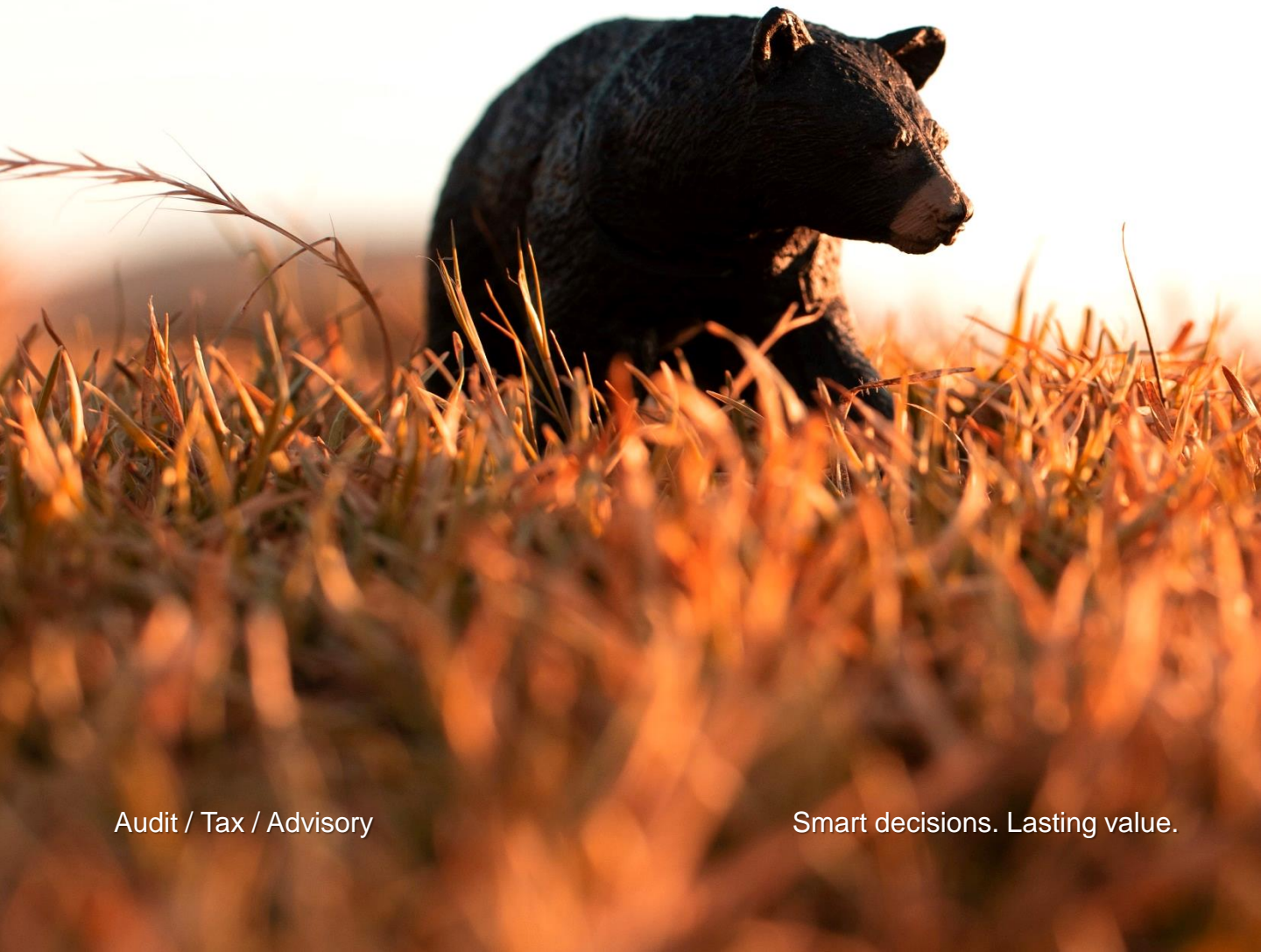




Initial Public Offerings (IPO) in a Bear Market

September 2022

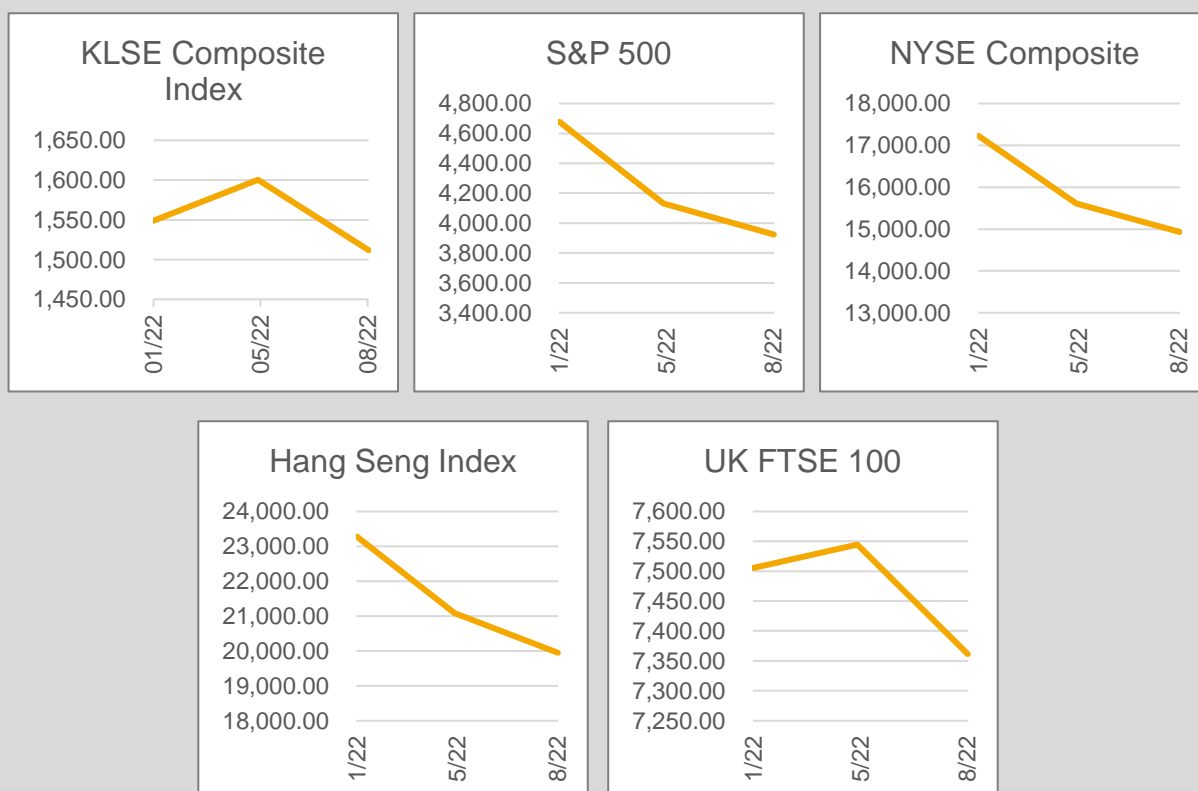


The State of the Equity Market

Are IPOs in a bear market still tenable? Let's survey the situation.

Global equity markets have seen better times with major markets retreating from their levels at the beginning of the year. The decline in major equity markets were caused by a combination of the Covid 19 pandemic effects, war in Ukraine, geopolitical tension between China and US, inflation, and recent hikes in interest rates.

The Kuala Lumpur Stock Exchange ("KLSE" or "Bursa Malaysia") is not spared, with its composite index dropping from 1,543 in January this year to 1,512 in August, a 2.39% drop. This is consistent with global markets indices which have also dropped between 2% and 17% as shown in the tables below.



The State of the Equity Market (cont.)

Major Markets	3/1/22	30/8/22	Points (+/-)	% (+/-)
KLSE Composite Index	1,549.05	1,512.05	-37.00	-2.39%
UK FTSE 100	7,505.20	7,361.60	-143.60	-1.91%
S&P 500	4,677.03	3,924.26	-752.77	-16.10%
NYSE Composite	17,226.10	14,931.42	-2,294.68	-13.32%
Hang Seng Index	23,274.75	19,949.03	-3,325.72	-14.29%

The bearish market seems to stem from lower growth due to reduced household purchasing power and tighter monetary policy. This was further exacerbated by lockdowns and the deepening real estate crisis in China and the spillover effects from the war in Ukraine. Global inflation has risen due to higher food and energy prices and supply-demand imbalances.

The global economy is facing multiple challenges with China contracting due to its zero Covid policy, Russia in a sharp recession due to Western sanctions, and Europe facing energy price spikes. This has led to trade deterioration, and a decline in real income and consumption.



IPOs in Malaysia – Bucking the Trend

The IPO market in Malaysia seems to buck the overall bearish outlook in the equity market, with 24 new IPOs in the first 8 months of the year. The total number of IPOs for the full year in 2022 is expected to surpass that of 2021 which was already a significantly better year than 2020.

Year	* Main Market	ACE Market	LEAP Market	Total
2022^	3	17	4	24
2021	7	11	12	30
2020	2	10	7	19

* Includes REITs

** Excludes ETFs

***Source: ISD/Exchange Market Data/Bursa Malaysia as at 30/8/2022

^ - 8 months to 31 August 2022

The 24 IPOs in 2022 raised approximately **RM1.3 Billion** through the issuance of shares to the public, underpinning the capital market's function as a platform for companies to raise funds.

All 24 companies raised funds in their IPO exercise except for the 4 companies listed on the LEAP Market.

In addition, promoters, and shareholders also monetised their hard-earned investments through the sale of their shares to the public amounting to approximately RM1.1 Billion.

IPOs in Malaysia – Bucking the Trend (cont.)

The share price performance of the IPO companies was mixed, with 15 companies recording gains while 9 were in the red. The rate of returns also fluctuated from a high of 320% gain to a loss of 35%. The share price performance by sector is as follows:-

Sector	Above IPO price		Below IPO price		Total	
	No. of companies	%	No. of companies	%	No. of companies	%
Construction	-	-	2	100%	2	8%
Consumer	3	50%	3	50%	6	25%
Financial Services	1	100%	-	-	1	4%
Healthcare	2	100%	-	-	2	8%
Industrial	2	33%	4	67%	6	25%
Plantation	1	100%	-	-	1	4%
Technology	6	100%	-	-	6	25%
Total	15	63%	9	38%	24	100%

The Technology, Financial Services, Healthcare, and Plantation sectors are the star performers in terms of share price movements since IPO with all the companies in these sectors recording gains since their IPO.

Most notable was that share prices of all 6 companies under the Technology sector recorded gains, with 2 of the companies, SFP Tech Holdings Berhad and Agmo Holdings Berhad making significant gains of 320% and 250% respectively.

This could be attributed to market sentiments in the era of accelerated digitization and adoption of technology.

The worst performer is the Construction sector where the share prices of both companies listed under this segment are below their IPO prices. Other segments such as Industrial and Consumer sectors showed mixed results.

This could be attributable to the weak consumption patterns, coupled with inflation and the increase in interest rates.

While this is a simplistic analysis, as share price movements are dependent on many factors, especially the financial performance and outlook of each company, it does provide some reference on the performance of different sectors broadly.

IPO Trend for the Rest of 2022

Based on the number of IPOs so far and those in the pipeline, it seems that the general sentiment in terms of investing is on the uptrend even though the market appears to be bearish (see KLSE Composite index chart). This may be due to the reopening of the economy during 2022 which has led to a rebound in certain business sectors as a result of pent-up demands for the past two years.

The reopening of borders is also expected to spur certain business segments, especially tourism and retail segments. The increased economic activities are expected to have a positive effect on the IPO market.

Should You Consider an IPO Under the Current Bearish Market?

The strong interest in IPOs despite the bearish equity market is an indication that taking a company public is not all about share price or the state of the equity market. While it is an important consideration to ensure that shareholders get a fair valuation for their companies when they go public, there are also other long term and strategic factors which are equally if not more important.

We look at some of these factors below.



Fundraising for Expansion

IPO continues to be one of the major avenues for companies to raise funds for expansion. As mentioned earlier, funds raised by IPOs in Bursa Malaysia totaled RM 1.2 Billion during the first 8 months of 2022. Farm Fresh Berhad led the pack, raising RM300 Million through its public issue.

Most funds raised from IPOs were for the expansion of businesses and working capital. This is especially important where companies have already utilised shareholders' equity and borrowings for their initial expansion. IPO continues to be a preferred fund-raising option for companies which do not want to over-gear and to maintain a healthy balance sheet, especially in view of the current volatile interest rate environment.

The high number of IPOs despite the lackluster equity market also demonstrated that growth companies can attract investors if they have a compelling business model and where the company demonstrates a good profit track record.

Should You Consider an IPO Under the Current Bearish Market? (cont.)



Succession and Retention of Key Employees

Succession issues and key employees' retention are also reasons for certain companies to consider an IPO, especially when founders of companies do not have an obvious successor or are facing a talent drain. This is especially relevant for companies in the high-tech industries where ESOS or other share plans are used effectively to retain and reward key employees.

Steve Jobs famously paid himself a token US\$1 during his tenure as Apple's CEO and derived his wealth from the appreciation of the company's share price.



Credibility and Visibility

A public company is required to publish its financial statements and make announcements of significant events to the public. They are also subjected to overviews and scrutiny by regulators.

As a result, public companies are generally considered to be more credible. These are important reasons for certain companies to go public, especially those which are expanding overseas or into new markets. These companies frequently find that their status as a listed company provides them the credibility and visibility necessary when dealing with both customers, vendors, and sometimes authorities. This is also applicable when companies need to tender for major projects and compete with their peers.

Should You Consider an IPO Under the Current Bearish Market? (cont.)



Mitigating Risks of Business Owners

In most private companies, the finances of the companies are interlinked with the owners. For example, it is quite common that private companies' bank borrowings are secured against the personal assets of owners or through owners' personal guarantees. This is especially when the companies are growing and relied on bank borrowings to fund their growth.

Unfortunately, if the companies fail, the owners will suffer financial ruin as well. An IPO allows business owners to separate their personal finances from that of their companies as it is common that personal guarantees are not required for listed companies. In this way, business owners can mitigate their financial risks.



Monetising Your Investments

During an IPO, a company raise funds through the issuance of shares to the public. At the same time, major shareholders of the company may also sell their shares to the public. This is often referred to as an Offer for Sale.

During the first 8 months of 2022, 13 of the 24 companies listed in Bursa Malaysia undertook an Offer for Sale exercise which raised approximately RM1.1 Billion to the shareholders, a sizeable return for the major shareholders of the companies.

In addition, in most of these cases, these major shareholders continue to have either a majority or a significant shareholding in the companies. This is compelling for shareholders who want to monetise a portion of their investments while continuing to manage the companies.



Leverage in Mergers and Acquisitions ("M&A")

In the current competitive and fast-moving business environment, M&A activities are crucial for companies to stay ahead of their competitors, either making acquisitions or mergers to capture market share or buy out up-and-coming competitors.

A listed company has the advantage of using its equity to carry out M&A activities, making its offer more attractive to vendors without exhausting the company's cash.

Conclusion



The bearish equity market does not seem to deter companies to continue their IPO exercise, at least for KLSE. Companies which have good business models, which operate in the “right” business segments, have competent and proven management team, and are raising fresh capital for expansion do not seem to be affected by the bearish capital market in deciding their IPO plans. Furthermore, there are many other good reasons for companies to take this route and we expect the IPO market to continue to be busy in the near future.

Thinking about listing your business?

At time of publication for this article, Crowe Malaysia has 7 IPOs and leads as the accounting firm with the most IPOs in 2022. We are ready to help you overcome the hurdles to becoming a public listed company on the road of the long and demanding IPO process. **Talk to us today.**

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