Securities Investors Association (Singapore)
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Email: admin@sias.org.sg www.sias.org.sg
UEN No: S99SS0111B
GST Reg No: M90367530Y

Issuer: PNE Industries Ltd

Security: PNE Industries Ltd

Meeting details:
Date: 17 January 2019
Time: 9.00 a.m.
Venue: Orchid Country Club, 1 Orchid Club Road, Sapphire 1, Orchid Lodge, Level 2, Singapore 769162

Company Description

PNE Industries Ltd, an investment holding company, manufactures and sells electronic and electrical appliances in Europe, Indonesia, Malaysia, Singapore, the People's Republic of China, and internationally. It operates in two segments, Contract Manufacturing and Trading. The Contract Manufacturing segment manufactures electronic controllers, and other electrical and electronic products. The Trading segment manufactures and trades in emergency lighting equipment, including conversion kits, emergency and exit luminaires, and staircase fittings. It also provides electrical apparatus, light fittings, and related products. PNE Industries Ltd was incorporated in 1999 and is headquartered in Singapore.
(Source: http://www.sgx.com/wps/portal/sgxweb/home/company_disclosure/stockfacts?code=BDA)

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1. The group's core business of contract manufacturing contributed revenue of $79.4 million and $69.2 million in FY2017 and FY2018 respectively. The segment profit (before tax) was $8.9 million (or 74% of the group's total profit before tax) in FY2017 and $4.1 million (or 61%) in FY2018.

A summary of the revenue and profit from the contract manufacturing segment since FY2014 is shown in the table below:

Contract manufacturing	FY2014	FY2015	FY2016	FY2017	FY2018
Segment revenue ($'000)	62,215	62,616	61,640	79,417	69,273
Segment profit ($'000)	6,005	8,756	7,851	8,872	4,053

(Source: Company annual report)

In the Chairman's statement, the following trends were also noted:

- Strong market competition
- Higher levels of inventories to support customers' supply chain management strategies
- Uncertainties and heightened volatility especially in Europe
- Protracted trade tensions between the USA and China
- Cost pressures in Singapore, China and Malaysia

(i) Given that the segment revenue from contract manufacturing has increased by just 2.7% per annum in the past five years, would management help shareholders understand the long term growth prospect of the segment?

(ii) What are some of the major trends and opportunities in the segment?

(iii) What are the major growth initiatives to scale up the business?

(iv) Can management elaborate further on the group's value proposition? What are the value-added services offered by the group that would allow it to differentiate itself from the competitors? How does management ensure that the group captures its fair share of value given the intense level of competition?

(v) What are the profitability targets set by the board/management?

2. The "Allowance for inventories" is a key audit matter (KAM) highlighted by the Independent Auditor in their Report on the Audit of the Financial Statements (page 19). Key audit matters are those matters that, in the professional judgement of the Independent Auditor, were of most significance in the audit of the financial statements of the current period.

As noted in the KAM, as at 30 September 2018, the group has inventories of $20.3 million, which is approximately 20% of its total assets. The group has made an allowance for inventories amounting to $1.9 million.

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As noted in the Chairman's statement, the group's level of inventories rose by $1.6 million even though sales declined. As at the end of the reporting period, the carrying amount of inventories is $20.35 million, up from $18.77 million a year ago.

In FY2015 and FY2016, the group only had inventories of $13.4 – $14.5 million. In FY2017 and FY2018, the group has increased its working capital due to inventories by $4.66 million and $1.52 million respectively.

The increase in inventories is the result of the group's efforts to better support the customers' supply chain management strategies.

(i) **Has management evaluated the costs and impact of the increased inventory levels? Has the board evaluated the increased risks, including inventory obsolescence risks, pricing/market risks etc?**

(ii) Inventories as a percentage of revenue has increased from 20.9% in FY2017 to 25.5% in FY2018 given that revenue has dipped while inventories have increased. **Has management set an internal limit to the level of inventories given the risks associated with an enlarged inventory holding?**

(iii) **Is there a single product/product category that accounts for a significant portion of the group's revenue?**

(iv) In FY2018, the three major customers accounted for $49.9 million or 63% of the group's total revenue. In FY2017, the (two) major customers accounted for $51.0 million or 57% of the group's total revenue. A major customer is one that accounted for at least 10% of the group's total revenue. **Can management elaborate further on how it is mitigating the customer concentration risks?**

3. In the financial year, the group has paid an interim dividend of 3 cents, comprising a 2 cents first interim dividend and a 1 cent special dividend. The board has further recommended a final dividend of 3 cents per share to bring the total dividend for the year to 6 cents per share.

While the company does not have a formal dividend policy, it has paid dividends at least once annually since 2007.

In the past three years, the company has paid 12 cents in FY2017, 8 cents in FY2016 and 6 cents in FY2015. As at 30 September 2018, the company still has cash and bank balances of $36.7 million, up from $35.5 million a year ago.

(i) **Has the board reviewed how the company could support a formal dividend policy?**

(ii) **Has the board reviewed the group's capital structure vis-à-vis the growth opportunities and capital needs of the businesses?**

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(iii) Did the board deliberate on how the group could leverage its large cash and bank balances of $36.7 million to further generate/crystallise value for shareholders? Are there any opportunities for mergers and acquisitions that would strategically transform the group's core businesses? If there are no appropriate investment opportunities, has the board considered right-sizing the balance sheet and return the excess capital to shareholders?

4. [*The following question on board renewal and long tenured independent directors was posted to the company following the review of the 2017 annual report. As the company has not responded nor improved its disclosure/corporate governance practices, the question is updated and reposted.*]

Mr. Tung Chee Weng and Mr. Tan Lee Khiang were both appointed on 4 May 2000 (page 5). As such, the two directors have each served on the board for more than 17 years. Guideline 2.4 of the 2012 Code of Corporate Governance states that the "independence of any director who has served on the Board beyond nine years from the date of his first appointment should be subject to particularly rigorous review."

(i) Can the company help shareholders understand if the independence of Messrs Tung Chee Weng and Tan Lee Khiang has been subject to "particularly rigorous review"?

(ii) If so, please describe how the "particularly rigorous review" was carried out?

In August 2018, the Monetary Authority of Singapore issued a revised Code of Corporate Governance ("2018 CG Code"). As a consequence of the revised 2018 CG Code, the Singapore Exchange has made amendments to its Listing Rules which came into effect on 1 January 2019, except for the rules on the 9-year tenure for independent directors and the requirement for independent directors to comprise one-third of the board which come into effect on 1 January 2022. Under the revised Listing Rules, the term of an independent director will be limited to nine years after which the long tenured directors will be subject to a two-tier vote by shareholders.

(iii) Has the company evaluated the impact of the 2018 CG Code and the amendments to the Listing Rules on the board?

(iv) Has the nominating committee reviewed the overall desired competency matrix of the board and identified any gaps in skills or competencies that could be addressed in future director appointments?

(v) What is the search and nominating process for directors, especially independent directors?

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(vi) Given that the board currently does not meet the recommendations of Guideline 2.2 of the 2012 Code of Corporate Governance that independent directors make up half of the board if the chairman is not independent, are there any near term plans to refresh the membership of the board to get the board membership in line with the new 2018 Code in good time?

A copy of the questions for the Annual Report for the financial year ended 30 September 2017 and 30 September 2016 could be found here:

https://sias.org.sg/qa-on-annual-reports/?company=PNE%20Industries%20Ltd

The company's response could be found here: -----