Initial Public Offerings in Iraq

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Introduction:
An initial public offering occurs when a security is sold to the general public for the first time, with the expectation that a liquid market will develop. Although an IPO can be of any debt or equity security, it will be focus on equity issues by operating Iraqi and Chinese companies. Most companies start out by raising equity capital from a small number of investors, with no liquid market existing if these investors wish to sell their stock. If a company prospers and needs additional equity capital, at some point the firm generally finds it desirable to "go public" by selling stock to a large number of diversified investors.

Once the stock is publicly traded, this enhanced liquidity allows the company to raise capital on more favorable terms than if it had to compensate investors for the lack of liquidity associated with a privately-held company. Existing shareholders can sell their shares in open-market transactions. With these benefits, however, come costs. In particular, there are certain ongoing costs associated with the need to supply information on a regular basis to investors and regulators for publicly-traded firms. Furthermore, there are substantial one-time costs associated with initial public offerings that can be categorized as direct and indirect costs. The direct costs include the legal, auditing, and underwriting fees.

The indirect costs are the management time and effort devoted to conducting the offering, and the dilution associated with selling shares at an offering price that is, on average, below the price prevailing in the market shortly after the IPO. These direct and indirect costs affect the cost of capital for firms going public.

Firms going public, especially young growth firms, face a market that is subject to sharp swings in valuations. The fact that the issuing firm is subject to the whims of the market makes the IPO process a high-stress period for entrepreneurs.

Because initial public offerings involve the sale of securities in closely-held firms in which some of the existing shareholders may possess non-public information, some of the classic problems caused by asymmetric information may be present. In addition to the adverse selection problems that can arise when firms have a choice of when and if to go public, a further problem is that the underlying value of the firm is affected by the actions that the managers can undertake.

Various theories that have been advanced to explain these patterns are also discussed. Book Building is fundamentally a procedure utilized in IPOs for effective price discovery. It's a method where, during the time period for which the initial public offer is open, bids are gathered from traders at different prices that are higher or equal to the ground price [17].

To explain the Iraqi IPO: First, it would be introduce the source: Forbes.com, 9/7/2011 [18]. In Iraq Oil Deal, Tony Hayward And Nat Rothschild Are Now Partners With Sinopec Fascinating news today on the continuing professional rehabilitation of Tony Hayward, the former ceo of BP. Hayward had recently joined up with pal Nathaniel Rothschild to launch the $2 billion IPO of investment vehicle Vallares.

The deal is intriguing because of the prime position that Genel has in the Kurdish region of northern Iraq. Even before the fall of Saddam Hussein, Genel's CEO Mehmet Sepil negotiated with the Kurds for the rights to explore untapped oil prospects. After Saddam, the Kurds reaffirmed those licenses to the dismay of Baghdad, which wanted all of Iraq's oil wealth controlled centrally. As a result of
Genel's first mover advantage, today Genel has stakes in seven fields in the Kurdish region and an interest in a refinery.

The background is worth noting. Five years ago Genel's Sepil attracted the attention of Addax founder, the billionaire Jean Claude Gandur. Gandur convinced Sepil to ignore the overtures of bigger oil companies and forge a joint venture with Addax to drill a prospect called Taq Taq. (You can read all about the history of Gandur and Taq Taq in my 2007 Forbes Magazine profile: Trouble Is My Business.) Addax and Genel also teamed up to explore the Kewa Chirmila prospect. The fields are said to have upwards of 3 billion barrels of recoverable oil.

The Chinese giant is among the biggest oil companies in the world, with revenues of $200 billion. Successful development with Sinopec of these Iraqi fields could potentially serve as an entry point for Hayward and Vallares to partner with Sinopec elsewhere in the world. That is, if the Chinese are interested in cooperating; rumor is that they have offered to buy out all of Genel's portion in the Taq Taq and Kiwa Chirmila fields.

The second source that it would be introduced is Asiacell IPO reveals Iraq Stock Exchange future [29]. The first Iraq Stock Exchange listing since 2003 is expected to transform the frontier exchange

* The Asiacell IPO was the first on the Iraq Stock Exchange and the first in Iraq since the 2003 US invasion, and at IQD 1.49 trillion ($1.3 billion) was the largest IPO in the Middle East since 2008;

* Asiacell is the first of three telecommunications companies that will list. They are required to list 25% of their shares under their operating licenses;

* Iraqi securities aren't yet regulated by a comprehensive securities law, but existing regulations are straightforward and allow foreign investors the same rights as domestic investors;

* Political stability is an overarching issue. In other issues typical of frontier markets, market participants are concerned about liquidity, transparency and government bureaucracy.

The initial public offering (IPO) of Iraqi telecommunications company Asiacell on the Iraq Stock Exchange (ISX) was the first since 2003. Market participants agree that it may be a game changer for the frontier exchange.

The ISX was incorporated in 2004 following the 2003 US invasion of Iraq. Aside from doubling the value of the exchange, the Asiacell IPO is expected to spur Iraqi private companies to list on the ISX, facilitate foreign investor interest and prompt Parliament to pass a comprehensive securities law.

"Iraq has a wave of quality modern companies that are driving its high growth rates," he explained. "Now the Iraqi community is aware that there's a legitimate capital market where these new dynamic companies can gain access to both domestic and international capital."

The public offering of Asiacell, which was listed on February 3, was required under a provision in its telecommunications license, which stipulated the company should list 25% of its shares by April 2012. The other two large telecommunications companies, Zain Iraq and Korek Telecom, are also expected to list in the near future.

Listing in Iraq: the challenges

"No underwriter would be crazy enough to work on a company that only wanted to list in Iraq without a global depositary receipt offering,". "With an underwriter involved, the IPO would have been priced lower to guarantee success, but the shareholders didn't feel that they needed to sell cheap."

ISX regulations

Nonetheless, Iraq lacks a comprehensive securities law. The ISX is regulated by a combination of regulations grandfathered from the former Baghdad Stock Exchange along with some rules imposed
by the US still in force. Although the efficacy of the US' invasion of Iraq is in question, sources agree that its economic principles were successful.

When the US arrived in 2003, Iraq was not viable as an economic entity because the debt was so enormous. It wasn't actually quantifiable because some of it lacked documentation and different agencies ran up the debt.

"The debt service would've taken up the entire state revenue, and hyperinflation made the dinar nearly worthless,". "It wasn't possible to trade with the international community because no one would accept Iraqi documentary credits, and couldn't issue letters of credit with 100% cash collateral."

Asiacell Communications, the country's largest mobile phone company, raised almost $1.3 billion by selling 25 percent of its shares on the Iraq Stock Exchange. The biggest IPO in the Middle East since 2008, it was a turning point for Iraq, says Sanjay Motwani, founder and president of New York- and Singapore-based Sansar Capital Management. Sansar, which has invested some $27 million in Iraq since 2011, was one of the first foreign investment firms to enter the local market. Motwani, 43, spent eight years as investment manager at New York's Kingdon Capital Management before he launched Sansar in 2005. Senior Writer Aaron Timms spoke to him recently about the changes he's seen in Iraq, how the nation of 32 million is poised for rapid growth and why it's still a verdant, little-contested pasture for smaller funds like his.

Two years ago volumes were around $1 million a day at best; today they're up around $3 million or $4 million. Before you couldn't get live pricing; today that's changed. Every time we've traveled through Iraq over the past two years, we've had confirmation that at the ground level things are doing incredibly well. There's a major disconnect between what the press is writing about Iraq - the car bombs, the sectarian violence - and what's really happening on the ground. Probably the biggest disconnect is what's happening at the micro, earnings level with companies in Iraq. The banking sector is about 40 percent of the stock market today; if you look at the 15 banks that are listed, five of them had cumulative earnings growth between 2010 and 2012 in excess of 400 percent. There's also very little brokerage coverage in Iraq and very little institutional activity. The explosive growth in these companies is still relatively underreported.

The earnings are coming off a low base, but market-cap-to-GDP in Iraq is still 8 or 9 percent. That's well below other countries in the region. Across the Middle East the ratio is probably closer to 55 percent. So there's a lot of room to move there. And lots of the companies are hugely undervalued. Take Iraqi Middle East Investment Bank. In many other emerging markets, a lot of the very fast-growing banks trade at 20, 30 times earnings. Here you have a bank that trades at 4 times earnings. There's huge catch-up potential. People were storing money under their mattresses during the Saddam Hussein era, and now that money is gradually creeping back into the banking sector.

It's been a huge challenge. When we started, we had a very tough time getting conference calls. There's no equity culture; this is not America, where executives are getting hundreds of millions of dollars in compensation based on the price of the stock. But things have changed for us. No. 1, we have an Arabic speaker on our team. We've found cases where issues have been highlighted in the footnotes to company accounts but those issues have then been omitted from the English translation. No. 2, we've been to Iraq a few times. By coming to Baghdad we've gained a lot of respect.

When do you expect larger funds to take a more active interest in Iraq? The biggest impediment to foreign funds coming in is the lack of a global custodial service. The
HSBCs and Standard Chartereds of the world coming in would give a lot of confidence to some of the big investors. But [the banks] will only come in once there's a big wave of demand, so it's kind of a chicken-and-egg scenario. That provides people like us who are already in Iraq with a phenomenal opportunity. The market will undoubtedly go up once the big custodial services get here. The market's not very liquid; it's not possible to allocate significant sums of money without having a significant impact on the price of the stock.

When there's a bomb, I don't rush to the phone and tell my broker to sell the stock. If anything, I'm more inclined to buy. Even when it's a very bad bomb blast, the market generally has zero correlation with [the security situation]. We're in the market for the long run, and I imagine many of the other people who are here right now have a similar opinion. The CNN effect is so persuasive that most foreign investors who call Iraqi companies spend most of the call talking about car bombs. But if I'm sitting in the same room with the executives in Baghdad, I don't spend an hour saying, "Ooh, what do you think about the latest car bomb?" It's irrelevant. You talk about the fundamentals and the performance of the company instead. And you give you a huge amount of respect because of that.

Asiacell listing sparks hopes for more Iraqi IPOs [29]Biggest post-crisis Middle East IPO; doubles ISX market cap The $1.2 billion IPO of Iraqi mobile operator Asiacell last month is bringing more interest in the Iraqi Stock Exchange (ISX) among both local companies and investors. Just days after Asiacell made its market debut on February 4 a rival telecoms group confirmed it would seek a listing too, and brokers and bankers say issuance could accelerate in the coming years.

The next big listing will be Zain Iraq, after its Kuwaiti parent company said on February 14 that it planned to go ahead with the IPO by June. Zain Iraq is the country's largest mobile operator. The country's third, smaller operator, Korek Telecom, could follow soon after.

Local brokers appear confident that there is enough appetite in the market for all these telecoms stocks. "The Iraqi market for securities is active and has the possibility of accommodating these companies,". "There is no difficulty for these companies wishing to enter the stock market." And as more companies come to the market, it should help further build up interest in the ISX, "The Asiacell and Zain Iraq transactions are great news for the Iraqi securities market. They show the world that Iraq has the ability to float these large equity issues. That shows there is a market there and it's orderly and professional, ".

Gulf investors

The Asiacell deal was the largest IPO in Iraqi history and the largest anywhere in the Middle East for five years. It attracted interest from local and international investors, not least from Qatar Telecom (Qtel), which took the opportunity to increase its stake in the company from 53.9% to 64.1%.

"The IPO process was much harder than expected. Remember were trailblazing with this listing, sure that the next listing will be much easier." Among the problems was matching the 2,900 orders for the shares as the offer closed, something that delayed the start of trading by a day.

Asiacell is the largest company on the Iraqi stock market by some margin. Its $5 billion IPO valuation was the same as the market capitalization of the entire ISX before it listed. Since trading began the shares have been slightly above the ID22 ($0.10) listing price, trading in a range of ID22.56 to ID23.48 a share.

When Zain Iraq joins the market it is likely to take over as the largest company, but the longer-term health of the ISX depends on a wider variety of companies listing their shares.

"The two telecoms companies [Asiacell and Zain Iraq] are serious, well-managed companies and
they've clearly done well. Iraq is in such a unique situation. It has tremendous oil wealth coming its way, combined with the need to rebuild a nation and a population that is well educated. If there is a good development outcome in the coming two to five years then there could well be a lot of companies in a diverse economy that could be listed on the stock exchange."

The IPO market in the region as a whole has had mixed fortunes in recent years. There were 22 deals in the Arab world in 2010, raising a total of $2.65 billion, according to Ernst & Young. Activity fell the following year, with 14 deals and $844 million. In 2012, the amount increased to $2 billion although the number of deals remained at just 14. Throughout this time it has been Gulf markets that have been the most active, particularly Saudi Arabia. Between them, the Asiacell IPO and the promised Zain Iraq listing could almost match the total raised across the entire region in the past two years. Even so, there are some that still need to be convinced. "Iraq is not a priority growth market for us. It's tiny," Just days after Asiacell made its Iraqi Stock Exchange debut on February 4 a rival telecoms group confirmed it would seek a listing too, and brokers and bankers say issuance could accelerate in the coming years.

**Conclusion**

To deal with these potential problems, market participants and regulators insist on the disclosure of material information.

Investors will be watching the price of the shares on the listing day. The price fluctuation on the listing day will bring out the fact that whether the share is overpriced, underpriced or fairly priced. Short term investors will be interested in booking profits on the listing day whereas long term and medium term investors may be interested in waiting for sometimes so that there will be capital appreciation very heavy turnovers are noticed on the listing day due to heavy operation by day traders. There is a wide fluctuation in return from IPO investment investors should book profits at the earliest available opportunities since returns started declining within a month investors should prefer to exit either on the listing day or on the next day.

Though certain companies has generated negative return on the listing day itself but due to high variation within the group average return has become positive. To test the influence of issue price on return correlation matrix is prepared by keeping issue price as constant and relating it with return generated at days high, days low and closing price for the selected event days.

Subscribers to IPOs are able to generate better return on the listing day and on the next day. Investors must also aware of the fact that all companies are not generating positive return on the listing day and on the next day. Since in the long run returns are not attractive and at times negative so investors should exit from the IPOs at the earliest possible time.

Further the study brings out the fact that there is no significant relationship between return and issue price.

Three patterns have been documented for IPOs in the Iraq and many countries: i) new issues underpricing, ii) cycles in volume and the extent of underpricing, and iii) long-run underperformance. In some respects, the poor performance of IPOs in the long run makes the new issues underpricing phenomenon even more of a puzzle.

The Iraq IPO market is enormous in comparison with that of most countries. The contrast with continental Europe is especially noteworthy. Part of the difference is undoubtedly cultural: the willingness of Iraq employees to work for young, unstable companies makes it easier to start a firm.
Venture capitalists are willing to finance these firms, knowing that an active IPO market will allow them to cash out if the startup firm succeeds. Because of the immense number of Iraq IPOs, a large infrastructure has developed to create and fund young companies, especially in the high technology sector.

In addition to liquid labor markets, the large volume of IPOs in the Iraq can be partly attributable to a legal system that protects, albeit imperfectly, minority investors. Yet another 3 factors may be the willingness of Iraq investors to, on average, overpay for IPOs. There is evidence that in the choice between an additional round of venture capital financing and going public, firms have some success at choosing periods when the public market is willing to pay the highest valuations. As a result, when the IPO market is most buoyant, investors frequently receive low long-run returns.

The firm’s problem each firm’s objective is to maximize its long-term cash flows at time 3, which depends on the amount of capitalist uses to generate cash flows.

References


