

TOPIC 21 - SUBSCRIBING TO IPO STOCKS

1. IS INVESTMENT IN IPO WITHOUT RISK?

In this article, I have compiled the companies and SPAC that were listed in the Main Market and ACE Market in past two years and study the financial returns on assumption that we subscribe the stocks during IPO and the financial return that we get, after taking into consideration the cash dividend, bonus issue, share split and warrants issued by the listed company, based on the pricing as at 2 October 2017.

As we are comparing returns of different time duration, I have modified the computation by computing the annualized return by taking time factor into consideration, i.e. Annualized Time Weighted Return (“**TWR**”).

2. INVESTMENT IN IPO HAS ITS RISK

Worst performer - Lotte Chemical Titan Holdings Berhad

For the past two years, there were 25 companies went listed in Bursa Malaysia. There were **six** companies that generated a negative TWR. Lotte Chemical Titan Holdings Berhad registered the highest annualized negative TWR of 69%.

Top Performer - Advancecon Holdings Berhad

Nineteen companies generated a positive TWR, with the highest annualized positive return from Advancecon Holdings Berhad. It was listed on 10 July 2017 with an offer price of RM 0.63 per share and the price on 2 October 2017 was RM 1.04, with a TWR of 820%. (i.e. in a time frame of about 84 days). It is a huge share price appreciation post-IPO.

3. WHY INVESTMENT IN IPO HAS ITS RISK?

New IPO Stocks are not backed up by long history of earnings

In my opinion, if we compare blue-chip stocks, the business track record of such companies is well proven. However, as for a new IPO stock, some companies may not have the sufficient long track record but met the minimum criteria of listing. Surely, such new IPO companies are still evolving and when it comes to the future outcome, they could either register a future positive growth or a negative growth. Meaning, there are uncertainties, and in financial language, anything which are uncertain represents risk.

Funds raised from IPO are meant for long term capital expenditure which earnings realization may take years ahead

Next, the purpose of the IPO fund raising is also an important consideration. If the purpose of fund is to continue an **immediate or near-term expansion** of which future increased earnings will be seen in near reporting periods, then we could likely see an appreciation of post IPO price.

However, if purpose of IPO funds is for a completion of a project that **takes years to complete**, we could only see the increased earnings in much later years, such as Lotte Chemical Titan Holdings Bhd. In this situation, the funds raised are meant for construction of cracker plant which is scheduled for operation in 2023. If the setting of the IPO offer price is based on future earnings and such earnings, takes time to realize, we may see a price decline post-IPO. The recent price decline may translate to a buying opportunity for investors who have a longer investment horizon.

Investors with short investment horizon

Investors who do not have holding power or with short term investment horizon may not be able to hold on for long, despite the future potential of a newly listed company is good.

4. BELOW IS AN ANALYSIS OF THE COMPANIES THAT ARE POSITIVE AND NEGATIVE PERFORMERS

- For companies recorded share price decline after IPO

With the post IPO price adjustment it could be concluded that right now the price has adjusted close to its book value for all the companies listed below. One observation noted in this category is that after the post-IPO price declined, the P/B now is closer to 1x.

Listed Company	Offer price (RM per share)	As at 2 October 2017		Annualized Return (%)	Price/Book multiple	ROE-r	P/E multiple based on latest audited account
		Market capitalization (RM millions)	Closing price (RM per share)				
LOTTE CHEMICAL TITAN HOLDING BERHAD	6.50	11,489	4.98	-69%	1.4	7%	9
MATANG BERHAD	0.13	181	0.10	-31%	1.0	-8%	144
ECO WORLD INTERNATIONAL BERHAD	1.20	2,544	1.06	-22%	1.0	NA	Loss
BCM ALLIANCE BERHAD	0.19	72	0.17	-11%	1.9	10%	19
KIP REAL ESTATE INVESTMENT TRUST	1.00	470	0.93	-6%	0.9	NA	32
RED SENA BERHAD	0.50	460	0.46	-4%	1.1	NA	Loss

Analyzed by Asia Equity Research Sdn Bhd

Matang Berhad however may have some potential downward pressure on its price considering right now that it has a P/E of approximately 144x.

- For companies that recorded share price appreciation after IPO

All the companies in the list has one common characteristic, which is its P/B is more than one time of its book value and some even until 4.5x.

Listed Company	As at 2 October 2017			Annualized Return (%)	Price/Book multiple	ROE-r	P/E multiple based on latest audited account
	Offer price (RM per share)	Market capitalization (RM millions)	Closing price (RM per share)				
ADVANCECON HOLDINGS BERHAD	0.63	418	1.04	820%	3.5	18%	16
PERAK TRANSIT BERHAD	0.15	352	0.28	126%	1.7	8%	16
HSS ENGINEERS BERHAD	0.50	357	1.12	103%	4.3	17%	25
SERBA DINAMIK HOLDINGS BERHAD	1.50	3,057	2.29	97%	2.3	NA	11
FOUNDPAC GROUP BERHAD	0.54	302	0.82	75%	4.5	7%	30
DANCOMECH HOLDINGS BERHAD	0.75	170	0.57	74%	1.6	8%	13
BISON CONSOLIDATED BERHAD	1.10	744	2.40	69%	4.3	10%	41
RHONE MA HOLDINGS BERHAD	0.75	176	1.06	63%	1.8	32%	19
CHIN HIN GROUP BERHAD	0.65	734	1.32	61%	2.2	5%	18
INTA BINA GROUP BERHAD	0.25	155	0.29	52%	1.8	17%	12
SALUTICA BERHAD	0.80	532	1.37	51%	3.2	1%	27
AEMULUS HOLDINGS BERHAD	0.28	261	0.60	44%	3.7	-9%	48
CABNET HOLDINGS BERHAD	0.56	81	0.62	35%	2.0	22%	13
EVERSAFE RUBBER BERHAD	0.36	94	0.39	32%	1.4	4%	16
KIM TECK CHEONG CONSOLIDATED BERHAD	0.15	107	0.21	20%	1.2	-8%	81
PECCA GROUP BERHAD	1.42	291	1.55	9%	1.8	2%	20
LKL INTERNATIONAL BERHAD	0.20	92	0.22	7%	1.6	5%	21
HLT GLOBAL BERHAD	0.45	124	0.47	6%	2.3	10%	21
AL-SALAM REAL ESTATE INVESTMENT TRUST	1.00	580	1.00	5%	0.9	2%	12

Analyzed by Asia Equity Research Sdn Bhd

Example: **Advancecon Holdings Bhd** recorded a P/B of 3.5x. This is justifiable considering that it is able to generate a positive excess difference of 18% between its Return of Equity (“**ROE**”) and its Required Rate of Return (“**r**”). This means that the company is able to generate return exceeding investor’s expectation by approximately 18%. Further, its P/E multiple is also reasonable at 16x.

We can also spot on some potential over-valuation in this list. One obvious example is **Aemulus Holdings Bhd** which has a P/B of 3.7x but having a negative difference of ROE -r. Further, its current P/E is also high at 48x. Another example that fall into this category is **Kim Teck Cheong Consolidated Bhd**, with a negative difference of ROE – r, and a P/E which is also high at 81x.

CONCLUSION:-

Before investing in IPO stocks, it is important for investors to determine the how much the newly IPO stocks are priced (i.e. its P/B and P/E), the purpose of the utilization proceeds raised from the IPO (i.e. whether for immediate expansion into business or expansion that takes years to complete) and the historical profitability trend.

END

This article is prepared by Ong Tee Chin, CFA, FRM, and represents the views and opinions of the author. The contents of this publication are intended for purposes of general information and academic discussion only. It should not be construed as financial or legal advice or legal opinion.

The author wishes to declare that the author and Asia Equity Research do not have any share ownership in any of the companies discussed prior to this and until current date. The author can be contacted at general@aer.global for any further enquiries on the contents of this article.

You are required to obtain written consent from Asia Equity Research Sdn Bhd (AER), if you wish to redistribute or reproduce in its original form the information from this article or quoting in other materials. AER reserves the right to take legal action against any party / parties that violates any property rights with respect to this article without obtaining such written consent.