

Trustee shares

Numerous articles have been written about trustee shares but the issue of whether investments in trustee shares are profitable remains debatable. In one way or another, investments in trustee shares have appeared and disappeared according to the tide of the market, appearing mostly when the market is weak. Let's examine the rules governing trustee shares and whether these rules warrant change.

Trustee shares are defined in the Trustee Act 1949. To classify a share as trustee under the Act, it must satisfy two conditions. One, the company must have a minimum paid-up capital of RM5.0 million. Two, it must have a record of declaring dividends for five years consecutively. These conditions are to ensure consistent and regular returns to shareholders.

Today, only 164 companies of the 1,108 companies listed on the Kuala Lumpur Stock Exchange (KLSE) are eligible for trustee share status. These companies, by the definition of the Trustee Act 1949, appear to be financially safe for investment.

Clearly changes are needed in the Act as market conditions and the investment environment have changed. First would be the need to raise the paid-up capital from a minimum of RM5 million. Currently, for a company to be listed on the main board and second board of the KLSE, it needs to have a minimum paid-up capital of RM60 million and RM40 million, respectively. This means all the stocks listed currently on the Kuala Lumpur Stock Exchange are eligible to be trustee shares!

The minimum capital requirement should also be expanded to include shareholders' fund. There are situations whereby a company may have a high paid-up capital but could have incurred higher losses, resulting in negative shareholder funds. For example, Amsteel had negative shareholder funds in 2001 but continued distributing dividends for that year so as to ensure its trustee status. Clearly, shareholder funds are more complete as a description of the financial standing of a company throughout the years in operation. Only when shareholder funds are higher than paid-up capital should a company be allowed to declare dividends. Other financial ratios may also be considered in the criteria of trustee status to reflect a company's financial strength.

Table 1: Trustee shares, which had negative shareholders' fund in 2001 (Source: Bloomberg)

RM'000	1997	1998	1999	2000	2001
Lion Corporation Bhd	434,681	250,354	114,599	-40,202	-242,880
Amsteel Corporation Bhd	1,573,800	1,795,318	893,110	192,227	-470,014

It is also best that dividend paying stocks should make profits in the preceding year before declaring dividend. This seems intuitive, as only profitable companies should be allowed to declare dividends. In 2001, 19 companies from the trustee shares listed distributed dividends although there they were making losses.

The reality about dividends, however, has not been fully understood by most investors. Dividend payment is a zero sum game. Whenever a company pays dividend, its net worth falls according to the dividend paid at the time of payment. After the entitlement date of the dividend, the market price of stocks normally adjusts downwards to reflect the fall in net worth. A high dividend payment does not necessarily mean a company is doing well. Even if a company does not pay dividends, whatever profit retained by the company still belongs to its shareholders. This is reflected in the increase in the net tangible asset of the company.

Dividend distribution naturally has its purpose, as profitable companies would definitely like to share the success with their shareholders. This is another way to reward shareholders who have been supporting the company.

An agency should be nominated to monitor the trustee status of listed companies. This agency should provide regular updates and recommend relevant changes, which better reflect current market conditions. The trustee list can give fund managers and investors the current status of trustee shares.

Ironically, despite the fact that trustee shares are widely followed by investors and perceived to be strong, performances of these stocks have been mixed. In a study undertaken by a Fund Manager, the range of performance of Trustee shares ranged from a high of 897.1% to a low of -50.6%, while the KLSE CI increased by 148.5%, for the period September 1998 to October 2002.

A review of the Trustee Act is clearly needed so as to reflect the changes in the listed equity market environment.

Attribution:

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