INITIAL PUBLIC OFFERING (IPO) - WHAT INVESTORS SHOULD KNOW

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Kenyans are expressing growing interest in investing in equities, especially shares, at the Nairobi Stock Exchange (NSE). Past Initial Public Offerings (IPOs) including the Kenya Electricity Generating Company (KenGen) attracted massive subscriptions and huge financial investments.

Today the country's capital markets marks a milestone with the injection of 10 billion additional shares through the Safaricom IPO. It is therefore important for Kenyans, especially the beginners, to understand the worth of investing long-term.

The Capital Markets Authority (CMA), through its investor education campaign, has succeeded in increasing the level of participation in the capital markets by proactively engaging in outreach programmes. The emphasis, that has lifted the country's capital markets ranking to be among the world's best, now focuses on enlightening the investing public on a number of salient issues especially after the introduction of electronic commerce. This involves knowing the investment climate.

Understanding Capital Markets in Kenya

The capital market is part of the financial system that provides funds for long-term development. This is a market that brings together lenders (investors) of capital and borrowers (companies that sell securities to the public) of capital.

In 1984, a study on the Development of Money and Capital Markets was jointly undertaken by the Central Bank of Kenya and the International Finance Corporation. In November 1988, the Government set up Capital Markets Development Advisory Council and charged it with the role of drafting a bill to establish the Capital Markets Authority. In November 1989, the Capital Markets Authority was set up through an Act of Parliament (cap 485A).The authority was eventually constituted in January 1990 and inaugurated two months later. The Authority licensees all the market players including Stockbrokers, Investment banks the central Depository and settlement corporation and the Nairobi Stock Exchange

How companies make IPOs

A company seeking listing for the first time on the stock exchange offers part of its securities to be subscribed by the public, as part of the listing exercise. When a major shareholder (e.g. the government) is the one off-loading shares the shareholder (the vendor), not the company retains the proceeds of the offering. This offer is called an Initial Public Offering (IPO). The term only refers to the first public issuance of a company's shares. If a company later sells newly issued shares (again) to the market, it is called a "follow-on" offering.

Any company wishing to undertake an IPO in Kenya would have to get the approval from the Capital Markets Authority before the IPO can be carried out. The Authority (CMA), in considering an IPO proposal, takes into account compliance with the legal and regulatory framework by the company undertaking the IPO. Once approved, the company is required to issue a prospectus that tells about the company; what it does, how it has fared and how it expects to perform in the future. The Capital Markets Act requires a certain level of disclosure. Under this Act the CMA is required to ensure that the company offering the shares provides all the necessary information for investors to make informed investment decisions.

So how do investors participate?

IPOs are normally heavily advertised in the media. Not only because it is statutorily required but because companies want maximum publicity to ensure that their issues are a success. Before applying, investors should ensure they read the Initial Public Offering **(**IPO) prospectus for the issue. A prospectus may be a lengthy and even boring document to read. However, it can help one to better understand the company in which one may decide to put their money. At the very least, one should read the key information summary section of the IPO prospectus If they do not have the time or inclination to go through the whole document. As for any document that is contractual in nature, it is important to read all the fine print. This means the footnotes, small print and "Notes to the Accounts" in the prospectus.

What is a Prospectus

A prospectus is essentially an invitation or offer to the public to subscribe for or buy the securities of a company. It must contain all relevant information about the company making the offer, and must be filed with the relevant authorities. Therefore the information that is disclosed in the prospectus relates to the terms on which the invitation or offer is made. It is important for an investor to read and understand these terms in the prospectus in order to be able to assess the risks or merits in investing in the company. A company seeking listing on the stock exchange must have its prospectus approved by the Capital Markets Authority

Why Investors Must Read the Prospectus

This is a very important document. For an investor, it is the means by which one can judge how profitable and viable the investment is before one decides whether or not to participate in an initial public offer. An uninformed decision may cost an investor dearly. One must therefore read the prospectus very carefully and understand what is really at stake before he/she makes a decision. One should carefully assess the fundamentals of the company offering shares by studying the information provided. Though IPOs appear to be a good investment opportunity because of the general expectation of earning high initial returns, called premiums, risks do exist and there is no guarantee that prices may not fall once the shares start trading in the secondary market.

What to Look for in a Prospectus

What goes into a prospectus is currently governed by the Companies Act, the Capital Markets Act and the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations 2002. While the contents of a prospectus are generally the same, the presentation may vary from one issuer to another. By reading the prospectus, one may want to know about the future of a company and whether or not its business will grow. Bigger turnovers generally mean bigger profits and therefore should lead to enhanced share prices. But numbers do not always tell the whole story. One needs to go over the prospectus with a fine toothcomb for hints on the company's growth prospects and risk factors.

An investor should also want to know who manages the company, what products it sells, who buys the products, and whether or not its business is sustainable. Key information on these aspects can be found in various sections of the prospectus. Investors need to scrutinize and seek advice where they cannot understand. This can be done by analyzing; Basic Information; indicative offering timetable; definitions; corporate directory; summary information; summary of share capital, issue/offer statistics, indebtedness and intended use of the proceeds; details of the public offering; business information; financial information; shareholders, directors and management information; risk considerations associated with business and prospects of company; appendices; and procedures for application and acceptance.

Get an application form and fill it up

One should pick up the application forms at any investment Bank or Stockbroker's office; or any other agent appointed by the company undertaking the IPO. It's important to ensure that the application form is accompanied by a prospectus. The forms and the prospectus are free of charge.

While filling the form one should ensure they follow the directions given in the form. It's important to ensure all the information in the form is as they would want it to be. Every issue has a minimum number of shares that one must apply for, which is specified in the application form. Investors must be aware of this amount. The filled form and the monies must be submitted within the time frame specified in the offer documents.

Submit the form.

One will have to submit the form to the collecting bankers (a list is given in the form), or to the collecting agents for the investment banks and stockbrokers involved in the entire issue.

In conclusion publicity by the issuer is important to increase the likelihood of all the shares in an initial public offer being taken up. However, a glossy marketing campaign is never a good reason to buy shares. It's vital to dig a little deeper and make sure the company you are investing in is a sound investment prospect. One should not buy shares in a company just because it's an IPO – one should do it because it's a good investment.

Instilling confidence on investors

The Capital Markets Authority (CMA) is empowered under the Capital Markets Act and Regulations to take whatever action it deems necessary to correct the conditions resulting from contravention of any provisions of the Capital Markets Act. The Authority may also impose both financial and administrative penalties. It may institute Civil or criminal proceedings against any person who has committed an offence.