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Appendix 13.1: Do the regulators understand risk?

The financial statements of various Sharemax syndications for 2006 and 2007 gave away a few ‘secrets’ and highlighted harsh realities the company wished to hide from the High Court in April 2008. At that stage Sharemax had refused to make available financial statements of syndication companies even when requested to do so during discovery proceedings.

MD Willie Botha explained the rationale: “The plaintiff (Sharemax) is not at liberty to simply make available to the defendant (yours truly) those companies’ financial statements. The defendant should, strictly speaking, be knocking at the door of those companies by way of a subpoena *duces tecum.”*

Johan Cronjé, candidate attorney of Thys Cronjé Inc duly handed Coenie Willemse, Sharemax’s attorney, a subpoena on the first day of what was supposed to be the trial. Sharemax refused to comply and launched an application to set aside the subpoena. Among others Botha proclaimed:

> “I am convinced that the reason why the Respondent is now seeking the production of the financial statements of the companies referred to, is exactly the same. It is not because he truly believes such financial statements to be relevant to the issues in the Applicant/Plaintiff’s action. His sole motive for requiring the production of these financial statements, I verily believe, is to

> obtain additional material as a basis for the publication of further information about the applicant/plaintiff. I therefore submit the respondent, by serving the subpoena, acted with an ulterior motive and not with the purpose of furthering his cause in the pending litigation with the applicant/plaintiff."[1]

I replied:

> "I will demonstrate, during trial, that the witness's answer to the subpoena *duces tucem,* and the Plaintiff's general conduct in this trial is one of non-disclosure, which was exactly my complaints in relation to the business activities of the Plaintiff in the articles complained of." [2]

As we now know the trial didn't go ahead. In his reply to me Botha stated that my assertion that Sharemax's business activities are one of "non-disclosure" was a "cheap shot".[3]

What Botha conveniently forgot is that financial statements of public companies are public documents.[4] Both in and outside court processes he had refused open access. Open access means that the motives for asking for these financial statements are irrelevant.

The fact is that regulators underestimate the value of disclosure. They (in particular Cipro) should actually encourage and make it easy for the public to vigorously seek access to public disclosures and to consult their professional advisors about them. They may very well be surprised at how positive an impact it would have on their task as regulators.

As a matter of course Cipro should, on receipt, make financial statements of controversial public companies available to the FSB, the Consumer Affairs Committee and to the Registrar of Banks.

Sharemax as promoter, is a private company and has to file financial statements with the FSB in terms of section 19 of the FAIS Act. Given the substantive interplay between Sharemax and dozens of syndication companies,

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[1] Transvaal Provincial Division of the High Court. *Sharemax Investments vs Deon Basson* Case number 2492/2006. *Application to set aside subpoena decus tecum.* Founding affidavit by Willie Botha, par. 20

[2] Case number 2492/2006. Answering affidavit by Deon Basson, par. 7

[3] Ibid. Replying affidavit by Willie Botha, par. 11

[4] See chapter 7

consolidated financial statements for the group, as propagated by André Prakke[5], is not such a far-fetched idea.
With reference to Waterglen Shopping Centre, Prakke points out that it is a stated condition in the prospectus that Sharemax will at all times have three directors on the board of all these entities, for a minimum period of five years.
He argues that the Companies Act specifies that where a company controls the decision-making of another company, such results of those companies have to be consolidated into the other company. The other basis where consolidation has to take place is where a company owns more than 51% of the shares in a company.
Should a company wish not to consolidate the results of its subsidiaries over which it has control permission can be sought from the Registrar of Companies. Sharemax did not seek such permission.[6]
By only perusing the financial statements of Sharemax the FSB or the Consumer Affairs Committee would not have the faintest idea of the risk profile of its activities. Likewise, the FSB would not be in any position to determine whether Sharemax's FSP license should remain current or not.
Only after I'd received the financial statements of certain Sharemax syndications was it possible to lift the lid on the financial performance of at least a part of the group that had made investors believe they'd been led down the garden path into a financial Canaan. What is fiction and what is reality?
One of the sales pitches was, and still is, the much acclaimed sale of properties. Here the propaganda mill worked overtime and Botha added much spice to this by referring to Sharemax as a "highly successful business" in court papers.[7]

[5]Transvaal Provincial Division of the High Court. *Sharemax Investments (Pty) Ltd vs Deon Basson.* Case number 3208/2006. *Forensic Accountants report.* Prepared by AE Prakke B.Com CA (SA), par. 17.3.4. Paginated papers, pp. 1149 & 1150
[6] Ibid
[7] Case number 2492/2006. Founding affidavit by Willie Botha, par. 13

"Highly successful" may of course mean "highly successful" for Sharemax and its directors who became immensely wealthy as a result of their property syndication model.
How then do Sharemax and its directors make their money? Quite simple. The major revenue source for Sharemax was and still is promotion fees. It is a cleverly worked out scheme where the promotion fees are normally styled as profits that accrue with the sale of shell companies with no assets (and which are worth nothing) to the public companies.
The public invests in a public company (in earlier times it was in an investment trust). The sale transaction of the shell company is funded with money raised from investors who acquired debentures in the public company. On average roughly 20-25% of the funds raised from the public company are skillfully and early-on moved to Sharemax by way of selling shelf companies to the various public companies.
This early application of funds has been severely criticized by André Prakke:

> "Partial withdrawals of funds will take place within 7 days of receipt of the funds from an applicant subscribing to the issue of shares. This means that allotment has taken place ahead of the completion of the prospectus and the acquisition of the shares of the subsidiary to acquire the property of the company was completed. The acquisition of the shares from the promoter has taken place, but the property has not been acquired and transferred into the company. This is a material condition of the Prospectus to acquire the property first, and contravention of a material contract and condition of the Prospectus registered with the Registrar. This is an offence in terms of the Companies Act. The Harmful Business Practices Act completely prohibits this kind of withdrawal in Section 2(b) of Annexure A to this Act. This paragraph actually states that funds may only be withdrawn in the event of transfer and registration. No exceptions are allowed."[8]

The trust era and secret profits

In the first phase of this process covering the period 1999-2003 an entity known as Sharemax Investments CC acted as the promoter and seller of private shell companies to 13

[8] Case number 3208/2006. *Forensic Accountants report.* Prepared by AE Prakke B.Com CA (SA), par. 15.5. Paginated papers, p. 1109

investment trusts. In doing so the CC earned promotion fees (styled as profits from sale transactions) of R105,7m without disclosing it to investors in marketing brochures.

The remainder of the funds raised by the trusts was transferred through loans to the private companies which then bought the respective properties.

Table 13.1: Sharemax Investments CC's 14 unlawful syndications [9]

Public Company/Trust	Syndication value of property	Purchase value of property	Promotion fee to Sharemax
Sold			
Centurion Office Park	9,5	6,1	3,4
Centurion Homefront	7,5	4,9	2,6
Centurion Highveld Park	29,1	21,0	8,1
Clubview Corner	28,0	18,2	9,8
Tygervallei Omniplace	21,6	16,5	5,1
Glen Gables	41,3	28,0	13,3
Groenkloof Plaza	35,9	25,0	10,9
Riebeeckshof	35,9	27,0	8,9
St Georges Square	63,1	50,0	13,1
Olive Wood	21,6	16,7	4,9
The Bluff	74,5	57,4	17,1
Subtotal	**368,0**	**270,8**	**97,2**
Not sold			
148 Leeuwpoort Street	9,7	9,7	Nil
Centurion Hazel	6,1	4,7	1,4
Oxford Gate	28,0	20,9	7,1
Subtotal	**43,8**	**35,3**	**8,5**
Grandtotal	**411,8**	**306,1**	**105,7**

At the outset Sharemax Investments CC had three members in Willie Botha, Stefan Schoeman and André Brand. Sharemax Investments CC paid commissions to brokers which, according to one well-placed source, had initially been as high as 11%.[10]

In the absence of detailed disclosures covering this aspect let's assume the average commission level was then 9% of syndication value, and other expenses 2%. That would have

[9] Various financial statements

[10] Letter from Kiep van der Westhuizen, former MD of Hamiltons Solutions to Willie Botha, MD of Sharemax Investments, 19 June 2003. See chapter 6, appendix 6.1

left Sharemax Investments CC with earnings of around R60m for the period 1999-2003. Much more lucrative profits would follow later, an issue to which I will return.
The three founder members of the CC in all likelihood became multi-millionaires with these undeclared, secret profits.
There is no indication as to what happened to the retained profits of Sharemax Investments CC before it was quietly put into voluntary liquidation in 2005. Sharemax Investments CC took secret profits[11] and the pro forma balance sheets in marketing brochures were fraudulent as they created the impression that all funds raised would be invested in property.[12]
The Bluff in Durban, the last syndication under the unlawful trust scheme, was a partial exception as the cost factor was disclosed in the marketing brochure. Unfortunately the positive effect of this was to some extent neutralized by an incorrect and misleading balance sheet showing that all the funds raised were invested in the property.[13]
Hundreds or even thousands of investors in the 11 properties being sold had, according to Sharemax's version, a capital amount of R67,9m added to their investments after entrusting risk capital of R368m to the promoter (see table 13.2). They also earned interest but that would have been the case with an alternative investment vehicle too, and could have been achieved at a much lower level of risk. In contrast Sharemax Investments CC, the promoter, and brokers added R97,2m to their own kitty without risking any capital (see table 13.1).

[11] Case number 3208/2006. Answering affidavit by Deon Basson, par. 22. Paginated papers. p. 398
[12] Ibid
[13] Basson, Deon. *The wrong balance sheet.* Finance Week, 29 October 2003 www.deonbasson.co.za

Table 13.2: The trust days - investors came second to Sharemax and brokers

Public Company/Trust	Gross sale value	Net sale value [14]	Syndi-cation value	Profit for inves-tors
Sold				
Centurion Office Park	10,8	10,2	9,5	0,7
Centurion Homefront	9,8	8,3	7,5	0,8
Centurion Highveld Park	39,8	34,2	29,1	5,1
Clubview Corner*	33,8	30,4	28,0	2,4
Tygervallei Omniplace*	21,6	22,4	21,6	0,8
Glen Gables	59,0	49,1	41,3	7,8
Groenkloof Plaza	46,5	40,0	35,9	4,1
Riebeeckshof *	43,6	39,5	35,9	3,6
St Georges Square*	89.6	77,7	63,1	14,6
Olive Wood	32,5	27,0	21,6	5,4
The Bluff	113,0	97,1	74,5	22,6
Total	**500,00**	**435,9**	**368,0**	**67,9**

*Sold to SA Retail/ SA Corporate

Sharemax made much of the sale of 11 properties which had previously been syndicated through an illegal trust structure. The implied argument seemed to be that the profits on the sales made good all historic non-disclosures and the unlawfulness of the trust scheme.

In the final analysis the profits were not that great at all. But whenever the opportunity arose Sharemax boasted about the performance of The Bluff in Durban by adding up capital, profits and interest for the total investment period of 33 months, and expressing it as a percentage of the syndication value. Being a period of much more than a year the numbers appear to be impressive. To say the least, this methodology is strange and is meant to mislead the reader:

> …the Bluff in 36 months[other Sharemax sources say it was 33 months – Author's comment] was sold for 51,68% over the syndication value, giving investors a gross return (with the interest included)[is this comment yours or Botha's? If they are different sources, suggest you use 2 styles of brackets to avoid confusion] of 82,42% in 36 months."[15]

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[14] Sharemax Investments (Pty) Ltd. Consolidated information on the buildings that were sold, as well as for those that are in the process of being sold as at 31 January 2007 http://www.sharemax.co.za/Portals/0/docs/Sharemax%20CV.pdf retrieved on 20 July 2008

[15] Case number 3208/2006. Second founding affidavit by Willie Botha, par. 49

The normal practice is to calculate annualized returns including interest and capital gains or losses. Sharemax's skimpy disclosure and interest subsidization makes it impossible to do such calculations. For that reason it is necessary to give them the benefit of the doubt and to copy their methodology in some way.

Add that questionable practice to uncertainty and further poor disclosure as to when investors in The Bluff and the other public companies got their money back, and the return on these investments is indeed poor. A Sharemax newsletter issued almost two years after the first property sales casts doubt as to how much investors have actually received to date and how much and when their final payments from the various companies will be:

> "Five properties were sold in 2006, namely, Centurion Highveld, Centurion Home Front, Glen Gables, The Bluff and Groenkloof Plaza. The final statements and tax returns were already provided to SARS in 2007. The SARS has only finalized The Bluff's audit at this stage. They were satisfied with the input VAT and the output VAT as well as with the tax matters of the company since its incorporation in 2003. The final tax report was issued on 31 March 2008 but the small refund has still not been received and the final dividend can therefore not be calculated and paid.
>
> "The SARS has indicated that they will now proceed with the auditing of Glen Gables' and Home Front's financial statements. Thereafter, it will be the turn of Centurion Highveld and Groenkloof Plaza. There is no date that we can promise when the SARS will be finished with these tasks.
>
> "In the meantime, a tax risk committee has been established, where the SARS has a representative, and met with Sharemax and the auditors, ACT Solutions, on a monthly basis to monitor progress. This committee has met a number of times and is performing their task in all earnest." [16]

Strangely, The Bluff Holdings[17] and its wholly-owned subsidiary The Bluff Investments[18] (previous owner of The Bluff) were voluntarily liquidated on respectively 3 and 2 November 2006. Returns submitted by the liquidators to the Master of the High Court show that the two companies had

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[16] Sharemax newsletter, 15 May 2008 http://www.sharemax.co.za/Portals/0/docs/Newsletter%2015%20May%202008.doc retrieved on 20 July 2008

[17] http://www.cipro.co.za/ccc/EntDet.asp?T1=M2003032001&T2=THE%20BLUFF%20HOLDINGS&T3=2003/032001/06

[18] http://www.cipro.co.za/ccc/EntDet.asp?T1=M2003011153&T2=THE%20BLUFF%20INVESTMENTS&T3=2003/011153/07

no assets or liabilities on liquidation, implying that all creditors had been settled prior to liquidation.
In that context it was revealing and surprising to read in the newsletter that the company's affairs with SARS had still not been finalized more than 18 months after the liquidation. Just as interesting are the financial statements of The Bluff for the year to February 2006. The underlying property was valued by the directors at R113m "based on the price a willing knowledgeable buyer (Ndawonye Props CC) is prepared to pay at an arm's length transaction."[19]
The financial statements were signed off about a month after the transaction was approved by shareholders, but the transfer of the property had not been concluded by then. The balance sheet showed:

Extract from The Bluff's balance sheet

Outstanding debentures	R74,4m
Equity	R30-,9m
Total	**R105,3m**

In theory the amount of R105,3m is what investors should receive. In fact, it is more than the net sale value of R97,1m reflected in table 13.2. Apart from the overstatement of the amount that investors could expect, the financial statements contain no substantive information about the upcoming wind-down of the company. No related party transactions were declared.
It is strange because it is a known fact that Willie Botha has an interest in a private company known as Intrax Investments 233. Intrax Investments 233 benefited by way of commission in various Sharemax sale transactions.
No financial statements for The Bluff for 2007 were filed with Cipro but on 28 March 2008 Sharemax witness Prof. Heinrich Regenass filed an expert summary including a summarized balance sheet and income statement for The Bluff for 2007.[20] It is hard to believe that he could have drawn up

[19] The Bluff, financial statements, 2006, p. 17
[20] Case number 2492/2006. *Expert summary: Rule 36 (9)(b) – Heinrich Wilhelm Regenass*

such a balance sheet without access to audited financial statements.

As assets the balance sheet reflects debtors of R1,7m and cash of R6,4m. The balance sheet further reflects unidentified current liabilities of R5m leaving a net asset value of R3,1m. It further shows that debentures of R74,4m had been repaid and the income statement shows that dividends of R18,6m had been paid to shareholders.[21] Adding the debentures redeemed to the dividend gives a net sale value of R93m which is again different from the numbers earlier presented by Sharemax. I must add that it is possible that the current liabilities may in fact be debentures which were reclassified and which will push up the net sale value to R98m.

The summarized income statement does not help at all to clarify the mystery of the cost factors which reduced the gross sale value of R113m to a net sale value of R97,1m. And how in fact could the company possibly still have a balance sheet with assets and liabilities on 29 February 2008 if it was put into voluntary liquidation on 3 November 2006 without any assets or liabilities?

Ominously, a dark cloud hangs over the sale transactions. Nevertheless, let's give The Bluff, as a 'star performer' in the Sharemax portfolio, the benefit of the doubt and assume shareholders have been paid in full (see table 13.2), and compare it with a selection of listed companies.

[21] Ibid, exhibit C

Table 13.3: The Bluff a flagship but a relative loser [22]

Period of two years five months	Selling price (c)	Current yield (%)	Purchase price (c)	Yield on purchase price	Current interest payment as % of purchase price	Gross capital uplift (%)
1. Premium	1 025	5,9	320	10,2	18,9	220,3
2. Octodec	1 175	6,6	410	11,6	18,9	186,5
3. Hyprop	3 510	5,4	1 285	10,2	14,5	173,2
4. Apexhi B	1 585	8,1	694	15,5	18,4	128,4
5. Paraprop	720	7,5	325	21,4	16,6	121,5
6. Redefine	580	6,9	265	11,2	15,2	118,9
7. Acucap	2 735	6,1	1 262	11,1	13,1	116,7
8.Growthpoint	1 210	6,3	638	10,4	12,0	89,7
9. Atlas	1 700	6,3	910	10,0	11,8	86,8
10. Panprop	1 317	7,4	715	12,4	13,7	84,2
11. SA Retail	1 000	7,1	575	10,8	12,3	73,9
12. The Bluff	**R1 517**	**7,6**	**R1 000**	**10,0**	**12,5**	**51,7**

It's clear that The Bluff was outperformed by a mile by listed companies with much lower risk profiles. The lower risk stems from greater liquidity for investors in listed companies and from the diverse spread of properties being held in their portfolios.

The comparison looks even bleaker for Sharemax if the net sale value of R97,1m is taken into account. Then the capital uplift reduces to 30,5%. For investments in listed property the cost effect is likely to be much smaller because brokerage is minuscule in comparison to Sharemax's cost. That means the gap in performance will be even bigger than that reflected in table 13.3.

Together with the other properties that were sold by Sharemax at a later stage, various items such as cost of sales, trade creditors and provisions, provisions for administrative costs, redemption of Sharemax's loan accounts, provisions for capital gains tax and secondary tax on companies were cited as reasons for the difference between the gross and net sale values.[23]

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[22] Basson, Deon. *Sharemax fails the relative test* ITI News. The Blog was first published by Moneyweb in June 2006. http://www.itinews.co.za/content/media/companydocs/b1a334ad-9ac8-44ee-8488-cdba83bd02b9.pdf and retrieved on 18 July 2008. Based on JSE records, The Bluff's financial statements for 2005 and sale documentation related to The Bluff.

[23] Various newsletters to shareholders and debenture holders in companies who sold properties to SA Retail, 2 October 2006

From the information in table 13.2 it can be calculated that a disproportionate 41% of the gross sale value would have been absorbed by the cost items listed in the paragraph above. For all 11 properties sold and listed in table 13.2 the equivalent percentage is 48%.

There's another way to look at the transaction. Originally, according to Sharemax, The Bluff was acquired for R57,4m in November 2003. If that is taken as the base value the gross profit on the sale value of R113m was R55,6m. Of that only R22,6m (40%) purportedly went to investors. This goes a long way to explain why this type of syndication scheme, with their outrageous upfront cost structure, can hardly be competitive.

The only possible competitive feature is the fact that interest is paid monthly to investors instead of twice a year as is the case with listed property. The problem is that with many of these syndications a portion of the interest payment was, and continues to be subsidized by Sharemax.

If they are so uncompetitive in an unprecedented bull market, then the business rationale of these companies rests on extremely shaky foundations in a bear market.

Other public companies which were also voluntarily liquidated on 2 November 2006 were Centurion Highveld Park, Glen Gables, Centurion Homefront and Groenkloof Plaza. Their private, wholly-owned subsidiaries were liquidated a day earlier.

Its rather odd that six weeks later (on 14 December 2006) Groenkloof Plaza, Centurion Homefront and Glen Gables handed in applications to postpone the holding of their annual general meetings and the submission of their financial statements.[24] In all cases the reason cited for the required extension was the introduction of a new accounting package.

Cipro's records show that these three public companies and Centurion Highveld Park had filed financial statements in 2006 but Cipro didn't or couldn't make them available to me

[24] Form 17 Aplications for extension of time for Centurion Homefront, Groenkloof Plaza Holdings and Glen Gables Holdings, 14 December 2006.

when I requested them. The fact is, it is strange for companies without any assets or liabilities to be liquidated before a final settlement with SARS. It is even stranger for a liquidated company to ask for an extension to hold an AGM, particularly if the directors minute this intention after the voluntary liquidation, when they have lost control of the companies.
Another sticky issue related to The Bluff is that company documentation indicates that the property was originally acquired in 2003 for R57,4m. However the records of the deeds office show it was R50,5m.[25] There is no explanation in financial statements for the difference of R6,9m.[26]

Sale to SA Retail

The sale of ten properties to SA Retail/SA Corporate gives rise to further questions. Four of the properties were originally syndicated through the unlawful trust structure (see again table 13.2) and the other six later, through public companies (see table 13.4).

Table 13.4: Investors came second again

Public Company	Gross sale value	Net sale value[27]	Syndi-cation value	Profit for inves-tors
Sold				
Atterbury Decor	68,6	58,7	42,8	15,9
Comaro Crossing	181,2	157,1	145,5	11,6
Montana Crossing	197,0	158,0	133,2	24,8
Davenport Square	110,8	94,9	79,2	15,7
Northpark Mall	202,3	176,2	155,5	20,7
Midway Mews	75,0	67,9	64,3	3,6
Total	**834,9**	**712,8**	**620,5**	**92,3**

The six properties purportedly generated profits of R92,3m for investors who'd invested almost R835m (table 11.4) but

[25] www.legalcity.co.za
[26] The Bluff Holdings, financial statements, 2005 and 2006
[27] Sharemax Investments (Pty) Ltd. *Consolidated information on the buildings that were sold, as well as for those that are in the process of being sold as at 31 January 2007* **www.sharemax.co.za**

Sharemax, who'd invested nothing, earned promotion fees of R115,9m upfront (see **annexure 8**).

Once again one encounters problems trying to find a basis on which to compare the performance of the various Sharemax companies with listed property companies. All the information required to do an orthodox analysis was simply not disclosed by Sharemax.

Atterbury Décor is considered Sharemax's blue-eyed boy in this group of companies because the sale purportedly achieved gross capital growth of 60,2% in 33 months.[28] Whether 33 months was indeed the investment period is doubtful. The property was first registered in the name of C-Max Investments 302 on 19 December 2003 [29] and according to the financial statements of the holding company, C-Max Holdings resumed doing business during that month.

Adding 33 months to December 2003 takes us to August/September 2006. At that stage the sale agreements with SA Retail had been signed, but due diligence had not been completed. In fact, the property was only registered in the name of SA Retail on 24 May 2007.[30] The investment term was thus 41 months and not 33 months.

Then there is also uncertainty as to how much C-Max Holdings did in fact pay to investors as a dividend on ordinary shares and as redemption of debentures. The uncertainty has been given further impetus by the following excerpt from a Sharemax newsletter written by André Brand:

> "The financial statements for the properties that have a February 2008 year end are currently being prepared internally where after ACT Solutions must still audit it and the directors must finally approve it. The financial statements must then be submitted to the Registrar of Companies. These statements will reflect the sale transaction. After this has been done, then the financial statements and tax matters will be provided to the SARS (sic). Then we are in the SARS hands.
>
> "The properties that have a February 2008 year end are Van Riebeeckshof, St George's Square, Olive Wood, Comaro Crossing and Atterbury Décor.

[28] Ibid
[29] Sharemax Investments Income Plan Portfolio www.sharemax.co.za
[30] www.legalcity.co.za

> "The properties that have a June 2008 year end are Montana Crossing, Davenport Square, Northpark Mall, Midway Mews and Silverwater Crossing.
> "The properties that have an August 2008 year end are Centurion Office Park, Clubview and Tyger Valley Omniplace.
> "We must just remember that, although the properties have been sold, there are still many processes that must be finalized before the properties' final dividend can be declared, where after each company can be liquidated."[31]

The tone of Brand's newsletter is in contrast with the earlier optimism of the marketing documents, where investors had been bombarded with the good news of the property sales. Geld-Rapport, under the mask of credible editorial copy, was specifically targeted as a propaganda vehicle to spread the so-called good news.[32]

Given the uncertainty created by Brand's newsletter one should treat the net sale values of Sharemax properties with a degree of circumspection. Montana Crossing is a striking example. The balance sheet on 30 June 2007 shows the value of the underlying property as R159,8m and it is stated that it is based on a sale agreement.[33] We know that the sale value was R197m. Why was there no detailed disclosure of the cost factors, particularly any commission payable to Intrax Investments 233? Why was the related party disclosure requirement sidestepped?

Another example is Northpark Mall Holdings where the income statement for 2007 shows that historic guarantee payments of R4m had been repaid to Sharemax. That makes a mockery of the interest subsidies paid to syndication companies.[34]

Giving Sharemax the benefit of the doubt, this is how Atterbury Décor squared up against listed property:

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[31] Sharemax newsletter, 15 May 2008

[32] See chapter 15

[33] Financial statements, Montana Crossing Holdings, 2008, pp. 7 & 18

[34] Northpark Mall Holdings, financial statements, 2007, p. 24

Table 13.5: Atterbury Décor vs listed property [35]

Period of 41months: Dec' 2003 to May 2007	Selling price (c)	Sel-ling yield (%)	Purchase price (c)	Yield on purchase price	Closing interest payment as % of purchase price	Gross capital uplift (%)
1. Hyprop	4 642	5,2	1 332	10,0	18,2	250,0
2. Redefine	756	6,5	293	10,4	16,7	158,0
3. Growthpoint	1 523	6,0	593	11,3	15,4	156,8
4. Apex-Hi "B"	1 752	8,8	747	14,4	20,7	134,5
5. Panprop	1 632	6,9	742	12,1	15,2	114,2
6. Emira	1 079	7,6	524	11,2	15,6	105,9
7. SA Retail	1 141	7,7	561	11,3	15,7	103,4
8. Sycom	2 037	6,2	1 007	10,5	12,6	102,2
9. Apex-Hi "A"	1 400	9,0	843	12,1	15,0	66,5
10. Atterbury	**R1 602**	**7,1**	**R1 000**	**11,9**	**11,4**	**60,2**
11. SA Corp	374	7,7	236	10,3	12,3	58,4

Atterbury Décor and The Bluff were clearly the leaders in the Sharemax pack. They were also pushed to the fore by expert witness Prof. Heinrich Regenass.[36] Even so, they underperformed listed property. Seen in that light Prof. Regenass' conclusion is not surprising at all: "The cost of the acquisition should be benchmarked against other similar investments and not any other investments."[37]

In a bull market some investors will feel they have been short-changed if their investment doesn't perform well relative to alternatives. But many are unlikely to make a song and dance about it simply because they don't know about the relative poor performance. But in a bear market the queue at the FAIS Ombudsman will gradually grow as and when investors find out that profit performances and consequently property values didn't meet the expectations created by prospectuses and marketing talk. In a mad bull market, such as South Africa experienced between 2003 and 2007, profits and interest payments which under performed prospectus forecasts, could be hidden by lower yields and higher property values. The reality of a bear market will be quite different.

[35] Table 13.4. Catalyst Fund Managers. *Listed Property Sector Review.* December 2003 and May 2007. http://www.catalystfundmanagers.co.za/index.htm?1 retrieved on 26 July 2008

[36] Case number 2492/2006. *Expert summary: Rule 36 (9)(b) – Heinrich Wilhelm Regenass*

[37] Ibid

More wealth for Sharemax directors

Annexure 8 shows that Sharemax (Pty) Ltd earned promotion fees of R433,5m from so-called income products subsequent to the termination of the trust scheme in 2003. My estimate is that it earned further promotion fees of about R80m with the promotion of capital projects. In total we are talking about promotion fees of about R513m.

These promotion fees are in fact a once-off, but massive, redistribution of wealth from investors to Sharemax, its directors and brokers. The fact that it has been disclosed in prospectuses after the termination of the trust scheme doesn't change the reality of this redistribution.

Unlike the situation under the trust regime, expenses were disclosed in prospectuses and investors could see that they would pay a sizeable premium to net asset value in both bull and bear markets. It is however doubtful whether they were really able to take an informed decision because it has now been proven that profit forecasts were generally too optimistic and that this optimism was not possible to detect at an early stage, due to the non-disclosure of the information that is required in paragraph 6 (h) of the Third Schedule of the Companies Act.

Willie Botha told RSG Moneyweb in July 2006 that Sharemax properties, unlike listed property, were sold at net asset value. This is not true. They are always sold at a premium, stemming from the heavy upfront cost structure.

It's difficult to determine the expense levels of Sharemax itself. The reason for this is because some of the general expenses disclosed in prospectuses are clearly unrealistic and overstated, and are likely to rather add to Sharemax's bottom line. A small example is the allocation of R94 000 to "travel and accommodation" for Waterglen Shopping Centre.[38]

Marketing costs in prospectuses are generally stated as 10% of the syndication value. It is common cause that

[38] Basson, Deon. *Incredible property valuations.* Finweek, 14 December 2005. www.finweek.co.za

commission levels had in later years settled to around 6%. Could it be that the other 4% was spent on marketing? For instance, how much could the marketing flirtation, unprofessionally dressed up as so-called credible editorial material in Geld-Rapport, contribute to the cost of syndications?

For the sake of argument, let's assume the total cost (including commission to brokers) is 10% of syndication value. That will be about R300m which still leaves Sharemax with pre-tax profits of roughly R200m for the period from termination of the trust scheme in 2003 until mid-2008.

Now, the real question is: how much of these profits have been distributed by way of directors' fees and/or dividends to Botha and his co-directors? I guess that tax-efficiency largely determines in which way directors have taken their share of the lucrative spoils.

But, there is another, more important consideration. How much of the profits have been left behind in the company? It's important to know the extent of reserves that are available to support the various schemes, to subsidise and guarantee interest payments to investors in syndication companies. That is, of course, if one accepts that these guarantee payments are lawful. Nevertheless, one should consider what kind of reserves Sharemax Investments will require in future to meet its interest subsidy and guarantee commitments.

Interest earned vs interest paid

The message in the early marketing brochures and prospectuses issued during the period 1999-2005 was clear – interest payments to investors will be funded from profits generated by the underlying property assets. There was no indication that profits would be used to fund interest payments.

Let's be frank about it. Profits generally didn't usually match the optimistic forecasts. Why? It's actually very simple. If you raise R100m from the public and buy a property of R75m, and tell the public you'll pay a yield of 10%, then you need to generate a profit of R10m from a property which is at the outset only worth R75m. Your yield on R75m then has to be 13,3%, and you're unlikely to make it. To keep the scheme credible you then have to find a way to subsidise interest payments.

Annexure 9 shows how many of the properties that were sold didn't make profit forecasts. Consequently, in order to support the marketing promises, interest payments had to be subsidised. This trend has continued with the next generation of properties which have not yet been sold.

The subsidy game

So Sharemax flexed its balance sheet to make good the interest shortfall with unsecured, interest free loans and to guarantee payments. The practice was first revealed in December 2005[39] and regulators can hardly say that they didn't know about it.

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[39] Basson, Deon. *Pyramid accounting.* Finweek, 21 December 2008, p. 22

Table 13.6: Loans from Sharemax

Public Company	2005	2006	2007
Centurion Office Park Holdings			R92 974
Centurion Home Front Holdings	R149 493		
Centurion Highveld Park Holdings	R233 717		
Clubview Holdings	R442 583		R1m
Tyger Valley Omniplace Holdings	R167 222		
Oxford Gate Holdings	R188 134		
Glen Gables Holdings	R1,4m		
Van Riebeekshof Holdings	R158 000		R847
St Georges Square Holdings	R108 448	R162 754	R59 236
Olive Wood Holdings	R416 028		R75 992
The Bluff Holdings	R255 005	R779 244	
C-Max Holdings			
Comaro Crossing Holdings	R606 876		R26 619
Montana Crossing Holdings	R85 737	R981 422	
Davenport Square Holdings	R323 680		
Northpark Mall Holdings	R318 421	R259 000	R1,6m
Midway Mews Holdings	R363 280	R282 470	R1m
The Village Holdings	R139 067	R356 970	R306 130
Witbank Highveld Holdings			R62 362
Tarentaal Centre Holdings		R64 543	
Magalieskruin Holdings		R1 099	
Flora Centre Holdings		R144 000	R196 942
Silverwater Crossing Centre Holdings			R1,5m
Waterglen Shopping Centre Holdings		R27 000	R430 469
Carletonville Centre Holdings			R64 537
De Marionette Centre Holdings			R607 333
Canterbury Crossing Holdings			R565 220
Total	**R5,4m**	**R3,1m**	**R7,7m**

The practice is a far cry from non-cross subsidisation policy touted by Sharemax. No guarantee payments were envisaged in the earlier prospectuses, as interest payments to investors were to be funded from profits. The legal and accounting consequences of guarantee payments are a mystery as it is unclear from the financial statements whether agreements have been concluded between Sharemax and the various syndication companies. It is also unclear whether the guarantee payments should be regarded as gifts.[40]

[40] Case number 3208/2006. Deon Basson's answering affidavit, par. 34.2. Paginated papers, p. 417

Table 13.7: Propping up profits with guarantee payments

Public Company	2005	2006	2007
Centurion Office Park Holdings	R803 961	R708 150	
Centurion Hazel Holdings	R653 758	R849 559	
Centurion Home Front Holdings	R234 184		
Centurion Highveld Park Holdings	R1,6m		
Clubview Holdings	R1,5m	R2m	
Tyger Valley Omniplace Holdings	R1,1m	R2,1m	
Oxford Gate Holdings	R6 802	R505 139	
Glen Gables Holdings	R724 364		
Van Riebeekshof Holdings	R1,1m	R1,3m	R1,35m
St Georges Square Holdings	R277 621		R350 141
Olive Wood Holdings	R246 377	R556 967	R300 000
Comaro Crossing Holdings	R1,7m	R1,6m	R900 000
Montana Crossing Holdings		R165 019	
Davenport Square Holdings	R850 000		
Northpark Mall Holdings	R800 000	R3,2m	
Midway Mews Holdings		R725 745	
The Village Holdings		R343 505	
Witbank Highveld Holdings		R1,3m	R700 000
Flora Centre Holdings			R1,4m
Carletonville Centre Holdings			R300 000
Total	**R11,6m**	**R15,4m**	**R5,3m**

There is a further reason why regulators should have been sensitive to the practice of loans and subsidies. The Nel Commission highlighted it in relation to Masterbond, and in view of the commission's harsh comments it is strange that regulators have taken such a gentle approach to the matter. The Commission recorded:

> "The prospectus/information document estimated the prospective returns that would be earned by the investors. From 1987 to 1990 Masterprop ensured that the investors received earnings per unit which were close to the estimated returns by subventing rentals and subsidising expenses. If, on the other hand, an investment earned more than the promised return, Masterprop charged additional fees to recover the excess return so that shareholders received no more than they were promised initially…" [41]

I highlighted the practice again in June 2006 with a Blog on Moneyweb. The Blog was later re-published on ITI News (see **annexure 10**).[42] Yet, no regulator seemed to

[41] Nel, Mr Justice H.C, *The first report of the Commission of Inquiry into the Affairs of the Masterbond Group and investor protection in South Africa.* Vol. 4, pp. 756-757

[42] Basson, Deon. *Sharemax subsidies ring a bell.* ITI News, 13 April 2008. http://www.itinews.co.za/content/media/companydocs/25314694-4a50-4364-adee-b952a2c73fd0.pdf retrieved on 28 July 2008. See annexure 10 for the text of the Blog.

appreciate the similarity with Masterbond, and all have failed to act in any meaningful way.
Although the practice is, financially speaking, fairly limited, some syndication companies have funds on loan to Sharemax. This was nevertheless a significant step, giving Sharemax a "treasury" function in the group, and the ability and authority to move funds around a-la-Masterbond.

Table 13.7: Loans to Sharemax

Public Company	2005	2006	2007
Centurion Office Park Holdings			R103 304
C-Max Holdings	R139 487	R223 213	
Montana Crossing Holdings	R147 048	R22 867	
Northpark Mall Holdings		R1,2m	
Midway Mews Holdings		R150 000	
The Village Holdings		R311 000	
Tarentaal Centre Holdings			R52 080
Silverwater Crossing Centre Holdings		R1,1m	
Waterglen Shopping Centre Holdings		R325 228	R1m
Total	**R286 535**	**R3,4m**	**R1,2m**

Diverse expense levels

In view of the loans to and from Sharemax, the subsidies from Sharemax, the cross-directorships between Sharemax and the syndication companies, and a single accounting function for Sharemax and the syndication companies, it is prudent to consider the possibility that expense levels are used to manipulate the profitability of the various syndication companies in the same way the Nel Commission suggested Masterbond did.
It is a given that the expenses per square meter of different syndication companies will be different . By the same token, significant differences between companies or for the same company between financial years should be more closely scrutinized by regulators in view of the Masterbond experience. The expenses per square meter of the

syndication companies vary significantly and are summarized in **annexure 11.**

Cash flow shortfall funds

Another trick up Sharemax's sleeve to prop up interest payments is the creation of so-called cash flow shortfall funds. These funds are kept within the syndication companies and are funded upfront by investors as part of the syndication amount. It's a case of Paul's capital being used to pay Paul's interest.

It was introduced in 2005 with the syndication of Magalieskruin Holdings and is one of the reasons why guarantee payments declined in 2007 (see **table 13.7**). The other reason is that various syndications that required propping up had been sold in 2006 and 2007.

Prakke pointed out the following flaws related to cash flow shortfall funds:

> "This raising of an additional amount and investing it in the company by investors is in direct contravention of the conditions of the long term Insurance Act and relates to the principles and fundamentals in the Act governing 'sinking fund' policies. A further serious matter to be taken into account of is the fact that the promoters, Sharemax, after earning upfront R14 million will use this fund to pay back to investors the so-called equalizer on their loans for showing a greater than actual return on capital. This is insurance business. A further contravention is the acceptance of these funds not invested separately with any approved bank and this portion of the transaction is in contravention of the Banks Act. The prospectus also does not deal with the fact what interest investors will earn on this fund…. It amounts to more than 50 depositors depositing money in a company to be repaid back later and exceeding the amount of R500 000 to be paid back to the same depositors in various different installments, although each depositor might not receive the same portion back as what was paid in and deposited by the investor. "[43]

There are examples where syndication companies depleted cash flow shortfall funds much quicker than was envisaged in prospectuses. Waterglen Shopping Centre is a case in point as is clear from **annexure 12.**

[43] Case number 3208/2006. *Prakke report,* par. 15.14. & 17.2.7. Paginated papers, p. 1112 & 1146-1147

Profits and valuations

In view of the diverse expense levels, the profits and valuations of the various syndication companies should be treated with a degree of circumspection. Nevertheless, **annexure 13** is a summary of the profits achieved by the various syndication companies over a period of time, coupled with the balance sheet valuations of the underlying properties. In the case of properties being sold, the sale value in the particular year has been cited. The yields have been calculated based on the profits (which exclude guarantee payments) and the valuations. Generally speaking it is evident that yields came down significantly in 2007 as a result of the sale transactions. Valuations of properties not being sold were clearly influenced by the sale transactions.[44] Many of the high valuations are in response to inflated property prices, as was highlighted in the report by Prof. Tanya Woker in 2006.[45] Some of the low yields are actually similar to those achieved by high quality and high liquidity listed companies and would not be sustainable in a bear market.

How sustainable are high valuations?

Although property is by definition a growth asset it is not risk free and capital losses are possible if the investor overpaid in the first instance. Property investments are very much linked to economic and interest rate cycles. Unless a property is being sold the value of an unlisted property is only an issue once a year when the financial statements are drawn up. It is interesting to note how aggressively Sharemax followed the bull market trend with its valuations in 2007 balance sheets. Investors are unlikely to be aware of trends in the commercial property market, in which prices of listed property instrument have gone into steep

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[44] Refer to chapter 11 for an exposition of the sale transaction to SA Retail

[45] See chapter 12

decline since the end of last year. Yields increased and premiums to net asset value switched to discounts. It would be foolish to ignore these broader trends. The boards of the syndication companies and the valuers will have to come up with realistic valuations, and the auditors will have to satisfy themselves that the balance sheets of these companies are reasonable. At the very least one should, as a prelude, consider some broad parameters and scenarios.

Table 13.8: Bear market scenarios

Public Company	**FYE[i]**	**Debenture liability (Rm)**	**Valuation at 9% yield**	**Valuation at 11% yield**	**Valuation at 13% yield**
Properties not sold					
Centurion Hazel Holdings	08/06	6,1	3,3	2,7	2,3
Oxford Gate Holdings	08/06	28,0	35,5	29,1	24,6
The Village Holdings	06/07	29,4	27,8	22,7	19,2
Witbank Highveld Holdings	02/07	100,9	101,1	82,7	70,0
Tarentaal Centre Holdings	02/07	31,0	28,9	23,6	20,0
Magalieskruin Holdings	06/07	29,9	26,7	21,8	18,5
Flora Centre Holdings	02/07	118,5	92,2	75,4	63,8
Silverwater Crossing Centre Holdings	06/07	75,0	57,7	47,3	40,0
Waterglen Shopping Centre Holdings	06/07	80,0	61,1	50,0	42,3
Carletonville Centre Holdings*	02/07	38,4	36,7	30,0	25,4
De Marionette Centre Holdings*	08/07	86,0	83,3	68,2	57,7
Canterbury Crossing Holdings*	08/07	35,6	33,3	27,3	23,1
Athlone Park Shopping Centre*	08/07	93,7	95,5	78,2	66,2
Total		**753**	**683**	**559**	**473**
Deficit			**70**	**194**	**280**

It is debatable at what yield properties should be valued. One can argue that the transaction with SA Retail/SA Corporate made SA Corporate's units a benchmark for Sharemax's properties. During July 2008 SA Corporate traded at yields between 11,4% and 13,4% and at a discount to net asset value of between 30% and 42%. It's a sobering thought that should certainly be taken into account by Sharemax, its valuers and auditors. **Table 13.8** sets out three valuation scenarios for the portion of Sharemax's

portfolio which had not been sold, and for which financial statements up to 2007 (or at least 2006) are available.
For more conservative yields of 11% and 13% it is clear that the margin by which liabilities exceed assets is alarmingly high. The *de facto* insolvency of this part of the portfolio continues, and appears to have worsened in certain instances. This is of course partly brought about by the high upfront cost structure.
Waterglen Shopping Centre is a striking example where the purported value of the property at yields of 11% and 13% is even lower than what the property was bought for. It's completely fair for investors to ask that the reality be presented to them and that the valuers disclose their assumptions.

Table 13.8 only reflects one portion of the unsold properties. In addition, **annexure 8** reflects a portfolio of about R1,1bn for which financial statements had not been filed at the time of writing this book. These syndications took place between the first half of 2006 and July 2008 and cash flow shortfall funds featured strongly in prospectuses.
If one accepts the slogan often used by Sharemax that the property-owning companies controlled by Sharemax bought the properties as "willing, knowledgeable buyers in an arms length transaction", then let's assume those transactions took place at the time at a fair market value.
But since then property prices have gone into decline, which is likely to mean that the original deficit between liabilities and assets may very well now be bigger than when the properties were syndicated.
One must remember that many investors who participated in some of the later syndications actually reinvested the capital and profits from earlier syndications. In that sense they took a fresh step backwards as their capital was diluted a second time by the massive promotion fees earned upfront by Sharemax. The difference is that this time it is unlikely that an extreme bull market and an overly keen SA Retail will come to their rescue.

The story of Louise Kennedy

On a glorious Free State Spring day in October 2007 (the day when Free State retained the Currie Cup in a thrilling encounter against the Golden Lions), I met an Oxford Gate investor named Louise Kennedy in Bloemfontein. She'd reached the end of the road in her attempts to cash in her investment, and the attempts by the company to sell the property had also failed.

She handed me copies of documentation in her possession and we agreed that I would help her to draft a letter to the FAIS Ombudsman. Later we changed our stance and decided to write one final letter to Sharemax. At the time I was not actively practicing as a journalist, so I was free to help her with this. From a research viewpoint it was an interesting opportunity to gauge the inner workings of the Sharemax model on a micro-level.

Kennedy asked for R1 489,35 per unit and got it. It is important to remember that until very shortly before the letter was sent, she had been getting the cold shoulder from the company. Then the letter arrived. Although Willie Botha stated that he disagreed with her letter, he has not at any stage thereafter attempted to refute the contents of the letter. It's important to record that the transaction effectively valued Oxford Gate at a staggering R41,7m, and that shortly before this the company had failed to sell the underlying property for R31m. Who the "willing buyer" was who bought the shares in a "private transaction" remains a mystery, but director Gert Goosen was quite keen to swiftly settle the matter with Kennedy.

The ordeal for Mrs Kennedy was, for me, an excellent case study underlining many of the flaws in Sharemax's business and compliance model. **Annexure 14** contains Kennedy's letter, which I drafted.

The reality

In substance Sharemax is in all probability more akin to a money purchase scheme than to a property operation. Botha indirectly admitted it.[46] Investors are lured with interest rates higher than ruling rates in the money market. If the property operation can't produce the required returns interest rates are propped up. Regulators and legislators have ignored (and continue to ignore) the concerns of the Nel Commission in relation to property syndication schemes' lack of sufficient share capital.[47] By July 2008 the following forces were at work, forces which inevitably will influence property syndication companies:

- High interest rates which are slowing down economic activity and curbing property rentals. This puts pressure on profitability.
- Being money purchase schemes, a high interest rate cycle creates a situation where investors wish to benefit from such high rates. For some of the later phases of the Zambezi Retail Park project Sharemax offers a staggering 12% interest rate.
- Consequently, the gap between interest paid to investors and interest earned by properties will grow. For each percentage point gap the cost of subsidisation to Sharemax is roughly R25m. If the gap grows to (say) 4 percentage points the cost will be R100m.
- The public doesn't know how much reserve Sharemax really has. Retained earnings is likely to be substantially less than the figure of R200m mentioned earlier because directors probably took out a portion of their money as dividends and/or directors' fees.
- The joker in the pack is the mammoth R1,1bn Zambesi Retail Park development. Disclosure is a problem and it is virtually impossible to appraise the risk of the

[46] See chapter 6
[47] See chapter 3

scheme accurately. Various parties have expressed their concern about the project.[48] Lack of transparency about the property development is reminiscent of the failure of TEA in Australia in the 1980's.[49]

- Holistically the total scheme remains factually insolvent.
- The first meaningful financial disclosure about the Zambezi project is only likely to appear in 2009. Couple that with the rather opaque disclosure of existing development projects totalling R500m, and the expected strain on shopping centres as the interest rates bite the South African consumer, and it is clear that regulators are sitting on an armed time-bomb.

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[48] For an analysis see Avocado Investment Managers. *Analysis of Zambezi Retail Park.* ITI News, 5 December 2007. http://www.itinews.co.za/content/media/companydocs/4c942687-0689-4b55-ae07-f7bdf3c0016d.pdf and Wilson, Brent. *Material non-disclosure of the facts.* ITI News, 12 December 2007 http://www.itinews.co.za/newsletters/viewArcNews.aspx?nid=187

[49] See chapter 3 and Sykes, Trevor. *The Bold Riders – Behind Australia's Corporate Collapses.* Allen & Unwin. Sydney, 1994, pp. 48-51

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