

Topic 16 - How Lotte Chemical Titan's IPO uses Price Discovery Mechanism and Stabilising Mechanisms

By AER | Aug 1, 2017

Lotte Chemical Titan (“**LCT**”), an integrated olefin and polyolefin producer, was listed on 11 July 2017, is another major Initial Public Offer (“**IPO**”) for the year.

Based on the audited Financial Year Ended 31 December 2016 information, the Price Earning ratio is 11.4 times, and the Price per Book Value ratio is 1.3 times.

Valuation Metrics

	Initial Prospectus	New IPO Offering	Allotment Result
	16-Jun-17	3-Jul-17	4-Jul-17
Net Assets Per Share (RM)	5.56	5.01	5.03
Price Per Share (RM)	8.00	6.50	6.50
Price Per Net Assets Ratio (times)	1.4	1.3	1.3
Price-Earning Ratio (times)	15.0	11.4	11.4
Return On Equity (%)	10%	11%	11%
Market Capitalisation (RM bil)	20	15	15

Prepared by Asia Equity Research

After LCT reduced the final IPO price, the fundraise amount decrease from **RM 5.9 billion** to **RM3.8 billion**. One of the main purpose for the utilisation of the IPO proceeds is to set up an Integrated Petrochemical Facility, which increases the current existing plants' polyethylene annual production capacity from 450 thousand metric tonnes to one million metric tonnes.

The plant is expected to commence its commercial operation in 2023. Total estimated project cost is RM15billion, to be funded by RM2.8billion from the IPO, and the balance will be funded either by borrowing or internal generated fund.

It is interesting to note that LCT does not to list in Korea where the headquarter is located, nor in Indonesia where the plant is to be located but has chosen to list in Malaysia instead.

Besides normal fundraising and expending the business operation, the main subject of this IPO exercise, setting up of the Integrated Petrochemical Facility most likely will also benefit the Korean contractors.

In this article, I would like to write on something that seldom being mentioned, which is setting up the price of the IPO share **based on price discovery mechanism before the listing date**.

In some of the IPO, the market price per share offered is **already fixed and pre-determined**, without price discovery mechanism is used. That works well if it is for small scale IPO.

However, for larger scale IPO, if setting a relative high price per share may result under-subscription and could not achieve the target amount of fund to be raised. If setting a relative lower price per share may result in opportunity loss to the major shareholders.

Price discovery mechanism is normally used in institutional offering, as institutional offering represents large portion of the total offering. Like LCT,90% of the IPO is made up of institutional offering. Whereas Final Retail Price is **based on** the final institutional offering price or the proposed retail price, whichever is **lower**. In the case of LCT, the proposed initial retail price is RM8 per share.

Price discovery mechanism is conducted by **inviting** institutional investors to submit bidding, then based on the institutional investors' appetite, the final IPO share price or the **cut-off price** that is acceptable by most of the institutional investors and maximising the fund to be raised by the company is determined. This is also known as **book building process**, or the **primary market**.

Based on LCT's book building exercise, the final IPO price was set at **RM 6.50 per share**. After the listing, the share price shall then be determined by market participants, the buyers and sellers in the open market, which is also known as **secondary market**.

Samples of IPOs adopting price discovery mechanism			
IPO	Retail Price on Prospectus (RM/Share)	Final Retail Price (RM/Share)	Discounted Rate
Lotte Chemical Titan	8.00	6.50	18.8%
Felda Global Ventures	4.55	4.45	2.2%
IHH Healthcare	2.85	2.80	1.8%
AirAsia X	1.45	1.25	13.8%

Prepared by Asia Equity Research

In recent years, in addition to adopting the price discovery mechanism, many major IPOs in Malaysia had also employed **price stabilising mechanism**.

Like LCT's IPO, a Stabilising Manager was appointed, at its absolute discretion, over-allot LCT Shares, **which borrowed** from the major shareholder, to institutional investors. In short, Stabilising Manager has two choices within 30 days from IPO listing date, (i) **buying-back** the LCT shares from the **open market** in order to return it to the major shareholder, or (ii) repay **RM6.50 per share in cash**.

Which option will the Stabilising Manger take?

When post listing market price is below IPO price, the Stabilising Manager may then come in exercising its **open market buying power**, to absorb the selling pressure.

Therefore Stabilising Manager role can be viewed as some comfort to institutional investors that the risk of price decline below IPO price after listing is mitigated, improve the level of the public confidence that the market price will be less likely drop significantly below IPO price.

When post listing market price is above IPO price, the Stabilising Manager shall then repay the major shareholder with cash at fixed price of RM 6.50 per share.

After listing, LCT shares traded below IPO price for past two weeks. Based on announcement made on 24 July, Stabilising Manager has bought back all the over-allotment shares from open market, which is **27.8** million shares, at average price from RM6.28 to RM6.47. Stabilising Manager has ceased the stabilising action afterward and the LCT share price shall be fully determined by open market.

Besides, this LCT IPO has also introduced another mechanism that is not commonly seen in other IPOs. LCT offers to buy-back from retail investors the LCT shares they subscribed from retails offering, at RM6.50 per share. After the closing of the offer on 18 July, the company received acceptance from 4,125 shareholders, total holding 34.8 million shares.

Although there were two buying forces for the LCT shares upon listing: 1. From the Stabilising Manager, 2. From the LCT buy-back offer, LCT share is still trading below IPO price after listing. Therefore, those companies which are seeking for listing shall have better planning and preparation to avoid the same situation.

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