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BY **Max Koh**

There had been much speculation about the privatisation of Penang-based hard disk drive (HDD) components manufacturer Eng Teknologi Holdings Bhd, but when the announcement came, it took the market by surprise. It was one of those rare occasions when a company actually volunteered information to stop speculation.

CEO Datuk Teh Yong Khoon says the management requested a share suspension because there was unusual activity in the company's shares on July 18.

"That morning, we saw an unusual amount of shares being traded in a short span of time and we had not announced anything. We thought it prudent to suspend the shares and make the announcement [as soon as possible] to curb speculation," he tells *The Edge*.

One might argue that the company's announcement prevented the share price from rising further, which might otherwise have pushed the offer price higher than what was intended.

However, the offer price of RM2.50 per share is still considered good for a stock that has been trading between RM1.62 and RM1.92 since Jan 1, 2011. The offer price was 1.3 times the RM1.90 at which the counter was suspended.

Teh is the major shareholder of TYK Capital Sdn Bhd, which will be acquiring the assets and liabilities of Eng Tek for RM307.2 million or RM2.50 per share.

He says TYK Capital is proposing the privatisation to fully maximise Eng Tek's capital investments for future growth.

"After privatisation, Eng Tek can fully utilise its capital to grow its operations and not worry about paying dividends and other financial commitments to shareholders," remarks Teh, adding that RM2.50 is a good price for shareholders to realise the company's potential value.

He says management arrived at the offer price after taking into consideration the valuations of Eng Tek's peers and other listed companies taken private in the last 12 months.

Teh says management will also be able to implement its capital expenditure plans without becoming a liability to its shareholders.

Eng Tek plans to invest RM50 million this year in expanding capacity, an investment that is necessary to cope with higher demand for component parts, according to Teh.

"With the consolidation of the big boys in the global market, the local component makers need to consolidate to increase capacity and meet demand."

While the privatisation route is an interesting one, Teh says there is a possibility that Eng Tek may join forces with another HDD player in the future.

"But we have no plans for that yet. We are focused on taking Eng Tek private at the moment."

According to Trendfocus, HDD shipments are expected to grow 9% to 707 million this year from 651 million in 2010.

Teh, meanwhile, says cloud computing will drive demand for HDD.

He believes that apart from maximising capital growth, Eng Tek's privatisation is prudent because its shares are undervalued while its trading volume is dismal.

Privatisation amid consolidation

Eng Tek's privatisation is an interesting move, considering that other companies are looking to consolidate to fortify their position in the industry.

It comes at a time when global HDD giants, such as Western Digital and Seagate Technology, are consolidating to remove excess capacity and prevent price wars.

Western Digital, which is the world's leading HDD manufacturer, is in the process of acquiring Hitachi Global Storage Technologies Ltd for US$4.3 billion. At the same time, Seagate Technology, the world's second-largest manufacturer, is buying Samsung Electronics Co's disk drive business for US$1.4 billion. Western Digital and Seagate Technology will then have a combined 90% share of the HDD market.

On the local front, Notion VTec Bhd was in talks with some parties to purchase a substantial stake in it. While the talks have been called off, analysts see more local mergers and acquisitions.

To recap, Eng Tek announced on July 18 that it had been notified of a possible privatisation exercise by certain shareholders and requested the suspension of its shares.

It announced five days later that it had received an offer from TYK Capital to acquire all its assets and liabilities.

The company then saw its share price climb to a one-year high of RM2.28 before closing at RM2.21 last Thursday. At RM2.21, the deal is valued at 1.13 times.

Under the proposal, TYK Capital will also acquire the employees' share options at the intrinsic value of the ESOS, which is the positive difference between the offer price per share and the ESOS exercise price.

The proposed acquisition will be satisfied via RM246.4 million cash and RM60.8 million as the amount owed to Eng Tek by TYK Capital. Upon completion of the proposal, Eng Tek will carry out a capital reduction and repayment exercise whereby all Eng Tek shares will be cancelled and cash will be paid to entitled shareholders.

Teh and his mother, Datin Low Yeow Siang, and Singapore-incorporated Advance Capital Partners Pte Ltd are the substantial shareholders of TYK Capital.

Teh and Low collectively own a 23.21% stake in Eng Tek. The other major shareholders are Permodalan Nasional Bhd (PNB) and Lembaga Tabung Haji (LTH) with 14.5% and 8.4% stakes respectively.

Teh says the board of directors will have to make a decision before Aug 5, which is when the offer lapses unless it is extended in writing. "If it goes through, we will convene a meeting to get shareholders' approval," he says.

Analysts are mostly positive about the exercise. Affin Investment Bank says the privatisation offer price is above its 10-year average share price of RM1.47, although short of its high of RM2.75 in March 2010.

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"We think the privatisation offer is fair and doubt that fundamentals alone [in the absence of the privatisation offer] would have been able to re-rate the share price to RM2.50 in the near term. We therefore believe that investors would be better off accepting the offer."

OSK Research says the valuation is on a par with that of Eng Tek's public listed peers. "The acquisition prices Eng Tek shares on a par with those of Notion VTec, which has a significant presence in the production of the less competitive camera components — at 7.4 times CY2011 PER but at a substantial 25% discount to JCY International's 9.7 times CY2011 PER due to the latter's sheer size."

It adds that its price-to-book value of 1.1 times is equal to JCY's but is at a hefty 30% premium to Notion VTec's 0.8 times for CY2011.

The research house believes that LTH and PNB will most likely give the privatisation exercise the green light and advises investors to accept the offer.

"Based on a rough calculation, we estimate PNB and LTH's average cost per share at RM1.40 to RM1.80 as they have been holding their respective stakes since the early 2000s.

"At RM2.50 apiece and with a potential capital gain of 35% to 75%, we believe the offer will be tempting enough for PNB and LTH to consider unlocking the value of their investments." E