Securities Investors Association (Singapore)
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UEN No: S99SS0111B
GST Reg No: M90367530Y

Issuer: HC Surgical Specialists Limited

Stock code: 1B1

Meeting details:
Date: 29 September 2020
Time: 2.00 p.m.

Due to the current COVID-19 pandemic, SIAS encourage shareholders to participate at AGMs via other means and not to attend any AGM physically. Where the AGM is webcast, they can stay on top of their investments by watching the webcast and submitting their question to the company in advance. Senior citizens should avoid attending AGMs altogether and stay home.

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Q1. As noted in the chairman's statement, FY2020 had been an eventful year for the company. The group expanded its network of clinics to 18 and added a 25% stake in an established general practitioner clinic, Medistar Services Pte. Ltd., in July 2019.

While the chairman highlighted that the group achieved a 15.3% revenue growth in the first half of FY2020, revenue for the full year was down 8.7% to $16.7 million. As noted in the chairman's statement, the group was affected by the pandemic for the last two months of the financial year and the news of Dr. Julian Ong's defamation suit and the Singapore Medical Council complaint in April 2020. The latter and the allegation of a breach of director's duty generated negative media publicity for the group.

(i) **Did the board assess the reputational damage to the group as a result of the defamation suit and the SMC complaint related to Dr. Ong? How much of the 8.7% drop in revenue could be reasonably attributed to the negative publicity suffered by the group?**

(ii) **Specifically, has JOES and/or the overall group experienced any significant drop in the number and proportion of female patients?**

(iii) **Has the senior management evaluated if the turnover of staff, especially the female employees, in the group has increased?**

In Note 5 (page 108 – Intangible assets), the company disclosed the carrying amount of goodwill before impairment. However, it was also disclosed that the group made an impairment loss of goodwill approximately $722,000 to one of its medical services under healthcare segment. The carrying amount of such medical service, which represents a CGU by itself, was determined to be higher than its recoverable amount of approximately $1,672,000 based on its current financial performance.

(iv) **Given that JOES is the only CGU that has goodwill of over $1.67 million (next highest is MLCS with $1.055 million in goodwill), can management confirm that it has impaired the goodwill allocated to JOES?**

(v) **For the benefit of all shareholders, would the board clearly disclose the carrying amount of goodwill *after* impairment?**

(vi) On page 109, management disclosed the key assumptions used in the value-in-use calculation, including a revenue growth rate of "-45% to 15%" for JOES. In the CEO's statement, it was disclosed that no patient had declined to see Dr. Ong after being informed of the complaint. **To help shareholders understand the potential financial impact on JOES, can management disclose the number of appointments, bookings and procedures before and after the negative publicity?**

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In fact, the "Impairment assessment of investments in subsidiaries" is a key audit matter (KAM) highlighted by the independent auditors in their Report on the audit of the financial statements (page 63). Key audit matters are those matters that, in the professional judgement of the Independent Auditors, were of most significance in the audit of the financial statements of the current period.

As noted in the KAM, during the financial year ended 31 May 2020, arising from indicators of impairment in certain subsidiaries, management carried out an impairment assessment and determined the recoverable amounts based on the value-in-use calculations by estimating the expected discounted future cash flow. Arising from the assessment, an impairment loss of approximately $3,683,000 was recognised on the investment in a subsidiary during the financial year.

In Note 7, it was further stated that the recoverable amount of the impaired subsidiary is approximately $2,294,000, as determined by value-in-use calculations using management-approved discounted cash flow projections covering a period of 5 years and projection to terminal year.

(vii) Given that the carrying value of only one subsidiary was impaired, it is unlikely that the reason would be the COVID-19 pandemic. **Can management confirm that it has impaired the carrying value of JOES? Was the reason due to the SMC complaint and the subsequent financial and operational performance?**

In addition, in Note 14 (pages 128-130), the group recognised $1.92 million in derivative financial instruments which relates to the put option requiring the vendor of JOES to repurchase the shares and the forward purchase contracts relating to MDS, MLCS, JOES and JLES. The put option has been assessed at $549,000 using the Binomial option pricing model. Management further stated that, as at the end of the reporting period, management has assessed the probability of exercising the put option by the company is minimal.

It was further stated that if the probability that the option is exercised is higher or lower than 5% from management's estimates, the group profit would have been higher or lower by $549,000.

As such, it can be reasonably deduced that management has assessed that there is only a 5% probability that the option will be exercised.

(viii) **Have the independent directors evaluated management's assessment that the "probability of exercising the put option by the company is minimal"?** This assessment by management was made "at the end of the reporting period". **Does management still hold the same opinion in September 2020 that the probability of exercising the put option is minimal?**

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(ix) **Given that the revenue growth rate for JOES could be as low as -45%, the written off in goodwill and the reduction of the recoverable amount to $2.294 million, would the independent directors be evaluating the pros and cons of exercising the put option with a view to protect the interests of shareholders?**

(x) The put option is exercisable within the 30th month and the 48th month of Dr Ong's employment with HCSS. The 48th month falls on 31 March 2021, or approximately six months from the AGM. **Would it be opportune for the independent directors to initiate a review of the company's options with regard to JOES (including exercising the put option) so as to safeguard shareholders' interests?**

Q2. On 6 September 2019, the company announced that it had disposed its 100% stake in the company's subsidiary, CTK Tan Surgery Pte. Ltd. ("CTK") to Dr. Charles Tan Tse Kuang for $1. The net tangible asset and net asset value of CTK as at 31 May 2019 was $49,000.

As noted in the announcement, the disposal was made following the resignation of Dr. Tan on 2 September 2019.

As set out in the company's Offer Document dated 25 October 2016, Dr. Tan had provided the group with a profit guarantee of $150,000 per year for a period of three years from 1 September 2016. This has been fulfilled prior to the disposal. The company stated that the disposal has no material impact to the net tangible assets per share and earnings per share of the group for the current financial year ending 31 May 2020.

(i) **Can the board/audit committee help shareholders understand if the carrying value of goodwill of $429,000 as at 31 May 2019 has been impaired following the sale of CTK?**

As part of the company's pre-IPO restructuring, on 4 August 2016, the group issued to the CTK vendor 1,481,481 shares then-valued at $400,000. The vendor has an option to re-purchase entire issued share capital of CTK at any time for a nominal value of $1, provided always that the vendor shall not be entitled to exercise the option for so long as he has not given notice to terminate his employment in accordance with his employment contract with the group.

(ii) **Can management disclose the revenue and profit contribution of CTK from September 2016 to August 2019 when it was part of the group?**

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(iii) **Given that the company paid $400,000 in shares for CTK in 2016 and had included an option for the vendor to unwind the sales after 3 years, would the board help shareholders understand how the deal structure would allow the group to grow in a sustainable manner for the long term? What were the other (non-financial) benefits of having CTK in the group from 2016 to 2019?**

(iv) As disclosed in Note 14 (page 130), the group had also granted a repurchase option to the vendor of LBPL. **What assurance can management provide to shareholders that acquisitions are structured to enable the group to grow in a sustainable manner and to meet its strategic objectives, and not only to meet short term financial objectives?**

Q3. Would the board/management provide shareholders with better clarity on the following operational and strategic matters? Specifically:

(i) **Acquisition of GP clinic:** The group acquired a 25%, non-controlling interest in Medistar Services Pte. Ltd. which operates The Ming Clinic, an established general practitioner clinic, in Camden Centre. **Can the board help shareholders understand if this acquisition is synergistic to the group which has its focus on endoscopic procedures (including gastroscopies and colonoscopies?**

(ii) **Investment in SPH: Can the company also elaborate further on the rationale for making a minority, non-controlling investment of 4.82% equity interest in Singapore Paincare Holdings?**

(iii) **Growth strategy: For the benefit of new and long-standing shareholders, can the board (re)state the group's growth strategy?**

(iv) **Oversight by management: How does the senior management, especially Dr. Heah Sieu Min as executive director and CEO, ensure that there is proper oversight of the group's operations as the group carries out its expansion plans?** Already there are 18 clinics in the group, and the CEO has to drive the group's overseas foray to Cambodia, respond to a fast-evolving pandemic, run his own medical practice, handle queries and the allegations made against Dr Julian Ong, and to defend himself against allegations of him breaching his director's duties.

(v) **Additional fees and management time: Would the company be charging the additional professional fees and management time to JOES?**

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(vi) **Financial position:** With the redemption of the convertible bonds, the group recognised a loss of $417,000 on the derecognition of the convertible bond. The $5 million convertible bond was redeemed for $5.196 million as the unwinding interest was computed using an effective interest rate of 9.8%. **Are the group's growth plans affected by the unexpected redemption of the convertible bond? What is the debt headroom, if any, for the group to support its growth?**

^Amid the global COVID-19 outbreak, issuers who choose to proceed with the AGM before 30 April 2020 must provide opportunities for shareholders to ask questions. Shareholders are encouraged to read the annual report and submit any questions they might have to the companies in advance. Issuers would then publicly address the questions at the general meeting via the issuer's website, through "live" webcast and on SGXNet.

Shareholders are welcome to use and/or adapt the questions prepared by SIAS and to forward them to the company.

Can't attend the AGM or view the webcast? Check out the latest questions on the annual reports of listed companies on SIAS website

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^ Joint Statement by Accounting and Corporate Regulatory Authority, Monetary Authority of Singapore and Singapore Exchange Regulation dated 31 Mar 2020 (https://www.sgx.com/media-centre/20200331-acra-mas-and-sgx-regco-update-guidance-general-meetings)