
Consultation Paper 22

**BASIS OF OFFER
PRICE OF AN IPO
FOR EQUITY**

November 2014

SEC | **SECURITIES AND EXCHANGE
COMMISSION OF SRI LANKA**

**LEVEL 28 & 29, EAST TOWER, WORLD TRADE CENTER
ECHELON SQUARE, COLOMBO 01.**

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Introduction:

Unavailability of a specific provision in the CSE Listing Rules which requires to disclose the basis on which the offer price of an IPO is determined, has led some of the entities to decide the offer price in a manner that may have resulted in an 'undervalued offer price' or 'overvalued offer price'. While undervalued share diminish the opportunity of the entity to raise higher capital for the entity for a given number of issued shares, overvalued share would tarnish the appetite of the investors for IPOs due to the negative market performance of the share subsequent to the listing of the entity. The consequence of an underpriced offer price may not be unfavorable as overpriced offer price; the latter would adversely affect the IPO market as well as the potential listing in the future by affecting the confidence of the IPO investors which in turn aggravate the systemic risk in the Exchange.

The entities which had obtained a fair assessment of the value of the entity in order to determine the offer price, might have adopted different valuation methodologies to arrive at such price, inter alia based on the Price Multiples, Capitalization of Future Earnings or Net Assets Value. In light of that, knowledge of the methodology used to arrive at the offer price is paramount important to an investor to make an informed decision about the respective investment.

In light of the above, the SEC decides to consult the public with respect to the draft amendments to the CSE Listing Rules in order to reduce the 'systemic risk' in the secondary market by mitigating any adverse effects that could occur in the capital market due to 'overvalued or undervalued offer price' in an IPO by entities and also to reduce risk that might pause on future IPOs due to possible negative impact on less sophisticated retail investors.

Disclaimer:

The contents of this paper do not constitute legal advice. The finalized rules relating to basis of offer price of an IPO for equity may change from what is proposed herein consequent to the comments we receive, further deliberations or due to any other reason, as determined by the SEC to be appropriate.

Comments Received:

The comments received would be subject to consideration by the SEC and may be made publicly available and will not be treated as confidential unless a special request is made in this respect. The SEC may consider convening consultative meetings as a further step depending on necessity. Please send in your comments with the title "**BASIS OF OFFER PRICE OF AN IPO FOR EQUITY**" on or before 01st December 2014 by registered post or e - mail or fax to:

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Director Corporate Affairs
Securities and Exchange Commission of Sri Lanka
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BASIS OF OFFER PRICE OF AN IPO FOR EQUITY

The SEC proposes the following disclosure mechanisms with respect to IPO Offer Price in order to improve the disclosures and transparency.

1. As the best practice, encourage the Entities to obtain a competent independent valuation on a **voluntary basis** for the purpose of determining the IPO Offer Price/Price Band in the case of Book Building and to disclose the summary of the valuation report in the Prospectus together with the following disclosers;
 - a. Qualifications and experience of the Independent Valuer or, if the report is made by a corporation or firm, the qualifications and experience of the individuals responsible for preparing the report;
 - b. Declaration by the Independent Valuer stating that;
 - i. The Valuer is neither Related Party as defined in Sri Lanka Accounting Standard nor who has significant interest in or financial connection with the company and/or the group; and
 - ii. the Valuer has the necessary skills and resources available at disposal to arrive at a competent independent opinion in determining the IPO Offer Price/Price Band; and
 - iii. the Valuer has made all the inquiries that it believes are desirable and appropriate in order to arrive at a competent independent opinion; and
 - iv. the Valuer is a member in good standing in a professional association relevant to the valuation assignment undertaken.
2. If the entity is not opting option 01 above, mandate the entity to publish the Research Report carried out by the accompanying Investment Banker together with the Prospectus. The said Research Report should contain, at minimum, a section that covers the basis and methodologies used to determine the Offer Price/Price Band for the IPO. The Entity should host the said Report on the CSE Website as well as the Entity's own Website for a period of 02 months.
3. Irrespective of the above requirements, mandate entities to disclose in the Prospectus, at minimum, the basis for IPO Offer Price/Price Band as per the format given in **Schedule I** hereto.

SCHEDULE I**BASIS FOR OFFER PRICE**

The Offer Price was/will be determined (in the case of Book Building Process) by the Entity in consultation with the (eg: Name of the Investment Banker/Competent Independent Advisor). The Net Asset Value (NAV) of the Equity Shares is Rs. XXX and the Offer Price is XX times the NAV of the Equity Shares.

(In the case of price band, the lower end of the price band is XX times the NAV of the Equity shares and the higher end of the price band is XX times the NAV of the Equity shares.)

INVESTORS SHOULD READ THE FOLLOWING SUMMARY WITH THE RISK FACTORS INCLUDED IN PAGE NO XXX AND THE DETAILS ABOUT THE ENTITY AND ITS FINANCIAL STATEMENTS INCLUDED IN THIS PROSPECTUS.

1. QUALITATIVE FACTORS

The qualitative factors that were considered by the Entity when arriving at the Offer Price/Price Band should be mentioned here OR alternatively the entity could provide the necessary cross references to the relevant sections in the Prospectus.

2. QUANTITATIVE FACTORS**2.1 Adjusted Earnings Per Share (EPS) & Average Return on Equity (ROE %)**

For Main Board entities: at least for last three (03) years based on the Audited Financial Statements and as per the latest interim financial statement (Not Annualized):

For Dirisavi Board entities: at least for last one (01) year based on the Audited Financial Statements and as per the latest interim financial statement (Not Annualized):

Year Ended	Basic EPS (Rs).	Diluted EPS (Rs).	ROE	P/E
March 31, 20X7				
March 31, 20x8				
March 31, 20X9				
Average EPS				
Three months ended June 30, 20X9 (Not Annualised)				

Note:

Earnings per share (Rs.) = $\frac{\text{Net profit as restated, attributable to equity shareholders}}{\text{Weighted Average number of equity shares outstanding during the year/period.}}$

Return on Equity (%) = $\frac{\text{Net profit after tax, as restated}}{\text{Net worth as at the end of the year / period}}$

2.2 Price/Earnings Ratio (P/E) in relation to Offer Price of Rs (XXX)

- a. Based on year ended March 31, 20XX Basic & Diluted EPS of Rs. XXX, the P/E Ratio is XXX
- b. Based on average EPS of Rs. XXX, the P/E Ratio is XXX
- c. Industry P/E XXX

Particulars	Name of the Peer Entity	P/E
Highest		
Lowest		
Industry Composite		

Source:

Sector Classification:

2.3 Net Asset Value per Equity Share

- (i) As on March 31, 20X9 – Rs. XXX (as per the latest audited financial statements)
- (ii) As on June 30, 20X9 – Rs. XXX (as per the latest interim financial statements)
- (iii) Post IPO: Rs. XXX
- (iv) Issue Price: Rs. XXX

2.4 Comparison of Accounting Ratios

The comparable ratios of the entities which are to some extent similar in business are as given below (as per the latest audited financial statements):

Peer Entity	NAV (Rs.)	EPS (Rs.)	P/E	ROE %

Source:,

Sector Classification of peers:.....