

27th March 2019

CHALLENGER TECH - EXIT OFFER TOO LOW

Mr Loo and Dymon Asia, via Digileap Capital, are attempting to take Challenger private at S\$0.56 a share. We believe this price to be significantly below the true value of the company. This offer will not go through if 10% of the shareholders reject it.

We at Pangolin own 2.9% of Challenger's shares and have made contact with other shareholders with 3.7% (total 6.6%). We would ask other shareholders who wish to discuss the bid to get in contact with us by clicking the CONTACT US tab and stating in the message box how many Challenger shares you own. If we think we can get enough support, then we will try to coordinate a response.

UPDATE

As of 26th April, shareholders amounting to 6.7% indicated they will reject the offer. Along with our 2.9% we are now at 9.6% against.

Date	% against
29 March	6.6%
1 April	7.4%
2 April	7.8%
3 April	8.0%
4 April	8.07%
5 April	8.2%
8 April	8.6%
15 April	9.0%
22 April	9.4%
26 April	9.6%

Please do not rely solely on our opinion but seek independent advice.

To access our report on Challenger, please see below.



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This report contains our current views on the value of Challenger Technologies' securities and action that Challenger Technologies' board may take to enhance the value of its securities. Our views are based on our analysis of publicly available information and assumptions we believe to be reasonable. There can be no assurance that the information we considered is accurate or complete, nor can there be any assurance that our assumptions are correct. Challenger Technologies' actual performance and results may differ materially from our assumptions and analysis. We have not sought, nor have we received, permission from any third-party to include their information in this report. Any such information should not be viewed as indicating the support of such third party for the views expressed herein. We do not recommend or advise, nor do we intend to recommend or advise, any person to purchase or sell securities and no one should rely on this report or any aspect of the report to purchase or sell securities or consider purchasing and selling securities. Although we state in the report what we believe should be the value of Challenger Technologies, this report does not purport to be, nor should it be read, as an expression of any opinion or prediction as to the price at which Challenger Technologies' securities may trade at any time. As noted, this report expresses our current views on Challenger Technologies. It also discloses our current holdings of Challenger Technologies. Our views and our holdings could change at any time. We may sell any or all of our holdings or increase our holdings by purchasing additional securities. We may take any of these or other actions regarding Challenger Technologies without updating this report or providing any notice whatsoever of any such changes. Investors should make their own decisions regarding Challenger Technologies and its prospects without relying on, or even considering, any of the information contained in this report. Investors should conduct independent due diligence, with assistance from professional financial, legal and tax experts, on the contents discussed in this document and develop a stand-alone judgement of the relevant markets prior to making any investment decision.

FORWARD-LOOKING STATEMENTS

Certain statements contained in this report are forward-looking statements including, but not limited to, statements that are predicated on or indicate future events, trends, plans or objectives. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties. Forward-looking statements are not guarantees of future performance or activities and are subject to many risks and uncertainties. Due to such risks and uncertainties, actual events or results or actual performance may differ materially from those reflected or contemplated in such forward-looking statements. Forward-looking statement can be identified by the use of the future tense or other forward-looking words such as "view", "believe", "convinced", "expect", "anticipate", "intend", "plan", "estimate", "should", "may", "will", "objective", "project", "forecast", "continue", "management believes", "strategy", "promising", "potential", "position" or the negative of those terms or other variations of them or by comparable terminology.



We would ask like-minded shareholders to get in touch with us by clicking the **CONTACT US** tab on our website at www.pangolinfund.com so we can coordinate our response.

Challenger Technologies (573.SES): Proposed a Voluntary Delisting

Offer price: S\$0.56
Market cap: S\$193m

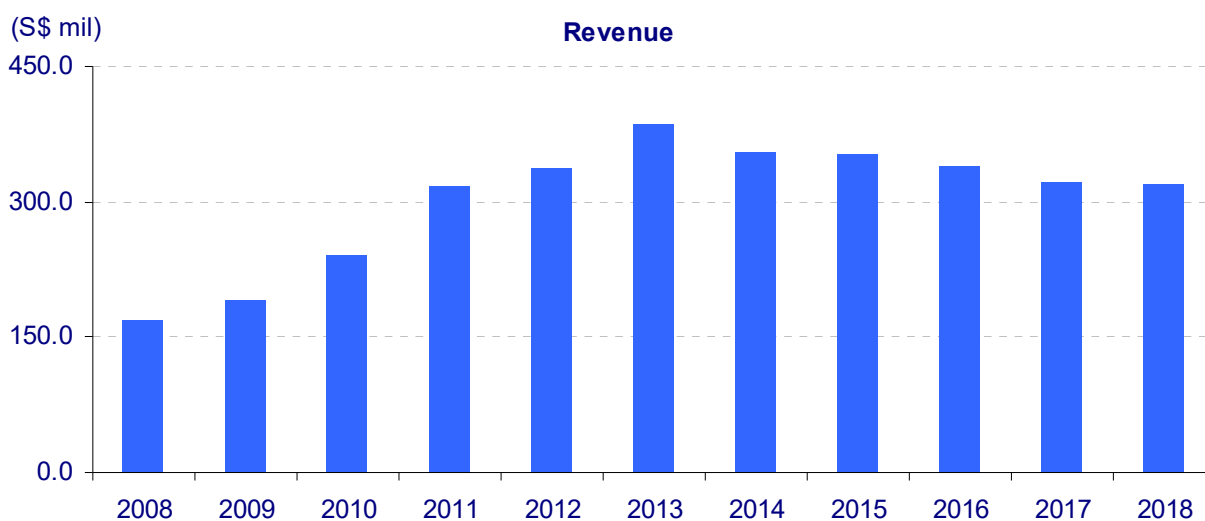
- **Why the offer to acquire Challenger Technologies' shares at S\$0.56 is too low**
- **We value Challenger at S\$1.025 per share**
- **Shareholders should reject this offer – it undervalues their shares**
- **If 10% of minorities vote against, it will not go through**

The Company

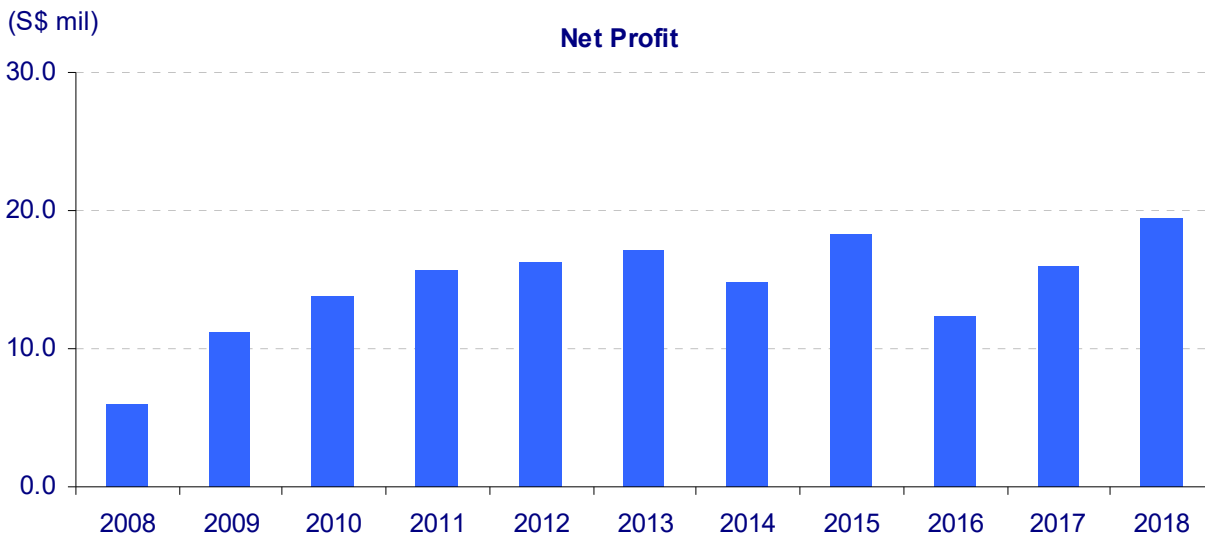
Cash-rich IT retailer with 105% upside potential, offer price of S\$0.56 is too low

- Challenger is the no.1 consumer IT retailer in Singapore with 38 stores
- Loyal customer base with half a million in-house Valueclub members who pay up to S\$28 for a 28 month membership
- Hachi.tech will be an important future growth engine
- No formal dividend policy and too much cash on balance sheet
- Net cash is S\$ 63m, 33% of market cap, S\$ 0.183 per share

Challenger has superior fundamentals as an IT retailer with steady revenue stream, a cash-term business and no debt. In a challenging market and despite a shift to online purchasing, Challenger has managed to maintain strong sales and profitability, largely because of its large membership base which accounts for approximately 10% of Singapore's population.



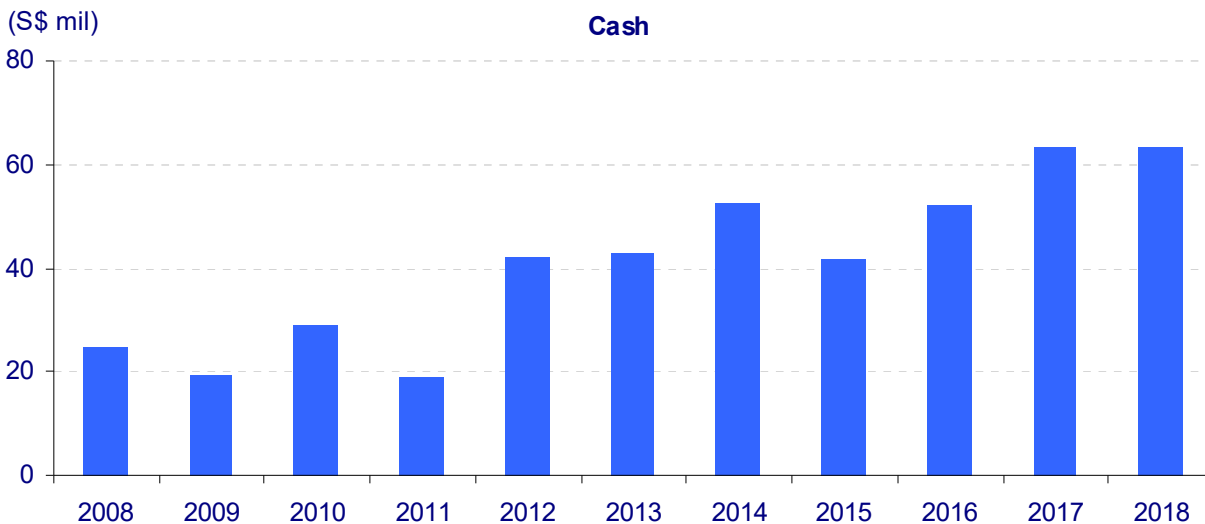
Source: Pangolin Investment Management



Source: Pangolin Investment Management

Challenger has too much cash on the balance sheet. As noted in the circular, Challenger has not carried out any exercise to raise cash funding on the SGX-ST since 2007 and is unlikely to require access to Singapore capital markets to finance its operations in the foreseeable future.

But this is a meaningless statement and no excuse for delisting. There are plenty of cash-rich listed companies which remain attractive to investors. Don't let the wool be pulled over your eyes by this statement.



Source: Pangolin Investment Management



The Offer

The founder Mr Loo and Dymon Asia (a private equity company), via Digileap Capital are attempting to buy the shares they don't currently own at S\$0.56 a share. They know the company is worth much more than this but are gambling on the minorities being happy to sell on the cheap rather than holding out for a better offer.

Those of you who have attended past AGMs will know that we at Pangolin Investment Management have been frustrated by Challenger's balance sheet management for a while – arguing that if excess cash were to be returned to shareholders then the share price would appreciate. We even prepared a presentation for the management explaining how to do this.

It looks like they have taken our advice on board and agreed with our valuation. However, instead of taking the recommended measures, the company is retaining the cash and paying out a smaller dividend than it did the year before; in fact the payout ratio has fallen to 55% from 70.2% in 2017.

Why would they do this? In order to make the shares less attractive to minorities of course. This cash belongs to all shareholders equally, not just to Mr Loo and his associates. Please bear in mind that the offer is 54c + the 2c dividend, not 56c.

At S\$0.56/sh, total settlement works out to be S\$193.3m. However, Mr Loo & family who collectively holds 54.58% will not receive any cash payment as their settlement will be treated as Related Party Loan to Digileap. Mr Loo only needs to pay the remaining 45.42% stakeholders with S\$87.8m. As at 31 Dec 2018, net cash balance was S\$63.2m. Essentially, he needs to fork out merely S\$24.6m to take the whole company private. For minority shareholders, the exit means losing the opportunity of dividend income and investing in a well-managed company with high profitability return of 93.8% ROIC.

Digileap Capital is behaving logically in trying to acquire an asset at well below its true value. That is what we, Pangolin Investment Management, as fund managers try to do all the time. However, the buyout price is derisory and shareholders must reject it.

Challenger should be valued at a higher price

Challenger should be valued by its cash flow to shareholders. Evidence shows that companies are rated by cash returns. Investors want balance sheet and operational efficiencies. This is why MNCs are valued at very high P/E (>20x).

Company	Market cap (USD m)	P/E (x)	ROE	Dividend payout
SATS Ltd	4,263	21.8	16%	78%
Vicom Ltd	423	16.5	23%	100%
Nestle Malaysia	8,530	53.0	102%	100%
Unilever Indonesia	26,200	41.0	143%	100%
Challenger Tech	130	9.1	23%	55%

Source: Pangolin Investment Management

If Challenger treats its minorities fairly by increasing the dividend payout, its share price should increase by 83% to S\$1.025.

We estimate the company requires no more than S\$20m in cash for working capital. Therefore, the company should return excess cash of S\$43m (or 12.5 cents/share) as a special dividend to shareholders. This will provide an additional return of 22.3%.

We can be pretty sure that the advice Dymon Asia is giving to Mr Loo is not far away from what we are recommending above. The question is whether the value of this company is extracted while it is still publicly listed, or afterwards.



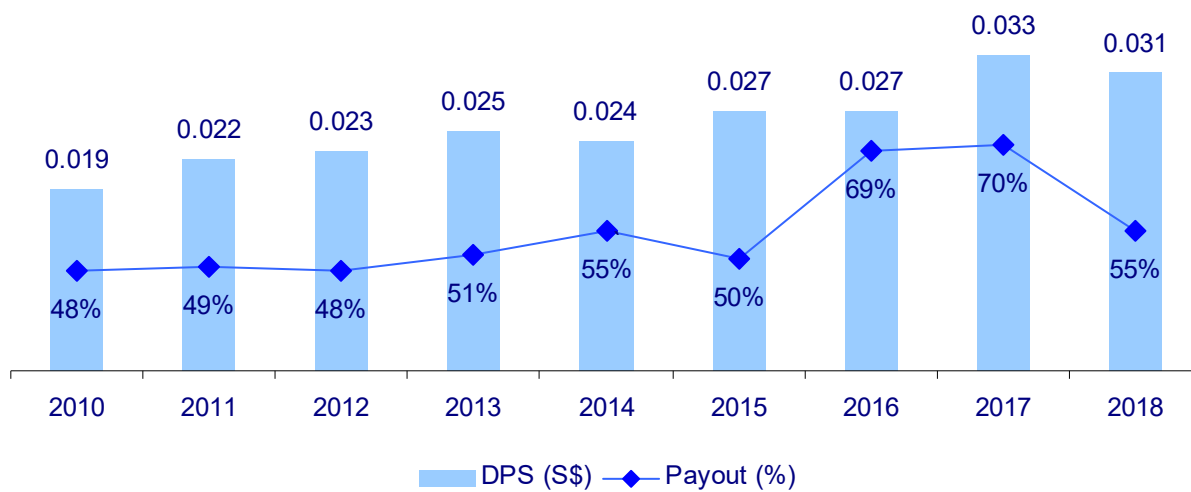
Increase dividend payout

The Dividend payout has been around 50% for many years. Excess cash is not paid out despite low capital expenditure requirement.

Challenger can afford a dividend payout ratio of 100% as not much capital expenditure is needed in the near future. Once earnings are all paid out as dividend, the dividend yield will rise to +10%.

The share price will naturally react to a higher payout as cash will be returned to shareholders on a consistent basis. **We estimate that the share price should increase by 83% from current price of S\$0.56 to S\$1.025** as the dividend yield will normalise to 5.5%.

Dividend History



Source: Pangolin Investment Management

Too much cash

Challenger holds an excessive amount of net cash which has been largely under-utilized and sits in the bank earning miniscule interest (1-2%). All cash that the company doesn't require i.e. everything in excess of working capital requirement plus an emergency fund, should be paid to shareholders by way of a dividend.

As of 31 Dec 18, Challenger has net cash of S\$63m. The company should set aside S\$20m for rainy day fund or working capital and the rest of the cash i.e. S\$43m or 12.5 cents/share, to be paid out as special dividend.

Here is how we do our calculations:

Offer price (S\$)	0.56
Offer PE (x)	9.9
2018 EPS (S cent)	5.64
2018 DPS (S cent)	3.10
2018 Dividend yield (%)	5.5
2018 Dividend payout (%)	55.0

Increase payout to 100% of net profit

At 100% payout ratio, DPS (S cent)	5.64
Dividend yield (%)	= DPS / Share price
	= 5.64 / 0.56
	= 10.1%



Here is how we do our calculations: (continue)

Fair value should be = (5.64/100) / 0.055
= **S\$1.025**

At S\$1.025, PE will be rated to (1.025 / 0.0564) = **18.2x**

Share price upside potential = [(1.025 / 0.56) - 1] x 100 = **83%**

Paying excess cash

Net cash at 31 Dec 2018 (S\$m)	63
Minus Rainy day fund / working capital (S\$m)	20
Excess cash (S\$m)	43
Issued & outstanding shares (m)	345.2
Excess cash/share (S cent)	12.5
Additional dividend return	= (12.5/100) / 0.56 x 100 = 22.3%

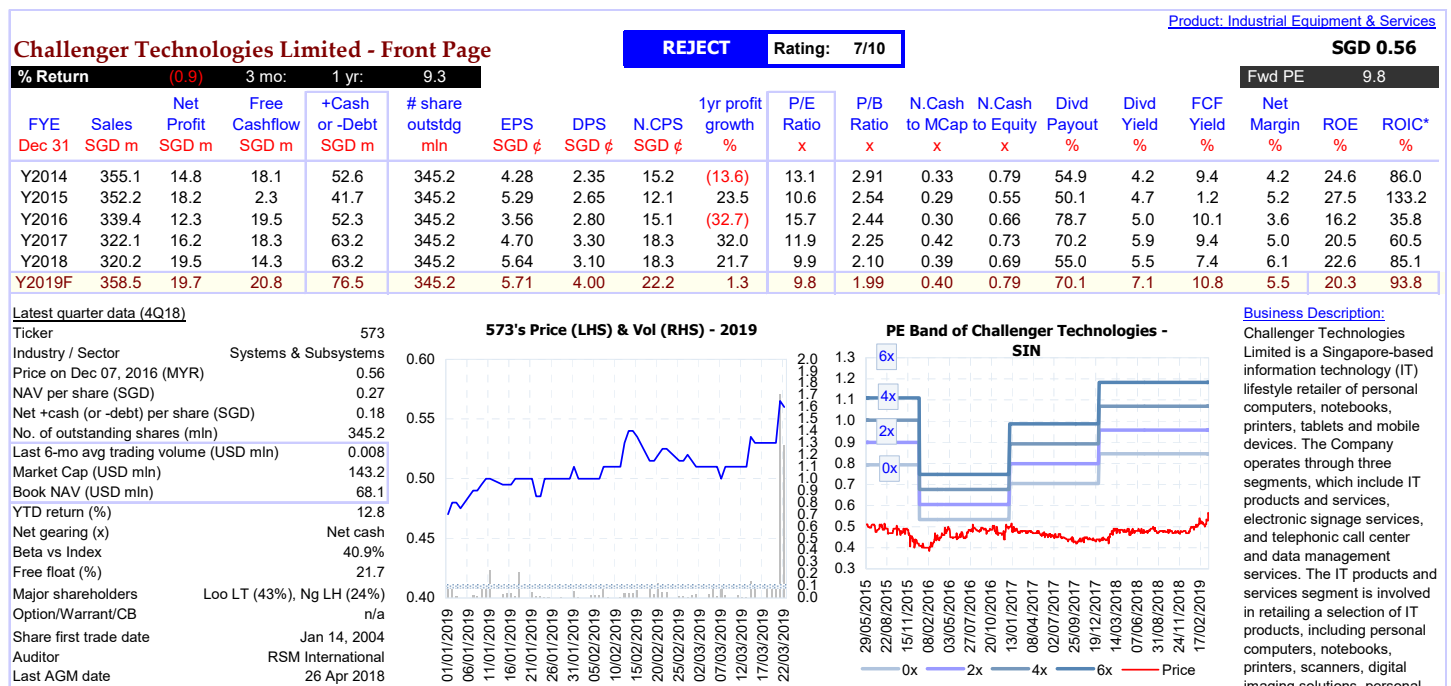
At S\$1.025, yield is still 5.5%. This will be a regular income stream conservatively assuming no profit growth. Market will easily pay that.

Conclusion

Offer price of S\$0.56 is way too low.

We reckon the fair value of the shares to be at least **S\$1.025** based on recurring dividend returns every year plus an additional one-off return of **12.5c** if Challenger pays out its excess balance sheet cash via a special dividend. **We strongly advise shareholders to reject this derisory offer during the upcoming EGM.**

Please note our valuation report below and that the RETURN ON INVESTED CAPITAL (ROIC) is in excess of 90%.





*We would ask like-minded shareholders to get in touch with us by clicking the **CONTACT US** tab on our website at www.pangolinfund.com so we can coordinate our response.*

We have also voiced out our view on the Business Times and The Edge Singapore. Here are the links to the articles for your reference:

<https://www.theedgesingapore.com/challenger-294-shareholder-says-offer-price-too-low-calls-higher-dividend-payouts>

<https://www.businesstimes.com.sg/companies-markets/pangolin-investment-says-exit-offer-for-challenger-is-too-low>