

# **BEST PRACTICE GUIDE IN RELATION TO INDEPENDENT ADVICE LETTERS**

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## Definitions

Bursa Securities	:	Bursa Malaysia Securities Berhad
CMSA	:	<i>Capital Markets and Services Act 2007</i>
Corporate proposal	:	Major Disposal, RPT, Withdrawal of Listing and Other Corporate Proposals as defined herein
Independent adviser	:	An independent adviser who is independent of the management and board of directors of the listed issuer which appoints it and free from any business or other relationship which could interfere with the exercise of independent judgment by such adviser (as defined in the Listing Requirements)
IAL	:	Independent Advice Letter
IAL Guide or Guide	:	<i>Best Practice Guide for Independent Advice Letters</i>
Listing Requirements	:	<i>Main Market Listing Requirements</i> or <i>ACE Market Listing Requirements of Bursa Securities</i> , as the case may be
Major disposal	:	A disposal of all or substantially all of a listed corporation's assets which may result in the listed corporation being no longer suitable for continued listing on Bursa Securities (as defined in the Listing Requirements)
Other corporate proposal	:	Other circumstances, not being a related-party transaction, Major Disposal or Withdrawal of Listing, where a listed issuer is required to appoint an Independent Adviser to advise on its proposed corporate proposal, particularly in situations where a listed issuer and/or its principal adviser or sponsor is not able to address all situations of conflict of interests satisfactorily
Related party	:	A director, major shareholder or person connected with such director or major director or major shareholder (as defined in the Listing Requirements)
RPT	:	Related-party transaction

SC : Securities Commission Malaysia

Withdrawal of listing : Withdrawal of a listed issuer's listing from Bursa Securities at the listed issuer's request

## OBJECTIVE OF THE GUIDE

In July 2011, the SC launched the *Corporate Governance Blueprint 2011*. The blueprint focuses on six main components of the corporate governance ecosystem, namely, disclosure and transparency, role of gatekeepers and influencers, public and private enforcement, shareholders rights, role of institutional investors and the board's role in governance. High quality disclosure and transparency are increasingly used by both international and domestic investors as a benchmark to gauge a company's good ethical conduct in the carrying out of its operations. Good ethical conduct promotes high level of investor protection, creates a conducive investment environment and maintains market confidence and systemic stability.

In September 2011, in line with the objective of enhancing the standards of disclosure in the marketplace, Bursa Securities issued the *Corporate Disclosure Guide* to help listed issuers in understanding the disclosure obligations in the Listing Requirements better, which in turn, will facilitate greater compliance with such obligations. The *Corporate Disclosure Guide* provides clarification on the disclosure requirements set out in the Listing Requirements and illustrates how the disclosure requirements should be applied in practice. It also sets out the best practices for establishing internal policies and procedures to enable listed issuers to fulfill their disclosure obligations.

The launch of the *Corporate Governance Blueprint 2011* and the issuance of the *Corporate Disclosure Guide* serve to reiterate the importance of disclosure and transparency as critical elements of a robust corporate governance framework. Quality disclosures provide the basis for informed decision-making by shareholders. Interposed between the companies and shareholders are the gatekeepers and influencers who play an important role in promoting self and market discipline. Independent Advisers play a very pertinent role as one of the enablers for informed decision-making by shareholders in relation to corporate transactions requiring the appointment of an Independent Adviser. In this regard, the IAL serves as an important communication channel for the Independent Adviser to communicate directly to the shareholders on its analysis, findings and opinion on the corporate transactions.

Given its importance, the SC and Bursa Securities are issuing this IAL Guide with the following objectives:

- (i) To clarify the SC's and Bursa Securities' views on the role of an Independent Adviser, and to provide guidance on the standards of disclosures in IALs; and
- (ii) To augment the SC's and Bursa Securities' continuous efforts in raising standards of corporate governance through the promotion of high quality disclosures.

Examples and Illustrations relating to particular situations have been set out in this IAL Guide to provide guidance on the SC's and Bursa Securities' views on how this Guide should be applied.

The enhanced disclosures and improved quality in IALs will better empower shareholders with quality information to make informed investment decisions. This will also result in greater transparency and better investor protection which will in turn, boost investors' confidence in the Malaysian capital market.

## **1. OVERVIEW**

The objective of the regulatory requirement for the appointment of an Independent Adviser is to safeguard the interests of the company and/or shareholders. Hence, it is critical that an Independent Adviser provides the shareholders with a balanced view on whether the Corporate Proposals are in the interests of the shareholders in order to assist them in making informed decisions in relation to such Corporate Proposals.

The Listing Requirements define an Independent Adviser as an adviser or an expert who is independent of the management and board of directors of the listed issuer which appoints it and who is free from any business or other relationship which could interfere with the exercise of independent judgement by such adviser or expert. As such, an Independent Adviser should conduct a self-assessment on its independence prior to accepting the engagement.

This Guide is applicable to IALs prepared in respect of Major Disposals, RPTs, Withdrawals of Listing and Other Corporate Proposals as well as IALs commissioned voluntarily. The objective of extending the coverage of this Guide to IALs issued in respect of all transactions governed under the Listing Requirements and also, those commissioned voluntarily, is to promote best practice amongst the Independent Advisers and consistency in IALs.

### **1.1. Regulatory Requirements in relation to Corporate Proposals**

#### **Related-party Transaction**

A related-party transaction (RPT) is a transaction entered into by the listed issuer or its subsidiaries which involves the interests, direct or indirect, of a related party.

Given the nature of the transaction whereby the parties involved are in a conflicted position, certain regulatory safeguards have been put in place in the interest of investor protection.

In this regard, the Listing Requirements stipulates, amongst others, that:

- (i) an Independent Adviser<sup>1</sup> must be appointed before the terms of the transaction are agreed upon; and
- (ii) listed issuers must obtain shareholders' approval in a general meeting in respect of RPTs exceeding certain thresholds.

The Listing Requirements also stipulates that an Independent Adviser must, in relation to the transaction,–

- (i) comment and provide an opinion as to:
  - whether the transaction is fair and reasonable so far as the shareholders are concerned; and
  - whether the transaction is to the detriment of minority shareholders,and such opinion must set out the reasons for, the key assumptions made and the factors taken into consideration in forming that opinion;
- (ii) advise minority shareholders on whether they should vote in favour of the transaction; and
- (iii) take all reasonable steps to satisfy itself that it has a reasonable basis to make the comments and advice in respect of the above.

Notwithstanding the requirements above, the Independent Adviser should also comment as to whether the transaction is in the best interests of shareholders and not merely that it is not to their detriment.

### **Major Disposal**

A Major Disposal involves the disposal of all or substantially all of a listed issuer's assets which may consequently affect its listing status.

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<sup>1</sup> The Independent Adviser must be a person who is permitted to carry on the regulated activity of advising on corporate finance under the CMSA. Bursa Securities has the discretion not to allow an Independent Adviser to continue to act or be appointed as an Independent Adviser, if in its opinion, the adviser is deemed not to be independent.



Pursuant to the Listing Requirements, a listed issuer which intends to undertake a Major Disposal must, amongst others,–

- (i) appoint an Independent Adviser; and
- (ii) obtain shareholders' approval of at least 75% in value of the shareholders present and voting either in person or by proxy in a general meeting.

The Listing Requirements also stipulates that an Independent Adviser must, in relation to the Major Disposal,–

- (i) comment as to whether the Major Disposal and its related proposals (if any) are fair and reasonable in so far as the shareholders are concerned. Such opinion must set out the reasons for, the key assumptions made and the factors taken into consideration in forming that opinion. In arriving at such opinion, the independent adviser should comply with the relevant provisions of Chapter 12 of the *Guidelines on Contents of Applications Relating to Take-overs and Mergers on Independent Adviser's Recommendation*<sup>2</sup>;
- (ii) advise the shareholders on whether they should vote in favour of the Major Disposal and its related proposals (if any); and
- (iii) take all reasonable steps to satisfy itself that it has a reasonable basis to make the comments and advice in respect of the above.

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<sup>2</sup> Chapter 12 of the *Guidelines on Contents of Applications Relating to Take-overs and Mergers on Independent Adviser's Recommendation* stipulates that a recommendation on a take-over offer made by an Independent Adviser should:

- (a) be short and comprehensive;
- (b) contain a brief resume of the rationale underlying the recommendation, drawn from the commercial and financial assessment and evaluation of the take-over offer as set out in the body of the Independent Adviser's letter, but such resume should not prejudice the overall target for the recommendation of brevity, clarity and certainty;
- (c) contain no restrictions on the reliability or applicability of the recommendation, except for those, which are absolutely necessary; and
- (d) not contain so many alternative pieces of advice and, therefore, alternative courses of action for offeree shareholders that the overall recommendation is obscured or rendered less meaningful.

### **Withdrawal of Listing**

Pursuant to the Listing Requirements, a listed issuer may not make a request to withdraw its listing from Bursa Securities unless—

- (i) the listed issuer obtains its shareholders' approval in a general meeting and if applicable, the approval of the holders of any other class of listed securities in a separate meeting;
- (ii) the resolution for the withdrawal of its listing is approved by:
  - a majority in number representing three fourths in value of the shareholders and holders of any other class of listed securities, if applicable, present and voting either in person or by proxy at the meetings; and
  - such shareholders and holders of any other class of listed securities who object to the withdrawal is not more than 10% of the value of the shareholders and holders of any other class of listed securities present and voting either in person or by proxy.

Where the constituent document of the listed issuer imposes a stricter condition in respect of the votes required to approve the withdrawal of listing, such stricter condition will apply in substitution of the foregoing provision;

- (iii) the shareholders and holders of any other class of listed securities, if applicable, are offered a reasonable cash alternative or other reasonable alternative (Exit Offer); and
- (iv) the listed issuer appoints an Independent Adviser, which meets the approval of the independent directors, to advise and make recommendations for the consideration of the shareholders and holders of any other class of listed securities, if applicable, in connection with the withdrawal of its listing, as well as the fairness and reasonableness of the Exit Offer.

### **Other Corporate Proposals**

There may be other circumstances where a listed issuer on its own accord decides to appoint an Independent Adviser or the listed issuer may be required to appoint an Independent Adviser to advise on a proposed corporate proposal, particularly in situations where a listed issuer and/or its principal adviser or sponsor is/are not able to address all situations of conflict of interests satisfactorily.

### **1.2. Important Notice**

It is essential to note that this IAL Guide is not meant to be an exhaustive reference on the Independent Adviser's obligations or the requirements of an IAL. Examples provided in this IAL Guide are purely for illustration and are not exhaustive. You are encouraged to seek your own legal advice in respect of compliance with all applicable laws.

This IAL Guide does not govern IALs issued pursuant to the *Malaysian Code on Takeovers and Mergers 2010*.

## **2. ACCEPTANCE OF THE ENGAGEMENT**

- 2.1 An Independent Adviser is expected to have the required personnel with the relevant expertise in respect of the scope of work it been engaged for. Before accepting an engagement, the Independent Adviser must satisfy itself that it has the necessary resources and staff with the relevant skills, knowledge and experience to carry out its role efficiently and effectively.
- 2.2 It is also essential that the engagement of the Independent Adviser by the listed issuer is not driven by fees or the desire for a particular opinion and recommendation. In this regard, an Independent Adviser shall be deemed not to be independent in the event that the Independent Adviser's fees are dependent in any way on the outcome of the Corporate Proposal which the Independent Adviser is providing its opinion on.
- 2.3 Both the Independent Adviser and listed issuer engaging the Independent Adviser are expected to ensure that the Independent Adviser's experience and qualifications are relevant to the Corporate Proposal on which the Independent Adviser is to express an opinion on.
- 2.4 The Independent Adviser's independence, as well as the qualifications and experience of the Independent Adviser and of the key individuals primarily responsible for the engagement, should be clearly disclosed in the IAL.
- 2.5 There may be certain situations whereby the Corporate Proposal or the background of the Corporate Proposal involves technical areas beyond the Independent Adviser's expertise. In such situations, the Independent Adviser should engage an expert or specialist to advise it in relation to those areas.
- 2.6 If the Independent Adviser has not been given:
- (i) sufficient information;
  - (ii) access to a company's records; or
  - (iii) adequate time to carry out an engagement,
- it should decline the engagement.

The IAL prepared must be adequate and the Independent Adviser should not attempt to deal with the limitations and deficiencies it faces by disclaiming responsibility or limiting its scope of assessment.

### **3. PERFORMING THE ENGAGEMENT**

#### **3.1 Substance over Form**

- 3.1.1 As an overall guiding principle, the Independent Adviser should–
- (i) focus on analysing the Corporate Proposal in a holistic manner;
  - (ii) critically evaluate the key issues that can reasonably be expected to affect shareholders; and
  - (iii) address anticipated concerns of the shareholders.

The Independent Adviser should focus on the substance of the Corporate Proposal, rather than the structure or mechanics of the Corporate Proposal.

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#### **GUIDANCE**

1. The Independent Adviser should consider highlighting only the material terms of the Corporate Proposal, rather than commenting on each and every term. This is to ensure that–
    - (i) the shareholders are provided with pertinent information for them to arrive at an informed decision and are not distracted with irrelevant information; and
    - (ii) the IAL is concise and its readability is enhanced.
  2. The terms that are in line with normal commercial practices need not be addressed in the IAL if it would not affect the Independent Adviser’s opinion. However, the Independent Adviser should consider highlighting and opining on the reasonableness of terms such as profit guarantees, terms and schedule of payment, deferred payment, provisions for adjustments or variations to the terms of the relevant agreements, compensations/penalties, termination provisions and conditionality of the proposals depending on the circumstances and the implications of such terms on the Corporate Proposal.
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**ILLUSTRATION**

Listed Issuer A had announced that it has received an offer from its major shareholder to acquire its entire business and undertakings including all assets and liabilities. Listed Issuer A proposes to distribute the disposal proceeds to its shareholders by way of capital reduction, subject to Listed Issuer A obtaining the court's approval ("**Distribution of Proceeds**"). The major shareholder intends to off-set the purchase consideration to be paid to Listed Issuer A with its entitlement under the Distribution of Proceeds.

**Do's:**

- ✓ The Independent Adviser should assess and comment on the implications to the non-interested shareholders as the major shareholder will effectively be receiving its portion of the Distribution of Proceeds ahead of the non-interested shareholders.

- 3.1.2 The Independent Adviser should evaluate on the fairness and reasonableness of the Corporate Proposal as a composite item rather than two distinct criteria.
- 3.1.3 The Independent Adviser should also provide its advice to holders of other class of listed securities, other than holders of ordinary shares, in instances whereby the approval of such securities holders are required for the Corporate Proposal. For example, Corporate Proposals that require the approval of the holders of preference shares, warrants or convertible instruments.
- 3.1.4 There may be occasions whereby the Corporate Proposal represents part of a larger corporate proposal. In such situations, the Independent Adviser should carefully consider whether there is a need to evaluate the said larger corporate proposal or the series of corporate proposals.

**ILLUSTRATION**

The common major shareholder of two Listed Issuers (“**Target Companies**”) has made an offer to the Target Companies to acquire their entire business and undertakings including all assets and liabilities. The simultaneous offers constitute a merger of both the Target Companies’ businesses. The offers are also inter-conditional upon each other.

The Independent Adviser had assessed the fairness and reasonableness of the disposal consideration for each Target Company in isolation when analysing the disposal consideration.

Do’s:

- ✓ The fairness and reasonableness of the disposal consideration is definitely an important consideration for shareholders. In addition, the shareholders of both Target Companies would also want to understand how the offer price for one Target Company compares to the offer price for the other Target Company.

As such, the Independent Adviser should compare the offer price for both Target Companies as well as the value and mode of satisfaction of the consideration, in addition to analysing the fairness and reasonableness of the disposal consideration for each Target Company in isolation.

### **3.2 Areas of Assessment**

3.2.1 The Independent Adviser should assess and disclose its opinion clearly on each of the following areas:

- (i) Rationale of the Corporate Proposal;
- (ii) Material terms and structure of the Corporate Proposal;
- (iii) Consideration involved in the Corporate Proposal;
- (iv) Basis which was used to arrive at the consideration involved in the Corporate Proposal;



- (v) Financial effects of the Corporate Proposal;
- (vi) Prospects of the industry, listed issuer and subject matter; and
- (vii) Risk factors.

3.2.2 However, such disclosure does not discharge the Independent Adviser of its obligations to exercise its due care, skill and professional judgement. The Independent Adviser should exercise its professional judgement as to–

- (i) whether additional areas need to be covered; and
- (ii) whether the Independent Adviser’s opinion is justified and supported by reasonable grounds based on the areas assessed given the circumstances and intricacies of the Corporate Proposal.

3.2.3 Having assessed the relevant areas, the Independent Adviser’s final opinion should be drawn from its evaluation of each area assessed.

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## **GUIDANCE**

As a general rule of thumb, the Independent Adviser should–

1. not rely entirely on the information provided by the listed issuer without undertaking some form of reasonableness check and where possible, corroborate such information with independent sources.
  2. consider the rationale for undertaking the Corporate Proposal and the anticipated impact of the Corporate Proposal on the listed issuer’s business plans, strategies and prospects.
  3. consider alternative proposals, if any, in evaluating the rationale for the Corporate Proposal and set out the reasons for its opinion vis-à-vis the alternative proposals.
  4. provide its views on the basis of arriving at the consideration paid/received from an independent perspective notwithstanding that it was not involved in the commercial negotiations.
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5. comment and provide its views, if applicable, on the effects of the Corporate Proposal, including, but not limited to:
    - (i) any dilution effect of the Corporate Proposal on the existing shareholders' interests and on net assets or earnings of the listed issuer;
    - (ii) how the Corporate Proposal is expected to contribute positively to the future earnings of the listed issuer; and
    - (iii) whether the earnings contribution from the subject matter is sustainable or a one-off item.
  6. take into account the prospects of the relevant industry segment when assessing the prospects of the listed issuer and/or the subject matter. There should be an in-depth analysis on the specific industry segment/value chain/market that the subject matter is involved in rather than conducting an analysis from a generalised perspective.
  7. provide its views on the risk factors relating to the Corporate Proposal and consider whether there are additional risk factors that have not been dealt with in the main circular.
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**ILLUSTRATION**

Listed Issuer B had announced that it proposes to acquire 100% equity interest in Target Company C from a Related Party. Target Company C is principally involved in and intends to stay focused in property development in Sarawak.

In assessing the prospects of the property development industry, the Independent Adviser discussed the prospects of the property development industry in Malaysia and did not comment on the prospects of the property development industry in Sarawak.

**Do's:**

- ✓ The Independent Adviser's discussion and assessment of the prospects of the property development industry should be focused on Sarawak.
- ✓ The discussion should include only information which is relevant for shareholders' consideration in making their decision on the proposal.

**3.3 Reliance on the Work of Another Expert**

3.3.1 Before making any decision as to whether to rely on the work of an independent expert or otherwise, the Independent Adviser is expected to conduct its own review on the said expert and the opinion provided by such expert.

Such reviews include, but are not limited to—

- (i) assessing the qualifications, expertise, experience and credibility of the expert in the industry;
- (ii) understanding the expert's scope of engagement;
- (iii) evaluating the reasonableness of the methodologies and key assumptions adopted by the expert; and

(iv) cross-checking the reasonableness of the results derived by the expert, wherever possible.

3.3.2 It is expected that the expert's assessment complies with applicable valuation standards and guidelines. If this is not the case, the Independent Adviser should clearly disclose this together with the justifications for such non-compliance and its significance on the Independent Adviser's opinion.

### **3.4 Reliance on Information Used by the Independent Adviser**

3.4.1 The Independent Adviser is expected to undertake due enquiries and exercise its due care, skill and professional skepticism to ensure that the information relied on by the Independent Adviser is reasonable, accurate, complete and free from material omission.

3.4.2 The Independent Adviser should make additional enquiries if there is any ambiguity on the reliability, accuracy and completeness of the said information. In addition, it should document any grounds/circumstances that led it to question the reliability, accuracy and completeness of the information.

3.4.3 The Independent Adviser should make relevant disclosures in relation to the information relied on in preparing the IAL. This is to enable shareholders to assess the reliance to be placed on the Independent Adviser's opinion.

Relevant disclosures may include, but is not limited to–

- (i) the sources of information relied on in preparing the IAL;
- (ii) the Independent Adviser's confirmation that the information used is reasonable, accurate, complete and free from material omission; and
- (iii) whether any interested party to the Corporate Proposal has refused to provide reasonable access to information or explanation, if the information or the explanation may influence the Independent Adviser's opinion.

## **4. VALUATION MATTERS**

### **4.1 Valuation Methodologies**

4.1.1 The Independent Adviser should exercise its due care, skill and professional judgement in selecting the most appropriate methodology(ies) to be used in its analysis. This must be supported by reasonable grounds and logical assumptions.

An inappropriate selection of the valuation methodology will inevitably affect the Independent Adviser's advice to shareholders. In the worst case scenario, the resulting effect is that the shareholders may arrive at a wrong voting decision in respect of the Corporate Proposal.

4.1.2 Methodologies that are generally appropriate to be considered by the Independent Adviser include, but are not limited to, the following:

- (i) Discounted cash flow method;
- (ii) Price-earnings multiple valuation;
- (iii) Market value; and
- (iv) Asset-based approach.

4.1.3 The Independent Adviser must be able to reasonably support its rationale for choosing any particular methodology(ies) as this is an important basis to the Independent Adviser's opinion.

**ILLUSTRATION**

Listed Issuer D is proposing to acquire various assets from a Related Party.

All the assets are of the same nature. However, the Independent Adviser had adopted different valuation methodologies to assess the fairness and reasonableness of the purchase consideration for each asset. The Independent Adviser had not disclosed its rationale for doing so.

Do's:

- ✓ The Independent Adviser should disclose the rationale for adopting different valuation methodologies despite all the assets being of the same nature.

4.1.4 The Independent Adviser should also disclose all relevant valuation methodology(ies) available. In this regard, the Independent Adviser should explain–

- (i) the common and appropriate methodologies for the subject matter;
- (ii) reasons for selecting the methodology(ies) adopted in its evaluation; and
- (iii) reasons for not selecting the other valuation methodology(ies) for its assessment.

As the methodology(ies) are often technical in nature, the Independent Adviser should explain the methodology(ies) adopted in its evaluation. This will assist shareholders to better understand the basis of selecting the methodology(ies) and the Independent Adviser's assessment in forming its opinion.

4.1.5 The Independent Adviser should, where possible, cross-check the results of its analysis by using at least another valuation methodology to analyse the Corporate Proposal. This helps ensure that the valuation process is more robust.

**ILLUSTRATION**

Listed Issuer E is proposing to acquire 80% equity interest in Target Company F from a Related Party.

The Independent Adviser used an asset-based valuation methodology to cross-check the results derived from the primary valuation. However, it was disclosed that the asset-based valuation methodology is not a commonly used method for that particular industry, but there was no disclosure as to whether such valuation methodology is appropriate in the first place.

Do's:

- ✓ The Independent Adviser should adopt a meaningful and reliable cross-check valuation methodology.
- ✓ The Independent Adviser should apply the principle of substance over form throughout the engagement.

4.1.6 There may be situations whereby the Independent Adviser adopts only one methodology due to the specialised nature of the asset. In such situations, the Independent Adviser should explain the reasons for adopting only one methodology and ensure that its valuation is justified.

4.1.7 When more than one valuation methodology is used, the Independent Adviser should state–

- (i) whether or not more emphasis should be placed on a particular methodology adopted in its analysis; and
- (ii) the reasons for more emphasis being placed on that particular methodology compared with the other methodology(ies) used.

For this purpose, the primary methodology should be distinguished from the other methodology(ies).

- 4.1.8 In adopting the comparable companies/transactions approach to valuation, there may be differences between the relevant comparables used and the subject matter. Such differences include, but are not limited to, the size of the company, operating history, geographical location, listing status, etc. In such instances, the Independent Adviser should highlight the differences. If quantitative adjustments can be made to account for the differences, the basis for the adjustments should be justified and disclosed.

#### ILLUSTRATION

Listed Issuer G had appointed an independent valuer to appraise the value of a piece of land to be acquired from a Related Party ("**Target Asset**"). The valuer had adopted the comparable transactions methodology and had considered numerous comparable transactions in its assessment of the independent market value of the Target Asset.

In assessing the fairness and reasonableness of the purchase consideration for the Target Asset, the Independent Adviser had reviewed the valuation conducted by the said independent valuer. However, the Independent Adviser only took into consideration *some* of the comparable transactions adopted by the said independent valuer in the Independent Adviser's own analysis without explaining its rationale for doing so.

#### Do's:

- ✓ The Independent Adviser should justify and disclose the basis for taking into consideration only some and not all of comparable transactions used by the independent valuer. For example, the selection of the comparable transactions may be due to the fact that the Independent Adviser only selected the comparable transactions in Malaysia, and not the foreign transactions which are less comparable.



### ILLUSTRATION

Listed Issuer H announced that it proposes to acquire a 100% equity interest in Target Company J from a Related Party. Target Company J is principally involved in the food processing industry.

In assessing the fairness and reasonableness of the purchase consideration, the Independent Adviser had considered the premium (i.e. the purchase consideration in excess of the market capitalisation) paid for past acquisitions involving target companies in various industries such as financial services, property development and construction.

Do's:

- ✓ If the Independent Adviser makes such comparisons, it should justify why the premium paid for past acquisitions involving target companies in various industries is comparable with the premium paid for Target Company J which is only involved in the food processing industry.

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### GUIDANCE

1. The Independent Adviser should, where possible, determine the parameters/criteria (e.g. business activities, size) for purposes of its analysis on comparable companies/transactions first before proceeding to select the comparable companies/transactions.
  2. The Independent Adviser should clearly disclose—
    - (i) the parameters used for determining the criteria of the comparable companies/transactions; and
    - (ii) the justifications for selecting the comparable companies/ transactions, to enable shareholders to assess the Independent Adviser's opinion and the extent of reliance to be placed on it.
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3. The Independent Adviser should, where applicable, clearly disclose the basis for using different comparable companies/transactions throughout the Independent Adviser's analyses.
  4. The Independent Adviser should consider the economic and market conditions at the time when the comparable transaction(s) occurred and the prevailing conditions at the time of the current Corporate Proposal.
  5. Adjustments should be made, if necessary, for dissimilarities between the source of earnings of the selected comparable companies and the subject matter.
  6. The Independent Adviser should consider excluding exceptional items from the earnings of the subject matter and the selected comparable companies for a more meaningful analysis.
  7. A reasonable number of comparable companies/transactions should be used to ensure an unbiased and fair analysis. In the event the Independent Adviser is unable to do so, the reasons for it should be clearly disclosed.
  8. The basis for including or excluding anomalous (i.e. outliers) items should be justified and disclosed.
  9. The sources of information and cut-off dates used to derive the data on the comparable companies/ transactions should be disclosed clearly.
  10. The Independent Adviser should consider the basis of the book value of assets recorded by the comparable companies and book value of the assets recorded by the subject of valuation. For example, whether the comparable companies record its assets at historical price or current market value and if a similar basis is adopted by the subject of valuation.
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4.1.9 The Independent Adviser should consider the need to conduct an independent valuation for the current market value of the target company's assets, particularly when the fair market value of the target company's assets is expected to differ significantly from its historical book value.

In valuing the said assets, the Independent Adviser may need to quantify and comment on any material differences between its valuation and the value of the asset used for accounting purposes.

The Independent Adviser should ensure that it has the expertise to value such assets. The Independent Adviser should engage a valuer or other expert to conduct the valuation if it does not have the relevant expertise to do so.

- 4.1.10 The Independent Adviser should conduct an analysis on the issue price of any form of securities which are to be issued as consideration under the Corporate Proposal. Such analysis is important to determine the fairness and reasonableness of the issue price of the said securities in comparison with its fair market value.

## **4.2 Assumptions**

- 4.2.1 The Independent Adviser should perform its own reasonableness check on the assumptions used in its assessment.
- 4.2.2 The Independent Adviser should disclose all material assumptions on which its assessment is based. This allows shareholders to evaluate the reasonableness of the Independent Adviser's opinion, the extent of reliance to be placed on the Independent Adviser's opinion and the significant uncertainties influencing the valuation.
- 4.2.3 The material assumptions disclosed should be specific and definite. Where possible, the Independent Adviser should explain the reasons for adopting such assumptions. General assumptions with no specific relevance to the company/assets being valued should be excluded.

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### **GUIDANCE**

In the event the discounted cash flow methodology is used, the key inputs that should be disclosed include, but are not limited to, the following:

- (i) key assumptions used to project the future cash flows;
  - (ii) derivation of discount rate (e.g. risk-free rate, equity market risk premium, beta, cost of debt and any other adjustments made);
  - (iii) duration of the future cash flows used;
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- 
- (iv) terminal value (including key assumptions used to derive the terminal value);  
and
  - (v) valuation of surplus assets, if any.
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The Independent Adviser should consider discussing assumptions relating to specific future economic conditions (such as inflation rates, exchange rates and commodity prices) as to their reasonableness and where possible, conduct an evaluation of their impact on the Corporate Proposal.

- 4.2.4 The Independent Adviser should also consider including a sensitivity analysis which sets out the potential impact of such material changes in the event that changes in key assumptions are likely to affect the valuation significantly.

### **4.3 Valuation Results**

- 4.3.1 In some instances, an Independent Adviser may conduct its own valuation of the subject matter. However, the value of the subject matter may be subjected to uncertainties and may fluctuate. Ascribing a precise value to the subject matter may not provide sufficient information for informed decision making.

As such, the Independent Adviser should provide a range of values for the subject matter, rather than ascribing a precise value.

- 4.3.2 Nonetheless, the range of values disclosed should be as narrow as possible. A wide range of values reduces the benefits of providing a range of values as it does not provide clear advice to shareholders on the value of the subject matter assessed.

If the Independent Adviser is unable to provide a narrow range of values, the Independent Adviser should justify and clearly explain how its opinion is still relevant despite the broad range of values.

4.3.3 The Independent Adviser must clearly state—

- (i) the meaning of the results from each analysis undertaken; and
- (ii) its conclusion of the results of each analysis undertaken.

Its overall opinion must be drawn from the individual conclusions made.

4.3.4 The Independent Adviser should also compare the results derived from the different methodologies used and comment on any significant differences in results.

#### ILLUSTRATION

Listed Issuer K is proposing to dispose assets to a Related Party.

The Independent Adviser assessed the fairness and reasonableness of the disposal consideration for the assets by adopting the price-to-book and price-to-earnings approach.

The Independent Adviser then explained the results of its analysis. When commenting on the price-to-book analysis, the disposal consideration was compared to the *range* of price-to-book ratio for the comparable companies.

When commenting on the price-to-earnings analysis, the disposal consideration was compared against the *average* price-to-earnings ratio result from its analysis. It was also disclosed that the implied price-to-earnings ratio based on the disposal consideration is *equivalent to the highest* price-to-earnings ratio for the comparable companies.

*Note: The disposal consideration was at the lower end of the price-to-book ratio range of the comparable companies. However, this was not highlighted.*

Do's:

- ✓ The Independent Adviser should provide a balanced assessment based on the more appropriate valuation methodology for the asset and not make selective disclosures that are favourable to the opinion provided.

## 5. CONTENTS OF THE INDEPENDENT ADVICE LETTERS

### 5.1 Executive Summary

5.1.1 The Independent Adviser is encouraged to consider preparing an executive summary. The main purpose of the executive summary is to provide shareholders with a summary of the Independent Adviser's key justifications in arriving at its opinion.

The key take-away of the executive summary should not be materially different in substance from the IAL. In essence, the shareholder's decision whether to vote for or against the Corporate Proposal, premised on the reading of the executive summary, should not be impacted by what is presented in the IAL itself. The IAL should only serve to provide more details and better understanding to the shareholders of the issues, parties and substance of the Corporate Proposal.

5.1.2 As a general rule of thumb, the type of information to be included and excluded from the executive summary is as follows:

<i>To be included</i>	<i>To be excluded</i>
✓ Overview of the valuation conducted including the methodology(ies) used and basis of selecting the said valuation methodology(ies)	× Disclaimers
✓ Summary of the Independent Adviser's analysis and findings	× Detailed information on the parties to the Corporate Proposal
✓ Independent Adviser's opinion and recommendation	× Detailed financial information or analysis
	× Outlook of the industry

Nevertheless, the Independent Adviser should use its professional judgement in making its final decision on the information to be included in the executive summary based on the particular facts and circumstances of the Corporate Proposal.

## 5.2 Effective Communication

### 5.2.1 The IAL should–

- (i) include only information that is relevant and necessary to enable shareholders to arrive at an informed decision; and
- (ii) be clear and concise.

The Independent Adviser should take due care to ensure that information is not presented in a misleading manner. In addition, there should not be incorporation of excessive information which results in the dilution of the effectiveness of the IAL.

The Independent Adviser should also take into consideration the effect of the information on different shareholders. As shareholders could be from a broad spectrum of background whereby some investors may have limited knowledge on finance and corporate finance matters, whilst others may have more in-depth knowledge, the IAL should not just be catered for any particular category of investors but should be generally catered for all types of investors.

#### ILLUSTRATION I

Listed Issuer M proposes to acquire 55% equity interest in Target Company N from a Related Party. The acquisition will result in Listed Issuer M having control over Target Company N.

The Independent Adviser reviewed Target Company N's historical dividend payout in assessing the reasonableness of the rationale of the transaction.

However, it may not be relevant to discuss historical dividend yield since Listed Issuer M will control Target Company N following the acquisition and hence, can control Target Company N's dividend policy.

Do's:

- ✓ The Independent Adviser should discuss the expected earnings contribution of Target Company N and not the Target Company N's historical dividend yield.

### ILLUSTRATION II

Listed Issuer Q is proposing to acquire 100% equity interest in Target Company R from a Related Party. Target Company R's business operations are highly dependent on a technology licensed from Company S. The licence is due for renewal in the near future.

Do's:

- ✓ As the license is due for renewal in the near future, the shareholders of Listed Issuer Q would be interested to understand:
  - (i) the factors which would have an impact on the approval for the renewal of the licence; and
  - (ii) the alternatives available to Target Company R if the licence is not renewed.

Salient information on these areas should be set out clearly in the IAL.

### ILLUSTRATION III

Listed Issuer S proposes to acquire an asset from a Related Party. The Related Party, in turn, owes Listed Issuer S an amount which has been outstanding for more than three years ("**Outstanding Amount**").

The purchase consideration is to be set-off against the Outstanding Amount. However, there were no disclosures as to why the debt has been outstanding for more than three years and the measures taken to-date to recover the debt.

Do's:

- ✓ As the Outstanding Amount has been long overdue and is to be off-set



against the purchase consideration, the Independent Adviser should also take into consideration and disclose–

- (i) the efforts taken by Listed Issuer S to recover the Outstanding Amount;
- (ii) whether there are any alternative means of settlement; and
- (iii) whether there are strategic reasons for the acquisition or is it merely to ensure settlement.

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### **Guidance**

The Independent Adviser should critically comment and provide its own views on–

1. the outlook and prospects of the relevant industry, listed issuer and subject matter.
2. the financial performance of the subject matter, including reasons for any changes in performance and unusual trends/items i.e. impairment loss and any implication to the Corporate Proposal.
3. the effects of the Corporate Proposal as stated in the main circular (including but not limited to the share capital, substantial shareholders and its shareholdings, net assets, net assets per share, gearing, earnings and earnings per share of the listed issuer). Any assumptions adopted should be reasonable and disclosed clearly.

The Independent Adviser is expected to discuss additional information which it deems to be necessary for its evaluation even if such information is not included in the main part of the circular to shareholders.

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- 5.2.2 There should not be any exclusion of material information from the IAL on the basis that the information is confidential. The Independent Adviser should consider all possible alternatives available to sufficiently support its opinion without compromising on the confidentiality of the information.

- 5.2.3 An Independent Adviser should ensure that the IAL is easy to read and follow. The use of content tables, cross-references, numbered sections is encouraged for this purpose.

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### Guidance

The Independent Adviser should–

1. consider the use of pictorial aids such as map, diagrams, charts and tables to assist readers in understanding the Corporate Proposal and the salient information effectively.
  2. consider making reference to the main circular instead of reproducing the entire paragraph/section from the main circular. This will avoid the IAL from being unnecessarily voluminous, thereby detracting focus from the Independent Adviser’s own discussion/analysis.
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- 5.2.4 The Independent Adviser’s opinion and recommendation on the voting decision to be made by shareholders should be disclosed clearly together with the reasons underlying its opinion and recommendation. It should not be vague and subjective, hence leaving it to the readers’ interpretation.

#### ILLUSTRATION

In stating its opinion on the fairness of the disposal consideration, the Independent Adviser made the following statement:

*“It appears that the implied disposal consideration is not fair as it represents a discount to the net assets of the target company...however, if comparison is made to the current market price of the shares in the target company, the implied disposal consideration still appears attractive and is deemed reasonable.”*

Do’s:

- ✓ The above statement does not provide certainty on the Independent Adviser’s opinion in relation to the fairness of the disposal consideration. The

Independent Adviser should provide a definite and firm opinion in giving its opinion on the subject matter.

- 5.2.5 The Independent Adviser should refrain from using technical terms, where possible. In instances whereby technical terms are used, the Independent Adviser should clearly explain in layman's language the technical terms used in a manner that would ease the understanding of the reader.
- 5.2.6 The use of technical terms must be those that are commonly used and widely understood in the relevant industry. In addition, the technical terms should be used consistently throughout the IAL.

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## 6. OTHER IMPORTANT MATTERS

### 6.1. Forward-Looking Information

6.1.1 The achievability of prospective financial information (including forecast and projections) or any other statements or assumptions about future matters (collectively referred to as "**Forward-Looking Information**") is typically uncertain and subjected to various factors that may not be within the listed issuer's control. As such, Forward-Looking Information should be excluded from IALs unless there are reasonable justifications to include it.

Reasonable justifications may include–

- (i) the subject matter being reliant on a long-term contract/concession;
- (ii) the subject matter having a lack of operating history; or
- (iii) the use of a discounted cash flow methodology for valuation purposes.

6.1.2 The Independent Adviser is expected to make due inquiries to satisfy itself that the Forward-Looking Information relied on was prepared on a reasonable basis. Providing sufficient disclosures on the Forward-Looking Information and other risk disclosures and warnings does not release the Independent Adviser from this responsibility.

6.1.3 There should be adequate disclosures on the Forward-Looking Information to enable shareholders to assess the reasonableness of the methodologies and assumptions adopted. The disclosures should include, among others, the following:

- (i) the limitations of the information and the reasons for its inclusion in the report;
- (ii) the key assumptions used and the justification for adopting the said assumptions;
- (iii) the basis and computation in deriving the discount rate, if applicable;
- (iv) the extent and nature of the adjustments made by the Independent Adviser to the raw data provided/compiled;
- (v) the technical expertise of the Independent Adviser in relation to the relevant industry and company/asset; and

- (vi) the specific period to which the information relates and the basis for selecting the said period.

## **6.2. Responsibilities After the Issuance of the IAL**

6.2.1 There may occasions where after the issuance of the IAL, the Independent Adviser or listed issuer becomes aware that–

- (i) the information relied upon by the Independent Adviser during its engagement has significantly changed; or
- (ii) a material statement in the IAL is false, misleading and/or deceptive.

Shareholders should be informed as soon as practical of any material change in information that would affect their decision. The Independent Adviser and listed issuer are obliged and responsible to ensure that the said change is communicated appropriately to shareholders. This may involve–

- (i) notifying each other immediately upon being aware of the occurrence of a material change in circumstances;
- (ii) considering the need to send a supplementary report to the main circular and/or IAL; and
- (iii) assessing the need to postpone the general meeting to provide shareholders with sufficient time to re-evaluate their decision in light of the new information.

6.2.2 The failure by the Independent Adviser to provide a supplementary report when a material change in circumstances has arisen subsequent to the issuance of the IAL may constitute misleading or deceptive conduct.

## **6.3. Documentation**

6.3.1 The Independent Adviser should ensure that there is adequate documentation of the work carried out in discharging its responsibilities and the relevant working papers that support the preparation of the IAL are maintained.

6.3.2 A rule of thumb for the extent of the documentation and working papers that should be maintained, is for a third party who is not involved in the engagement to be able to review the documents, understand the key concerns and any steps taken to address the concerns.

These include, but are not limited to,–

- (i) discussion notes, minutes of meetings and correspondences relevant to the engagement;
- (ii) documents supporting the selection of the valuation methodology, the major assumptions adopted in the IAL and the detailed workings supporting the valuation analysis; and
- (iii) other sources of information, reports or documents relied upon by the Independent Adviser as well as evidence to support the extent of review or checks conducted on these.

6.3.3 The Independent Adviser should be able to readily draw on its documentation and working papers to demonstrate that its opinion is reasonably justified.

6.3.4 It is pertinent to note that the quality of the documentation and working papers can be taken as an indication of–

- (i) the Independent Adviser’s quality control and review process; and
- (ii) the Independent Adviser’s performance of its due diligence obligations.