . Even the both finance companies are not a tier one finance company, but BNM allowed the two finance companies to be merged and being potential "anchor" company under which to merge small and medium size finance companies. CCM and EON finance companies were picked as an "anchor" company based on their good asset quality. Bad loans of the two were way below the industry average of 6.3% for the six month period ending December 1998. CCM's non performing loans is about 16.7% while EON finance 1% based on the new revised guideline of non performing loans from three months to six months[19]. Both finance companies portfolio are mostly to do with the hire purchase of new Proton cars.

6.1.2. Capital Requirement for Tier-One Status

With the merger of EON finance and CCM, their shareholders' funds is expected to rise to about RM 750 million, thus meeting the RM 650 million capital requirement for Tier-one status.

[19] Annual Published audited report of CCM and EON Finance Bhd

If it merges with other finance companies , its shareholders' funds would exceed RM 1 billion and total assets would amount to more than RM 11 billion. Before further discussion on the merger process, it is important to analyse the company's profiles prior to their prospect of mergers . This will provide a better understanding on the operation or strengths of the company's before merge.

6.2 Company Profile - CCM

The company was incorporated in Malaysia as Credit Corporation (M) limited on April 26, 1963 with an initial issued and paid up capital of RM 1.25 million. In December 1996, the paid up capital was increased to 29 million and further increased to RM 38 million during the year ended December 31, 1987, with an authorized capital of RM 50 million.

In February 28, 1994, the shares owned by Australia Guarantee Corporation Limited and Standard Chartered Bank PLC in Credit Corporation (M) Berhad were sold to Gadek (M) Berhad. The authorized capital was increased to RM 300 million. With the floatation of Gadek Capital Berhad on the KLSE in April, 1996, Credit Corporation (M) Berhad became a wholly - owned subsidiary company of listed Gadek Capital berhad as the ultimate holding company.

The issued and paid up capital of Credit Corporation (CCM) currently stand at RM 291 million with an authorized capital of RM 300 million. It is also a member of the DRB- HICOM group of companies. It has about 25 branches network. CCM is principally engaged in all aspects of finance company's business, particularly the hire-purchase business. CCM is the finance arm of Gadek Capital(M) Berhad and part of DRB HICOM group.

6.3 Company Profile - EON Finance Berhad

EON Finance Berhad, a wholly - owned subsidiary of EON Bank, had total assets and shareholders' Funds of RM3.28billion and RM 381.51million respectively as at June31,1997. EON Finance was incorporated on February 15,1965, under the name of National Finance Corporation Berhad. In September 1992, Edaran Otomobil National Berhad took control of the finance company and rename it as EON Finance Berhad.

In 1997, EON Finance increased its Paid-up capital to RM275 million, EON Finance is part of the enlarged DRB-HICOM group of companies. Currently, EON Finance has a network of 36 branches located in Peninsula Malaysia, Sabah and Sarawak. EON Finance Berhad provides a wide range of services covering interest free banking products (Islamic Banking Products), financing hire-purchase, leasing, housing and other fixed loans, and acceptance of monies on deposits. Hire-purchase loans make up the bulk of EON Finance's total loans and advances.

6.4 Reason For The Merger Between CCM and EON Finance

The prospect mergers between EON finance and CCM will create a new entity of a strong hold in the motor vehicle finance market. The mergers will also seem to have a consolidation of groups' financing of new Proton and USPD cars. EON finance does most of the financing of the EON Berhad cars while CCM handles cars rolled out of the USPD lines.

CCM is a non bank - backed finance company but EON Finance is fully owned by EON Bank Berhad. With the merger, CCM will become under the bank backed finance arm. Another reason for the merger is to meet the government call for consolidation of finance companies while enabling the merger partners to diversify so as to reduce its dependence on hire-purchase and to achieve balance in its loan portfolio.

6.5 The Proposed Steps Involved In The Mergers

The mergers between CCM and EON Finance would be made through an acceptable arrangement of share swaps. The market share will be valued base on the net tangible assets (NTA) per share of the groups acceptable and realistic pricing of shares. For example, if the group used CCM's listed vehicles , Gadek Capital Berhad to undertake the shares, the possibility was to set up a new holding company under Gadek Capital Berhad. Under this new holding company, the finance company to be merged will issue shares base on their net tangible assets backed by assets.

6.6 The Effects Of Mergers between CCM and EON Finance

If the mergers exercise between CCM and EON Finance completed, then the group would be expected to be third largest finance company in Malaysia, in term of market capitalization. Upon merging their shareholders' fund is expected to rise to about RM 750 million.

The mergers also expected to create some synergistic value as the integration between CCM and EON Finance will provide the group with a wide array and higher margins loan balance mixed, in addition to efficiency operation and reduction in administration and establishment cost. The merger is expected to increase its branch network currently 63 branches to 100 branches throughout the country. Moreover, the merger would emerge its bank and finance arms with a broader market reach to further increase its deposits, loans and advances.

If the mergers between CCM and EON Finance is successfully materialised, it would be able to set up clear group strategies, lending directions, objective and well managed capital control management. That is streamlining of its operation, which in turn is expected to enhance the financial performance of the group as a whole. This exercise would lead to the aspiration of BNM that to ensure finance company industry continues to remain sound and less risky.

Finally, the size of the group will be enlarged and scale of economics will be achieved as well as efficiency of operation benefit. The group will be well managed, and capital base will be increased. This is important because any risk arises from the slowdown in the economy able to sustain and keep resilience in the industry.

6.7 Analysing The Economic Gains And Cost From Mergers.

Analyst expected, the profitability will be improved from the mergers. Hence, it is estimated, the valuation of Credit Corporation(M) Berhad at price of RM 1.50 (estimated figure) was considerably higher than its earning per share at end of march 1998 of just RM -20.00(as per the audited and Published annual report). This was simply because Credit Corporation (M) Berhad was believed need to provide a considerable provision for bad loans, even as much as RM 1.0billion. As at March31,1998, audited report shows NPLs of RM728.71 million(16.70% of total loans). Moreover, recoveries expected of the certain bad loan portion would increase Credit Corporation(M) Berhad's profits and push up earnings.

Based on pre-merger estimation, at around RM 1.50 per share, EON finance (M) Berhad estimated to buy 100 percentage of Credit Corporation(M) Berhad at cost about RM 398 million. Since Credit Corporation(M) Berhad holding was listed, then, the value of Credit Corporation(M) Berhad is based on the net tangible assets as at September of 1998(estimated based on BNM guidelines) was about RM 378 million(present value)[20]. The cost (C) for the merger therefore is :

$$\textbf{Cost} = \text{Cash} - \mathbf{PV}_{\text{CCM}}$$
$$= \text{RM398 million} - \text{RM378 million}$$
$$= \textbf{RM20 million}$$

Shareholders of Credit Corporation (M) Berhad's gain is the cost incurred by EON Finance (M) Berhad[21].

Based on the EON Finance Berhad's estimation of its earning per share of RM1.75, the value of EON Finance (M) Berhad has estimated at a value of RM414 million[22]. Using the 1997 figures, it is estimated the new entity (combined firm) will have net earning per share at average of RM1.80. The proposed merged finance company's value is estimated at RM840.00(estimated pre-merger proposed value) . Therefore, the gain or benefit from the merger is:

$$\textbf{Gain} = \mathbf{PV}_{\text{CCM, EON}} - [\mathbf{PV}_{\text{EON}} + \mathbf{PV}_{\text{CCM}}]$$
$$= \text{RM840 million} - \text{RM414 million} - \text{RM378 million}$$
$$= \textbf{RM 48 million}$$

Therefore, The net present value (NPV) to EON Finance berhad's shareholders is equal to overall gain from the merger less that part of the gain captured by credit Corporation(M) Berhad's shareholders.

[20] Estimated value based on using BNM's NTA adjustment framework in1998(appendix 5)
[21] Richard A. Bearly, Principlle of corporate Finance 1997,Page:915
[22] Estimated value based On using BNM's NTA adjustment framework in 1998 (appendix 5)

$$NPV = \left[PV_{CCM,EON} - Cash\right] - PV_{EON}$$

= Wealth with merger - wealth without merger

OR

$$= PV_{CCM,EON} - \left[PV_{EON} + PV_{CCM}\right] - \left[cash - PV_{CCM}\right]$$

= RM840 million- RM 792million- RM20 million

= **RM28 million**.

Since the net present value(NPV) is positive the merger should be considered as a success and justified mergers[23]. Suppose the shareholders do not anticipate the merger between Credit Corporation(M) Berhad(CCM) and EON Finance Berhad(EON). The announcement will cause the value of CCM's value to rise from RM378million to RM 398 million, a 5.29% percent increase. If both finance companies share management's assessment of the merger gains, the market value of EON's value will increase by RM28 million, thus, increase by 6.76%. When calculating the net present value(NPV) of the merger from the perspective of EON shareholder's means ,we are calculating that part of gain which EON's stockholders get to keep. So, The NPV to EON's stockholders equals the overall gain from the merger less that of the gain captured by CCM's stockholders:

NPV = Gain - cost

= RM48million - RM 20 million

= **RM 28 million**.

It confirm that, if there is a successful merger, EON shareholders need to come out RM28 million ahead. This has been proved through the NPV or gain that will achieve. The positive NPV indicates that by way of combined each other, they will achieve benefit. Finally, the justified merger gain shows that the prospect of mergers between CCM and EON finance is expected to enhance competition, and improve the efficiency operation and resilience of the finance companies as a whole to withstand a downturn in the future.

[23] Richard A. Bearly 1997, Principle of Corporate Finance , Page:915