STOCK MARKETS
Waiting to Exhale

K.L.'s Second Board may be due for a blow-up

By Steven K.C. Poh / Kuala Lumpur

HERE'S ONE VOICE OF reason in Kuala Lumpur's craze over small second-liners. "People are putting unrealistic values on these companies," warns a local investment banker. "At current levels, anything above $4 on the Second Board of the Kuala Lumpur Stock Exchange would be considered expensive. If you hold stocks at these prices, sell." Is anyone listening? Many cashed in their chips last week -- but buyers were still out in force. On April 26, the KLSE's small companies index hovered around 491 points, 3% shy of the record 507 points set April 15 and 54% higher than the Jan. 3 figure. A third of the Second Board's 175 counters were trading at $4 or more.

Some had gone sky-high. PWE Industries, a maker of electrical wiring, closed at $37.10 -- from just $6.15 on Jan. 3. Its price/earnings multiple: 424 times forecast 1996 profits. That's nothing compared with Poly Glass's p/e of 985 -- and Carpets International's 1,440. "Prices have gone to dangerous levels," says Vasu Menon of Singapore's Keppel Securities. "The Second Board is definitely not for the faint-hearted." How long can the brave make money? "It's possible for the Second Board index to achieve a 150% growth from its low of 223 points in 1995," says Patrick Lim, president of the Malaysian Investors' Association. That means 557 points, 13% higher than the April 26 index.

But fund manager Tan Chong Koay has had enough. He is no longer buying because "it's very difficult to find undervalued stocks." In March, he trimmed $6-million worth of shares in his $85-million Malaysian Emerging Companies Growth Fund, which has outperformed the Kuala Lumpur index by more than 38% since Tan formed the company in 1994. "The KLSE has become a two-tier market, with the smaller capitalized stocks at an all-time high while the composite index is still 12.5% off its 1994 peak," he says. One sign of the craziness: Second Board counters, which have a combined market capitalization of $16.6 billion, less than 6% of the entire stock exchange, trade on some days more heavily than the big boys.

The speculation-led frenzy started late last year. Repco Holdings, a timber, gambling and auto-parts firm capitalized at just $2.6 million, saw its share price start rising in December -- for no apparent reason. The stock scaled new heights: from a low of $1.74 on Jan. 24, 1995, it closed at $35.20 on Jan. 7, 1996. "There are no new material developments or other conditions affecting the company's business that might account for such interest," Repco repeatedly told the exchange. Trading was suspended several times, but the stock remained buoyant -- despite posting a loss of $320,000 on turnover of $9.6 million in 1995. It closed at $31.70 before the company requested that trading of its shares be suspended from April 17.

"If there are rumors and prices shoot up, it's like a self-fulfilling prophecy," says Franklin Tan of Arab-Malaysian Securities. The talk about Repco was that it would win a new gambling license, which never happened. Rumors about a tie-up with the Malaysian national rice agency Bernas fueled speculation in Super Enterprise Holdings, a product-packaging group capitalized at $10 million. Selling at less than $4, the stock price soared to $14 in March. On April 2, the KLSE restricted trading in Super Enterprise, requiring among other things that purchasers pay for the shares immediately. The counter may start climbing again from last week's $11.20 on expectations that MP Salamon Selamat, a former political secretary of Deputy Prime Minister Anwar Ibrahim, will head the company.

Takeover rumors are keeping the momentum going. In January, the Securities Commission doubled the minimum paid-up capital for companies listing on the Main Board to $16 million and those on the Second Board to $4 million. "Second Board companies are attractive targets given their small market capitalization, share market float, low gearing and simple structures," says Merilly Chiam of Singapore's Nomura Research Institute. But only three takeover proposals have actually been made so far, of which one has been approved. The Securities Commission tightened takeover rules in 1993 and 1994, limiting approvals only to rescues of ailing companies, privatizations and deals considered in the national interest.

Malaysia's remisier system is also seen as contributing to the frenzy. Stock brokerages have networks of associates called remisiers who focus on retail investors. While they are credited with helping educate Malaysians in stock investing, these dealers are also said to encourage their clients to constantly buy and sell shares since they are paid solely on commission. Remisiers deny pushing short-term trading, but they are among the beneficiaries of the Second Board boom. "At the moment, it's buy on rumors and sell on facts," says Richard Khoo, president of the Remisiers Association of Malaysia. "If you don't have the facts, you speculate. And the current market rampage is good for trading."

Is there a cartel that is pushing up prices? The authorities have found no evidence of one. Munir Majid, chairman of the Securities Commission, regards the bull run with equanimity: "There's speculation in the market and it gives spice." The prevailing attitude seems to be, "let the punter beware." In any case, says investors' association president Lim, "the law of supply and demand is more important than corporate fundamentals" when trading in the Second Board. "In most of the floatations, the offer of shares for public subscription per company is approximately 3 million or less," which explains why price movements can be very volatile.

A new factor: international players are starting to buy second-liners so as not to underperform the KLSE index. Lim sees other motives: "It has been a global trend for the past few years for fund managers to invest in smaller capitalized companies. Small is beautiful and big is not always better." The Second Board was formed in 1988 to help companies grow and eventually join the Main Board, with all the prestige and capital-expansion possibilities the "graduation" would bring. So far, six second-liners have moved on, including industrial products maker Lim Kim Hai Holdings and trading company Corrugated Carton. The worry is that the process may slow if the current Second Board boom suddenly collapses and scares away investors.

Expectations of a blow-up is one reason why fund managers like Tan are cautious. "If you know how to pick small companies, you'll make a lot of money," he says. "But the key is to buy them when their prices are low. When one considers the market to be in an overbought position, one should be selling. But why has this not happened? Share prices have gone to abnormal heights because everyone wants the same stocks." The fever shows no signs of abating. Last week, shipper Global Carriers listed on the Second Board -- and punters chased the initial price up 205% by the close of the first day. Some painful lessons may be learned when the bubble bursts, as has happened in Taiwan and Japan. Until the next speculative binge.