Article

BOUNCING BABIES AND STILLBORNS

IPO returns on the Ghanaian stock market

By Benjamin Amoah-Adjei
bamoah-adjei@firstbancgroup.com

An IPO is the primary introduction of a company onto a stock market. To do this, the company "floats" its shares, which means it makes the shares available to the general public for the first time and allows for those shares to be traded on a recognized, regulated stock market, such as the GSE. The company may have existed for several years preceding the offer, but the IPO is unique in the sense that the company's shares, which represent ownership interests in the firm, become freely available to all interested investors and tradeable in an open market after the IPO. The offer may also involve a sale of existing shares, whereby existing owners sell off all or a portion of their holdings, or an issue of new shares to incoming investors. The GSE listing rules guide companies as to the processes involved in introducing a company onto the exchange. These rules ensure that the investing public is furnished with all relevant information including the risks associated with the listing. In Ghana, we recently saw the initial public offer of Agricultural Development Bank and Access Bank Ghana on the Ghana Stock Exchange in December 2016. The current government has also mooted the idea of introducing the Volta River Authority (VRA) to the stock market via a listing of shares.

In the run-up to an IPO, it is normal to see equity investors, especially individual investors, who may already own shares of other listed firms, inquire about and attempt to partake in these offerings. Some of these investors seek to participate in IPOs not because of some conviction about the underlying company's future prospects or the quality of its management, but rather under the assumption that shares purchased in an IPO will enjoy a surge in price after trading begins. This is because brokers and investment bankers who sponsor the offer (bring the company to the stock market) price the company at a discount to make the offer attractive to investors. Buying into an IPO is thus premised on the expectation that as soon as trading in the newly-listed stock begins, market participants will drive the price up to its "fair value", which is a market consensus of how much those shares should actually be worth.

Over the last decade, there have been 12 IPOs on the local stock exchange. Out of these, several equities appear to have recorded significant returns over the first week of trading. (See table below), even when adjusted to account for general market performance. At a cursory glance, this may seem to support the impression that investing in IPOs solely for a quick return in the initial days following the onset of trading is a successful strategy. The table also shows that IPOs that are priced below 50Gp per share are likely to record significant returns early on. All of the companies in the table that's issued shares priced below 50Gp gained at least 10% in the first week of trading. On the other hand, stocks which were priced well above that level recorded relatively weaker gains over the first week. The only exception was ADB, which rose almost 26% in the first week.

	IPO	Listing	Returns (%)			
	Price	date	1-week	1-month	3-month	1-year
GOIL	0.20	Nov-07	13.0	33.5	55.0	80.0
SIC	0.30	Jan-08	10.0	40.0	40.0	53.3
GSR	3.00	Feb-08	3.3	3.3	3.3	3.3

UTB	0.30	Nov-08	10.0	10.0	0.0	-33.3
TLW	31.00	Jul-11	0.3	0.1	0.2	24.4
MAC	3.00	Apr-14	16.7	16.7	10.0	50.0
SAMBA	0.72	May-15	1.4	1.4	1.4	1.4
MMH	0.10	Jul-15	10.0	10.0	10.0	10.0
HORDS	0.05	Aug-15	20.0	40.0	60.0	100.0
IIL	0.08	Dec-15	12.5	12.5	12.5	12.5
ADB	2.65	Dec-16	25.7	44.5	44.5	N/A
ACCESS	4.00	Dec-16	2.5	2.5	2.5	N/A

Table 1: 1-week, 1-month and 3-month market-adjusted returns on newly listed stocks from 2007 through 2017, GSE
Source: Ghana Stock Exchange, FirstBanC Research

Should you invest in IPOs?

An IPO represents the initial introduction of a company to a stock market. This means that it is usually difficult to measure the value that various investors place on the company's stock, compared to already-listed firms that have seen significant trading activity over time and which have a history of price discovery. Since stock price movements are the result of the activities of equity investors and the value they place on various companies, a newly-listed firm will have to trade for an extended period, sometimes for several months, before investors settle on a value they want to place on the company's stock. As a result, buying into an IPO in expectation of an initial short-term bounce in the price may be a risky strategy that borders on active trading. Due to the uncertainty surrounding the value the market would place on a company's stock, especially in the aftermath of its listing, it is important for investor to seek advice from a broker or an investment advisor.

A phenomenon that has been observed in some markets, including ours, is that increased investor activity by itself, even in the absence of information on fair market values, may drive up prices in the short-term. In the US and other jurisdictions, IPOs may be closed, whether deliberately or not, to individual investors. As a result, the first few days or even hours of trading represent an opportunity for what is termed "flipping". As individual investors try to obtain some of those shares on the first day, the price is bid up significantly and institutional investors who obtained shares during the offer period then sell off their shares to fund managers and individual investors who missed out or could not obtain shares during the IPO period, sometimes making significant profits in the process. It is worthy to note, however, that even in these circumstances the initial sharp increase in price is temporary and the stock prices fall back to IPO levels after those first few days of heightened investor activity. Empirical evidence has also shown that purchasing IPOs as an investment strategy has generated weaker returns in the long term as compared to general market performance, pointing to the fact that a majority of new listings may be overvalued during the IPO, may not involve fundamentally strong companies or do not undergo a proper assessment of the company's inherent risks.

The flurry of activity that is usually witnessed in the aftermath of IPOs in developed markets and which contributes to rising prices in the first week or so of new listings, are almost non-existent in Ghana. This is because of the less developed nature of our market where trading volumes are significantly constrained by a variety of factors. As a result, trading volumes for newly-listed stocks are usually weak and only pick up over extended periods. A fairly recent example is the listing of ADB shares on the market. Investors who bought into ADB's IPO would have made 26% in the first week, but would have found it frustrating to realize those gains; not a single share of that stock has been traded throughout the whole of 2017 till date. In fact, the "impressive" gains made in 2016 were based on three price movements, which occurred on three trading days and possibly in three individual trades on weak volumes.

Furthermore, IPOs are usually open to the investing public, and anyone who wants to can usually buy substantial portions of the offer for themselves if they have the money to do so. This means that “flipping”, and the opportunity to do so, is less likely to occur in our setting.

This does not mean that IPO participation is always a bad idea. The interested investor may still buy into the listing with confidence if they feel the underlying company has good future prospects, or has the potential to generate significant, sustainable returns over time. Of course, the sponsoring firm, usually an investment bank or advisory firm, will attempt to sell the company as a good one in order to generate participation from investors (Their fees are linked to the success of the IPO after all!). But investors without the particular skill set to analyse a company’s fundamental business, the industry within which it operates and the quality of its management and board will be well served by seeking advice from a trusted investment professional. A good company’s shares may not necessarily generate the elusive initial bounce that some investors chase after, but is sure to generate solid returns over the long term.

And that should be the purpose of stock market investment: a long-term investment over several years that transcends business cycles and covers the period of the company’s long-term strategy. Short-termism and poor analysis are the bane of the equity investor. Every company, already-listed or being introduced in an IPO, must be probed for its prospects over time. The investor must also appreciate that the stock of good companies are best held over the long-term. Think Coca-Cola, Wal-Mart or Apple in the US, and the many millionaires that those companies have created in their wake since listing in 1919, 1972 and 1980 respectively. Also remember that Coca-Cola’s shares lost 50% in the first year although the business remained profitable, and investors who did not understand the business well may have sold off and lost out on the superior return that have since followed. In Ghana, Ecobank comes to mind; its stock gained 4.5% in the first week, certainly unimpressive, especially if you consider the impact that fees would have on your return if you sold over that period. Three years after listing, the stock had risen 181%, and that return does not even account for dividends received by investors over the period.

Also remember that a fundamentally good company may have been overpriced in the IPO, in which case an appropriate strategy might be to wait for the stock price to drop post-IPO before you buy. A good company, with strong growth prospects and a record of above-average profitability, may be a bad stock due to its current pricing, and the investor must take note of such outcomes especially in relatively illiquid markets like ours. To determine if an IPO price is “fair”, you would again need to speak to your investment advisor, especially an experienced one who understands the interplay between market sentiment and underlying company performance.

In conclusion, you may invest in IPOs, but do so cautiously and only after considering all the relevant facts concerning your investment. An IPO investment should not be based on short-term expectations of a price surge.

The writer is an analyst with ***FirstBanC Brokerage Services, a leading brokerage house in Ghana****. For advice and recommendations on equity investments and IPOs, contact us at 0302 660 709 or visit our office on the 12th floor of the World Trade Center, Ridge-Accra.*