

What to look for in new **Share Floats**

By Mark Story



The rush to list everything from education and child-minding centres, massage parlours, and funeral homes through to salmon producers, dairy technology outfits – and just about everything in between on the Australian Stock Exchange (ASX) – suggests there’s never been a better time for companies to contemplate “going public”. So how do investors pick the best of the bunch?

Strong investor appetite for new offerings

– boosted by an improving local and international economic outlook - does bode well for companies wishing to raise capital through an initial public offering (IPO). In fact, recently floated companies - that joined the (Australian) market over the past six months - raised around four times the amount of cash secured by companies that joined the exchange late in 2002.

Richard Murphy ASX head of listings and business believes the latest wave of (Aussie) floats reflected “pent-up demand” for capital raising due to a six-month lag between a company’s decision to list and its actual listing. But a cursory glance at the recent performance of most new Aussie listings reminds investors that not all IPOs stay afloat – at least not over the short-term.

FLOATS DISAPPOINT

Recent research from KPMG Corporate Finance found most public company floats in 2000-01 showed a loss for investors at year-

end. In fact, the KPMG figures, released in its annual capital markets survey, revealed 62% of the 124 IPOs in the year to June 30, 2001, were trading below their issue price (at year-end). Even those investors lucky enough to pick the right float in 2000-01 received only paltry rewards for their efforts.

There’s already a plethora of Aussie companies - including mini-miners and brand icons alike - (representing an estimated A\$10 billion worth of floats) queuing up to join recently-listed big guns like: Richard Branson’s Virgin Blue, Australia’s biggest automotive parts retailer Repco Corp, and privately-owned building company, Multiplex Constructions – on the ASX. In fact, with a large pipeline building for 2004 already, many brokers are preparing for their busiest March quarter for floats ever.

BLOCKBUSTER FLOAT

The blockbuster float for 2004 looks to be consumer goods company, Pacific Brands. Encompassing brand icons like,



THE FIRST RULE TO REMEMBER ABOUT A FLOAT, SAYS BRIGHOUSE IS THAT IT'S NOT BEING OFFERED AS A FAVOUR TO YOU.

Bonds, Berlei, Holeproof underwear, and King Gee - most brokers expect Pacific Brands to be attractively priced and offer shareholders a good dividend yield. TXU Australia - an offshoot of US energy giant TXU - is also planning to list on the ASX in 2004, and brokers expect rival telco Primus Telecommunications to raise up to A\$800 million through an IPO.

KIWI FLOATS

On this side of the Tasman, those publicly named as candidates for floats in 2004 include: Pumpkin Patch, and Stirling Sports, while Charlie's, the fruit juice company founded by former All Black Mark Ellis, is soon to list on the recently established NZAX. A float in Australia with a dual listing in New Zealand is also touted as likely for Carter Holt's tissue division. Meantime, gold mine Macraes is due to end up listed on the NZX again through a GRD (Macraes) IPO.

IPO SCRUTINY

Attracted by the strength of the brand, it's hardly surprising that mum and dad investors clamoured for slice of the Virgin float. While new listings will (in varying degrees) present opportunities for investors, Mark Brighthouse chief investment officer with Arcus

Investment Management Limited warns that all IPOs must be considered on their merits.

To Brighthouse this means applying a rigorous valuation approach to new listings and

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“ANOTHER TIP, SAYS SHANE EDMOND IS TO CHECK IF THE FLOAT IS UNDERWRITTEN. THIS TYPICALLY GUARANTEES THAT THE BROKER WILL BUY ANY SHORTFALL OF SHARES NOT SOLD DURING THE FLOAT.”

existing listed companies. “It’s about how much (if any) of a discount the new shares are offered compared to their long term value.”

In fairness to IPOs, half of the 48 companies listed (on the ASX) since 1 July 2003 are trading above their issue price - by as much as 106%. By late November, 26 of the newest listed companies were trading at an average 30% premium to their issue price - outweighing the 22 that had fallen - by an average of 15% below the price nominated in the prospectus.

But the recently-listed Australian Leisure and Entertainment Property Group (ALH) - the property arm of Foster’s spin-off - suggests it’s a mistake to assume a good brand name (alone) translates into a good stock. Shares in ALH - the 78th listing for the calendar 2003 year - is now trading at A\$2.29 after hitting a high of A\$2.53 shortly after listing.

While the current market does favour new issues, Brighthouse says the success and failure of the new floats is all about the underlying quality of the company. “That means identifying companies with a clear competitive advantage, sustainable pricing and earnings growth momentum.”

WHAT TO LOOK FOR

So what do you need to know to ensure you invest in the right floats? The first rule to remember about a float, says Brighthouse is that it’s not being offered as a favour to you. He says it’s important for investors to find out whether raising capital will be as mutually advantageous for new shareholders as it will be for founding (pre-IPO) shareholders. “Preferably IPOs should raise additional capital rather than provide a convenient exit strategy. But a sell-down by a previous investor doesn’t necessarily mean the investment has no further potential.”

In other words, if somebody wants your money, the crucial question is where that money is going - into somebody’s pocket - or ploughed into the business? So it’s important to check what’s buried in the fine print at the back of the prospectus under related party transactions, management agreements or directors’ interest to find out how much the vendors will suck out of the company once it lists. As you may expect, the most dramatic float flops are typically those where most of the money went to the vendors for selling their business to naive shareholders.

WHO’S BENEFITING?

Not surprisingly, Brighthouse recommends looking for IPOs where the lion’s share of the float money will go into the business



rather than the vendors of the shares. Be sure to check the offer proceeds section in the prospectus to tell you what money is going where and to whom. In Virgin Blue's case, about 75% of the A\$500 million-plus proceeds will go into the business. The remainder was a convoluted carve-up between major shareholders, Branson and Patrick Corporation.

When considering the price at which the shares are being sold, check what the going rate is for similar companies. The company isn't necessarily cheap just because the price appears to be low – especially if there are many shares on issue.

UNDERWRITING THE FLOAT

Another tip, says Shane Edmond manager of retail broking with Forsyth Barr is to check if the float is underwritten. This typically guarantees that the broker will buy any shortfall of shares not sold during the float.

While that's good, exactly how much the listing company pays the underwriter can be a telling sign. Anything above 4% may suggest the underwriter senses a big risk with the float.

But what can put the lid on a share price, argues Edmond is when a weak underwriter lands itself with a large amount of stock that it didn't expect to own - as happened on both the AMP and Macquarie Airports floats.

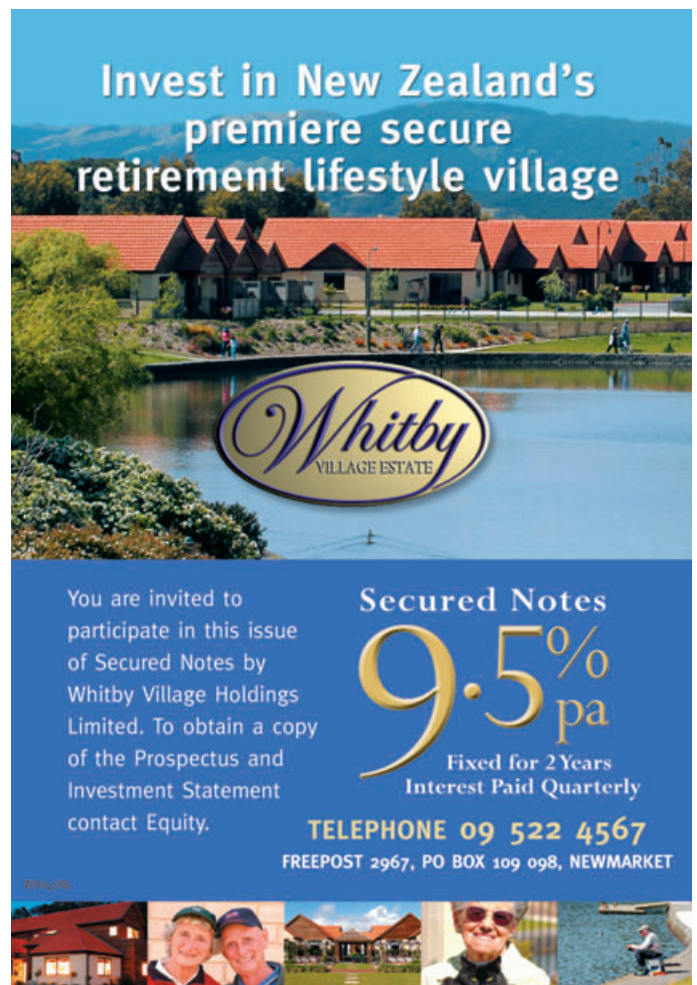
Admittedly, being 'out of the money' (on an IPO) doesn't necessarily mean you've invested in a lemon, especially if you plan a buy and long-term hold approach. But what can add further insult to injury for IPOs (that leave shareholders seriously 'out of the money') is the likely wall of sellers that often surface when the stock finally trades above or close to the issue price.

ALLOCATIONS

Just because an offer takes oversubscriptions is no guarantee you'll get the number of shares you asked for. In fact, with allocations based more on capital market nuances than fairness, you might not get any at all. And assuming you do miss out, there's no guarantee you'll be paid interest for the weeks the company had your money.

PROFIT FORECASTS

As shareholders of plastics manufacturer, Vertex discovered the hard way, profit forecasts aren't necessarily worth the paper they're printed on. What's more important, says Brighthouse are the assumptions on which those forecasts are based. For



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example, companies that need to maintain an upper limit of a US\$0.65 exchange rate to remain profitable or that need to

borrow more as interest rates rise – should trigger alarm bells. “There’s a big difference between poor share price performance due to an adverse environment and poor share price performance due to unrealistic forecast assumptions. The latter causes more lasting damage to investor confidence and management reputations,” says Brighthouse.

IPO PREMIUM?

Those who invested in Promina at the time of its IPO have almost doubled their money in six months. So assuming a company has been correctly valued and has some accurate profit forecasting - what sort of premium

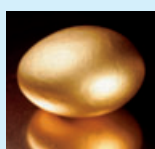
can investors realistically expect for buying shares during an IPO? The pricing of floats is clearly a function of the market. But as attractive as they were, the quick returns garnered from pre-bull market floats - like Promina – now look to be a thing of the past.

But Edmond says an IPO should start trading on day one 5% to 10% up – with a little bit left on the table. “The days of getting a 30% premium on listing are unrealistic,” says Edmond. “Promina is a classic example of a forced seller, no underwriter, the price set at the lower end of the range (based on negative sentiment) - and a case of buying something when not too many buyers wanted it.”

Another good way to get a feel for the float, says Edmond is by looking at what brokers are competing to be involved. For example, several of the country’s largest brokers, including Merrill Lynch were so keen to be a part of the Telstra float that they pulled out of the bidding for Optus.

HOW THEY FARED

With commodity prices on the rise, it’s hardly surprising that resources sector (predominantly West Australian mining stocks) dominated the list of ASX newcomers. While listings were consistent throughout the year – for example four in July, eight in August, four in September and 11 in October – November heralded a frenzy of new listings (21) not witnessed since the dot-com boom in 1999-2000.



TOP TEN

The top ten listings by size over the past six months, including Multiplex, Australian Leisure & Hospitality, Virgin Blue and Macquarie DDR Trust, consumed A\$5.1 billion of the A\$6.6 billion raised on the market.

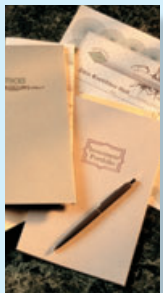
But the best capital gains on shares came from small companies worth between A\$25 million and A\$50 million, that (by December 8) had recorded an average rise of 22%. Top of the list was Kip McGrath Education Centres - up 126%, followed by Nkwe Platinum, Boom Logistics, Red Metal and Knights Insolvency Administration.



WORST TEN

The ten worst – from those that have fallen since listing - include Metabolism Health (54%), Marengo Mining

(35%), Comdek (32.5%), Allied Gold (32.5%), Innamincka Petroleum (30%), Navigator Resources (27.5%), Westcoast Mining (22.5%), Financial Resources (22.5%), Pharmaxis (22%) and Cryptome Pharmaceuticals (20%).



NZ IPOs

New Zealand has largely been a bystander to Australia's flood of floats. The number of NZ Listed Issuers rose from 153 in

December 2002 to 170 in December 2003 - an increase of 11.11%. While the number of Overseas Listed issuers fell from 72 to 60 over the same period – two newly listed issuers in December brought the total for the year to 25 (including 13 on the new NZAX). Like Promina, Edmond says the NZX and Freightways listings – up over 60% and 40% respectively since floating – are classic examples of identifying opportunities offering real value.



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[#]All rates issued are per annum and are subject to change.

COVER STORY

UPCOMING FLOATS ASX						last updated Thursday, January 08 2004
Company name	Ticker Code	Issue price	Amount sought	Underwriter	Expected float date*	
Tri Origin Minerals	TRO	\$0.20	\$5.0m	N/A	1100 AEDT 09-Jan-04	
Transol Group		\$0.25	\$6.0m	Melbourne Capital	TBA	
Mt Dimer Gold Mines	MDG	\$0.20	\$4.5m	N/A	TBA	
Republic Gold	RAU	\$0.20	\$5.6m	Lands Kirwan Tong	TBA	
Paramount Mining Corp	PCP	\$0.20	\$3.5m	N/A	TBA	
BioDiem	BDM	\$1.25	\$10.0m	Lead Managers: EG Capital, EL&C Baillieu	14-Jan-04	
Clime Capital	CAM	\$1.00	\$30.0m	N/A	14-Jan-04	
Mediguard	MGZ	\$0.20	\$5.0m	N/A	14-Jan-04	
Crusader Holdings NL		\$0.20	\$2.2m	N/A	15-Jan-04	
Signature Brands	SBL	\$0.20	\$3.2m	KTM Capital	19-Jan-04	
Austin Engineering		\$0.20	\$1.8m	N/A	23-Jan-04	
Granite Three Pillars	GNP	\$1.00	\$100.0m	Lead Manager: White Funds Management	23-Jan-04	
CogState		\$0.50	\$5.5m	EG Capital	28-Jan-04	
Wilson Leaders	WLS	\$1.00	\$250.0m	N/A	29-Jan-04	
Liberty Gold NL		\$0.20	\$2.0m	N/A	09-Feb-04	
Warrenmang		\$0.35	\$6.0m	N/A	17-Feb-04	
Transerv Australia		\$0.20	\$2.0m	Lead Manager: Paterson Ord Minnett	18-Feb-04	
CollTech Australia		\$0.20	\$4.5m	N/A	26-Feb-04	
Lionheart Exploration	LHX	\$0.20	\$2.0m	N/A	Withdrawn	
Connect Group	CGR	\$0.75	\$10.8m	Lead Manager: Paterson Ord Minnett	Withdrawn	
Macarthur Diamonds	MDD	\$0.20	\$2.5m	N/A	Withdrawn	
Tamagulla Resources	TRR	\$0.20	\$5.0m	N/A	Withdrawn	

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PROSPECTUSES MISS THE BOAT

Results from recent research by University of Melbourne Professor Ian Ramsay prove convincingly that prospectuses simply don't fulfil investor expectations. Believe it or not, when it comes to making investment decisions, investors ranked the prospectus in fourth position, after newspapers, investment magazines and broker advice.

While over half of the 900 respondents spent between 30 minutes and an hour reading a prospectus, those who didn't read it were put off by its complexity, plus the legal and technical jargon.

Ramsay's results also reveal that investors perceive prospectuses to be too long, highly repetitive and detailed – especially on financial matters. Not surprisingly, only 36% claimed the prospectus gave them sufficient information to make an investment decision, while 52% still felt the need to seek additional professional advice. Those who did read it, says Ramsay were primarily interested in performance projections, executive team details, and returns.

In addition to not complying with statutory requirements - required to make an informed assessment of the investment - Ramsay argues that the value of prospectuses is relatively limited from a decision-making perspective. Until the prospectus can be improved, he suggests shareholders take their cue from survey respondents and do their homework on new floats by reading the newspapers and investment magazines and getting advice from their broker.

HOW TO SMELL AN IPO ABOUT TO FLOP

- The company lacks special market appeal.
- Vendors are selling out and banking proceeds.
- Management has a questionable track-record.
- Too many management agreements & related-party transactions.
- The proposed price is out of whack with that of similar stocks.
- Assumptions are not given for profit forecasts.
- There's no dividend forecast.
- There's an unusually high underwriting fee.
- The prospectus is written in legal jargon.
- There's no compelling reason for the float.
- There's no rivalry between brokers to get in on this float?
- Most shares remain in the hands of company directors?
- There's insufficient interest from the fund managers?