

## **Workshop on Book Building Method**

February 17, 2008, Venue : DSE Board Room

Chief Guest

Mr. Faruq Ahmad Siddiqi  
Chairman, Securities and Exchange Commission (SEC)  
Session Chair

Mr. Md. Abdullah Bokhari,  
President, Dhaka Stock Exchange Ltd.

Key Note Paper Presenter

Mr. Mohammad Abdul Hannan Zoarder  
Executive Director, SEC

Moderator

Mr. Salahuddin Ahmed Khan  
Chief Executive Officer, DSE

Designated Discussants

Mr. Ahmad Rashid Lali  
Senior Vice President, DSE

Mr. Latifur Rahman

Director, DSE and President-Metropolitan Chamber of Commerce and Industry.

Mr. Mahbubur Rahman

Director, DSE and President-International Chamber of Commerce, Bangladesh.

Mr. Imtiyaz Husain

Former Chairman, DSE

Prof. Mahmud Osman Imam

Chairman-Department of Finance, Dhaka University.

Prof. Dr. Mohammad Musa

Professor, School of Business-United International University.

Mr. Saiful Islam

Managing Director, Equity Partners Securities Ltd

Mr. D.H Chowdhury

Deputy Managing Director, The City Bank Ltd.

Mr. Yawer Sayeed

Managing Director and CEO, AIMS of Bangladesh Ltd.

Mr. Wali-ul-Marroof Matin

Former Chief Executive Officer, Chittagong Stock Exchange Ltd.

Ms. Silmat Chisti

Resident Vice President and Head of Capital Markets, Citibank N.A.

Mr. Samir Asaf  
Group CEO, Rahimafrooz Ltd

Mr. Fazlul Bari  
Economic Editor, The Daily Inqilab



*Securities and Exchange Commission (SEC) Chairman Mr. Faruq Ahmad Siddiqi addressing at a DSE organised workshop titled “Book Building Procedure for IPO” on February 17, 2008. Session Chair Mr. Md. Abdullah Bokhari, President, Dhaka Stock Exchange Ltd., Key note paper presenter Mr. Mohammad Abdul Hannan Zoarder, Executive Director, SEC, Moderator Mr. Salahuddin Ahmed Khan, Chief Executive Officer, DSE, Mr. Ahmad Rashid Lali, Senior Vice President, DSE, Mr. Sharif Ataur Rahman, Vice President, Mr. Latifur Rahman, Director, DSE and President, MCCI, Mr. Mahbubur Rahman, Director, DSE and President, ICC-B, DSE, Mr. Imtiyaz Husain, Former Chairman, DSE, Prof. Dr. Mahmud Osman Imam, Chairman, Department of Finance, Dhaka University, Mr. Moazzem Hossain, Editor, The Financial Express, Mr. D.H Chowdhury, Deputy Managing Director, The City Bank Ltd. and Mr. Samir Asaf, Group CEO, Rahimafrooz Ltd are also seen in the picture.*

A workshop on proposed new IPO pricing method “Book Building Process” was held at the Dhaka Stock Exchange (DSE) Ltd. on February 17, 2008. Securities and Exchange Commission (SEC) Chairman Mr. Faruq Ahmad Siddiqi was present as Chief Guest of the function. Moderated by the DSE Chief Executive Officer (CEO) Professor Salahuddin Ahmed Khan, the workshop was also attended by the Members and Executive Directors of SEC, Presidents of two leading chambers, bankers, issue managers, underwriters, representatives from different companies, academicians leading editors and journalists and other business personalities. SEC Executive Director Mr. Abdul Hannan Zoarder made a presentation on the proposed Book Building Method while DSE President Mr. Md. Abdullah Bokhari presided over the workshop. The workshop is expected to help the SEC to explore cross sectional opinion on the proposed IPO pricing process through book-building method as the some of the key stakeholders placed valuable suggestions on the system through the workshop.

The excerpts of the speakers and the Chief Guest are presented as under:

Mr. Faruq Ahmad Siddiqi

Highlighting the fundamental weakness of existing IPO pricing method, the Chief Guest categorically mentioned that, the present pricing method is not encouraging the successful entrepreneurs as it is most often under pricing the offer price as reflected in the post IPO price of the securities. Thus in the prevailing system, retail investors gain more than that of the entrepreneurs (sponsors) of well performing companies. Even though, under the present method of IPO pricing entrepreneurs (those who have invested significant volume of funds to start a business venture) are not getting fair price. Under the system while issuing shares through IPO, leading companies having good and authentically strong fundamentals cannot set appropriate price for their shares because of the inherent weakness of the system.

However, he hoped that under the proposed Book Building Method (BBM), this limitation can be removed specially for the successful and larger companies with strong financial track record

and continuously growing operation will be able to get a fair price of their shares. Accordingly Honorable Chairman hoped that the proposed method of IPO pricing will truly encourage the real investors to come to the securities market. The whole process to launch book building system is at the discussion level.

A committee has been formed in this regard which is working relentlessly to find out a time-bound solution. As a large number of stakeholders are associated with the process they have been seeking comments, suggestions and advice from all the persons, groups and institutions including media, academic personalities and businesspersons and business organizations. After consulting with all the relevant parties a final solution will be found out. The SEC will not impose anything on the corporate level keeping all the people under dark. Through the introduction of BBM Method of IPO pricing the SEC has been trying to create a balance between unfair fixing of prices of shares offloaded by big companies and investors gaining more.

Big companies will be encouraged to go public if the book-building system is introduced. In this system investors will be encouraged to participate in the secondary market and that will help reduce the borrowing cost by the industrialists. But of course the regulatory body will try to create balance among the big, medium and small companies. The introduction of BBM is the primary stage and comments, views and observations will be taken from different groups. After consulting all the parties concerned, the method will be finalized. The market is growing gradually and the future growth will get a momentum once the book-building method is introduced.

Mr. Abdul Hannan Zoarder

Considering the difference between the issue price and price of securities on the first date of trading after listing it appears that IPO pricing system needs further scrutiny. To scrutinise the existing price difference the SEC asked its consultative committee to look into the possibility of adopting Book Building Method (BBM) of IPO pricing. SEC has further decided to discuss recommendations of the consultative committee with the key stakeholders. Book Building is a process of price discovery for security that is intended to be listed through public offering. In most initial public offering of stock investment banker is engaged by the issuer company that intends to issue share sets number of shares to be sold and suggest a price range ie cap and floor. Generally initial price band is fixed on the basis of past performance, expected future earning of the issuer and the P/E (Price Earning Ratio) ratio of other peer group companies of that industry. When issuer company goes for road show it gets the first hand views of the investors about the issue which plays an important role in deciding the floor price or price band. Usually institutional investors/syndicate members bid electronically by auction deadline, saying how many shares they would buy for how much. Investment banker and company executives assemble bids stating with the most expensive fist and count down until they reach number of shares to be sold. Shares are issued at bid price of individual investor or weighted average at cut off or at cut off price. Issuer may issue share below cut off price with the approval of the regulator. The companies offering Tk 30 crore or more may avail of the Book Building Process for pricing of security through Initial Public Offering. The Book Building Process will have two stages-first one is the price discovery and Book Building by eligible institutional investors and the second one is Public Offer based on price through Book Building Process. Here Issue Manager registered by the SEC shall act as book runner and registrar to the issue.

The price discovery process will involve eligible institutional investors as per guidelines set by SEC in the regard and the types of eligible investors may be as follows.

- Merchant Bankers

- Mutual Funds
- Portfolio Managers
- Foreign Institutional Investors registered with SEC.
- Pension Funds and Provident Managers
- Financial Institutions under regulatory authority of Bangladesh Bank
- Insurance Company and
- Any other company allowed by SEC for this purpose.

The above-mentioned institutions (either licensed or authorized for this purpose by SEC) will be considered eligible institutions to participate in the price discovery process under Book Building System. The 'Base Price/Cut Off Price' for public offer will be determined through 'True Dutch Auction' method. "Dutch Auction" is an auction in which the seller reduces the offering price until a level can be found that clears the market. In True Dutch Auction issuer accepts the highest bids first and work through progressively lower bids until an issue is completely sold.

#### Pre-requisites of Companies for BBM

- The company should have been in operation for at least last immediate five years.
- Shall have net profit in immediate last three years with steady growth in earnings.
- Shall have no accumulated loss at the time of application
- Shall have minimum rating of 'Investment Grade'
- Is regular in holding annual general meeting
- Shall offer at least 10 % shares of paid up capital (including intended offer) or Tk 30 crore whichever is higher.
- Shall be required to conduct independent audit of last five years annual report by a firm of Chartered Accountants who satisfies the requirements of Securities and Exchange Rules, 1987/ (SEC Panel of auditors)
- However, Commission, if deems appropriate for the interest of investor or development of capital market, may exempt all or any of the requirements.
- Operational Procedures of BBM
- Issuer shall comply with all requirements of public issue rules in preparing draft prospectus.
- Issuer in collaboration with Issue Manager and potential institutional investors shall give an indicative price in the draft prospectus and shall submit the same to the Commission with a copy to stock exchanges for approval. Such indicative price shall be determined as per price indication from at least 10 eligible institutions covering at least five different categories of firms identified at paragraph 2 above. Rationale for the indicative price must be included in the prospectus.
- Issuer shall invite for indicative price offer from the approved institutional categories through proper disclosures, presentation, documents, seminars and road shows.
- The indicative price shall be the basis for formal price building with an upward/downward limit of 20 % of indicative price within which eligible institutions shall bid for the allocated amount of shares for this purpose. If institutional quota is not cleared at 20 per cent below indicative price or at par whichever is higher the issue will be considered cancelled.

- No institution shall submit more than two offers and shall not be allowed to quote for more than 10% of shares reserved for institutional category.
- Institutional bidding period will be three working days. However, Commission may extend it, if considers necessary. The bidding will be handled through automated system of Exchanges specially developed for Book Building. The volume and value of bid at different prices (if quoted price is dissimilar) will be displayed in the monitor without identifying the bidder.
- Institutional distribution will be made on the basis of “True-Dutch Auction” method. By ‘True Dutch Auction’ method it is meant that, the bidders will be allotted shares at the price at which they submitted their bid. Therefore the highest bidder will be required to pay the highest price, and subsequent bidders shall pay according to their bid till such price would clear the total amount of securities earmarked for this purpose. However, if all institutional bids are made at the same price, or that, there are more bids than earmarked quota for institutional investor within ‘Cut-Off’ price; distribution will be made on pro-rata basis.
- Institutions shall place their bid with 20% of the amount of bid in advance and the rest 80% shall be paid within two working days prior to general public subscription opens. In case of failure, 50% of upfront money deposited by defaulter institutional investors shall be forfeited by the Commission;
- Institutions may bid below the floor price but not below the face value of the securities. Further, if all the institutional offers are on the floor price and the issuer wants to lower the floor price, in that case, issuer may take permission from SEC to revise Floor Price;
  - o The price at which the institutional quota shall exhaust that will be the Cut-Off price.
  - o General Investors and NRB’s shall buy at Cut-Off price. Mutual Fund, despite its participation in the bidding, will be issued security at cut off price.
  - o General investors shall apply for at least one market lot or its multiple, if there is over-subscription in terms of application; allotment will be made through lottery to be conducted by CDBL;
  - o Subscription period for general investors shall remain open for five working days.
  - o General investors shall place their application through the brokerage house with full fund and brokerage firms shall forward the valid application to the concerned stock exchanges with a detailed list of applications in both soft form and printed form together with required money.
  - o The brokers shall send all valid orders with required fund received from investors to the concerned Exchange one day following the close of subscription closing;
  - o The brokers shall get a collection fee maximum @0.10 on the amount collected against public applications/biddings from the issuer;
- Stock Exchanges shall keep all the applications money in a separate account.
  - o Issuers make underwriting agreements with underwriters for 50% of issue size.
  - o IPO will be cancelled if subscription falls below 50% of public portion;
  - o Minimum eligible number of applications is required to be 400 for listing purpose;

- Stock Exchanges would refund the money to individual brokers who in turn will return the unsuccessful applicants, if any.
  - There shall be no lock-in on any investor for security issued through this mechanism.
  - Stock Exchange shall make the system ready for operation within three months from the date of commission approves the rules. The cost of developing software will be shared by both the exchanges.
- Probable Impact of Book Building on Bangladesh Capital Market
- IPO pricing may reflect both issuer and investors expectation;
  - Good issuers would be encouraged to raise fund from capital market;
  - Issue price and first day trading price will be narrowed down;
  - Institutional investor will carry out due diligence since they will have to take up shares at price they bid in the bidding period.

Tendency for opening fake BO accounts will be reduced.

(Shortened from the presentations made in the Round Table Discussion Meeting held on February 17, 2008 at DSE. The presentation was based on the recommendations of SEC Consultative Committee on Alternative Pricing System of Securities-Book Building Method)

Mr. Ahmad Rashid Lali

Actually Book Building is a window for big companies. After introduction of Book Building Method, many larger companies will be interested to come to market.

Mr. Latifur Rahman

Companies having paid up capital less than Tk 30 crore would increase the amount when they will think of going public through Book Building Method. Independent Auditors should be appointed by the SEC for 3 or 5 years at the cost of issuer. Proper dissemination of information and credit rating agencies should be part of Book Building Method and the cost will also be borne by companies. All the stakeholders including SEC, NBR and other related institutions should work closely to find out time-bound solution and reap greater benefit from the introduction of BBM in IPO. Indicative Price would be justified by the market participants. Fair pricing should be ensured rather than any fiscal incentives to attract more companies to come to market. SEC should not enforce the companies to go public, rather environment should be created that companies feel encouraged to go public.....account is very important for transparency in fund management. He proposed that quota can be arranged i.e. inter-change can take place within institutional group if issue is undersubscribed by any party.

Mr. Mahbubur Rahman

I raise question about quota and amount of paid-up capital of Tk 30 crore. Why the amount of paid up capital is Tk 30 crore; why is it not more or less? I also suggest for thinking the concept of 'Indicative Price'. The concept of independent audit is also well but SEC directive on compulsory listing cannot be supported.

Mr. Imtiyaz Husain

The reserve quota for a specific section is not supportable. The quota system gives privilege to some at the cost of others. The price distortion changes the entire distribution pattern.

Mr. Salahuddin Ahmed Khan

General investors will be benefitted by the Book Building Method and both companies and investors will also derive benefits. In Bangladesh almost all established business houses prefer bank finance for greater degree of flexibility, opportunities for retaining control and also to avoid required disclosure to regulators or other stakeholders (including shareholders). The sponsors of these companies consider these inconvenience outweighing the higher cost of banks finance. In order to attract them to market, stronger incentives including attractive price for giving away some of their rights to retain total control over the company can be attained by giving fair price to their securities offered.

Prof. Dr. Mahmood Osman Imam

BBM for IPO should be applicable only for large size IPOs. For fixing price underwriters, regulators, issue managers are to be implicated and also applicable to allocation. There should not be any quota for any specific group as they are allowed to participate in bidding. Manufacturing company can be exempted from mandatory rating. Pricing and allocation must be fare and transparent. Allocation should be done by issue manager or lead underwriter. He also proposed to introduce English auction rather Dutch auction.

Prof. Dr. Mohammad Musa

Regulators should allow institutions to bid above cap price. Let the investors/institutions set price. There should be fair play ground on 'Indicative Price' and this indicative price should be in BBM. SEC should allow underwriters to form syndicate to form price mechanism and to buy the undersubscribed shares at cut-off price to reduce uncertainty for institutions. That will surely help achieve market efficiency and help the investors and market participants.

Mr. Saiful Islam

I propose mandatory registration with SEC for being institutional investors and registration criteria for merchant banks should be set first and should be conveyed to custodian banks for foreign investors understanding. Besides, clarification of institutional investors is must for foreign investors. The provision of 80 per cent bid amount shall be paid within two working days prior to public subscription open date is not sufficient enough for the foreign investors due to difference in holidays of Bangladesh and rest of the world. Anti-money laundering act has a barrier in case of fund transfer prior to start trading in USA.

Mr. D.H. Chowdhury

Instead of investment grade, due diligence process might be followed for the time being in Book Building Method. The concept of Investment Grade might be replaced by 'Due Diligence'. When Mr. Zoarder in his presentation suggested for Dutch Auction Mr. Chowdhury opined on

behalf of combination of 'Quasi Dutch Auction' and detailed guideline for indicative price is also needed.

Mr. Yawer Sayeed

'Investment Grade' be discarded. The pros and cons of BBM and its consequence should be considered by all the stakeholders associated with the process.

Mr. Wali-ul-Marooof Matin

Book Building Method would encourage big companies and discourages the small investors who also play important role in capital market. General investors should be allowed to set price band. The authorities concerned will examine the necessity of face value. A provision should be introduced so that NRBs can take part in BBM process from residing abroad. BBM will create an stimuli for big and large companies having good and authentic fundamentals but it will directly make the small investors reluctant toward capital market who have tremendous contribution here and there participation is also necessary.

Ms. Silmat Chisti

I suggest for some ultimate floor prices and of course there should be some alternative options. I also propose to introduce Green Shoe Option.

Mr. Samir Asaf

Fiscal incentives should be increased to go for listing and Tk 30 crore paid up capital may be ignored. Decision for going public should be optional rather than mandatory. Alternative valuation method should be specified. I suggest to relax the steady growth provision in net profit or earning in case of blue chip companies. I also question that 20 per cent limit for cap floor on indicative price is not flexible enough which should be..... I want to increase the institutional quota.

Mr. Fazlul Bari

General investors' participation should be ensured through Road Show and communication barrier should be removed through using language used by mass people.