

**Монгол улс**

**Монгол улс**  
**Монголын хөрөнгийн зах зээлийн**  
**чадавхыг бэхжүүлэх төсөл**

**Мэргэжлийн туслалцаа, хамтын**  
**ажиллагааны үр дүн**

**2018 он 1 дүгээр сар**

**Японы Олон Улсын Хамтын Ажиллагааны**  
**Байгууллага (JICA)**

**Дайва Судалгааны Хүрээлэн**  
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**【Reports】**

| Sr. | No. | Date       | Title  | Document     | In charge   |
|-----|-----|------------|--|--------------|-------------|
| 3   | 3   | 2015/4/4   | Report on the current status of Mongolian capital market | Word         | consultants |
| 8   | 8   | 2016/12/15 | Concept paper on Self Regulatory Organization (SRO)      | Presentation | consultants |
| 9   | 9   | 2017/1/30  | Concept paper on Policy Committee                        | Word         | consultants |

**【Training in UB (SOEs): 31 March 2015】**

| Sr. | No. | Date      | Title  | Document     | In charge   |
|-----|-----|-----------|--|--------------|-------------|
| 16  | 2   | 2015/3/31 | Consulting approach for initial public offering (IPO) & dual listing | Presentation | consultants |

**【Training in UB (Regulatory authority): 27 April - 1 May 2015】**

| Sr. | No. | Date      | Title  | Document     | In charge   |
|-----|-----|-----------|--|--------------|-------------|
| 17  | 1   | 2015/4/27 | Organizational structure of Financial Services Agency (FSA) and framework of regulation and supervision for securities sector in Japan | Presentation | FSA         |
| 18  | 2   |           | Supervision of securities firms in Japan   | Presentation | FSA         |
| 19  | 3   |           | Off-site monitoring  | Presentation | FSA         |
| 20  | 4   | 2015/4/28 | An overview of securities inspection   | Presentation | FSA/SESC    |
| 21  | 5   |           | Risk evaluation and key indicators in inspection process   | Presentation | FSA         |
| 22  | 6   | 2015/4/29 | The role of securities firms and the implications  | Presentation | consultants |
| 23  | 7   |           | Investor's roles   | Presentation | consultants |
| 24  | 8   |           | Stock markets in Asia  | Presentation | consultants |
| 25  | 9   | 2015/4/30 | Corporate finance basics   | Presentation | consultants |
| 26  | 10  |           | Financial analysis basics  | Presentation | consultants |
| 27  | 11  |           | Financials for securities companies  | Presentation | consultants |
| 28  | 12  | 2015/5/1  | Case study - BDBSec's annual financial summary   | Presentation | consultants |

**【Training in UB (Securities companies): 20&23 May 2016】**

| Sr. | No. | Date      | Title  | Document     | In charge   |
|-----|-----|-----------|--|--------------|-------------|
| 30  | 2   | 2016/5/20 | IPO & Dual-listing (1): Scheduling                     | Presentation | consultants |
| 32  | 4   |           | IPO & Dual-listing (3): Capital policy                 | Presentation | consultants |
| 33  | 5   | 2016/5/23 | Business promotion - How to approach potential clients | Presentation | consultants |
| 34  | 6   |           | Investor education                                     | Presentation | consultants |
| 35  | 7   |           | Business ethics for securities companies               | Presentation | consultants |

**【IPO&DL Seminar No.1 (23 June 2015)】**

| Sr. | No. | Date      | Title   | Document     | In charge   |
|-----|-----|-----------|---|--------------|-------------|
| 37  | 2   | 2015/6/23 | Costs and benefits of initial public offering (IPO)                             | Presentation | consultants |
| 38  | 3   |           | Dual listing: Benefits and introduction of Asian major stock exchanges          | Presentation | Daiwa CM HK |
| 39  | 4   |           | Privatizing state-owned corporations (SOCs) - Lessons from Japanese experiences | Presentation | consultants |
| 41  | 6   |           | Opportunities for Mongolian companies to IPO in Japan                           | Presentation | JPX         |

**【IPO&DL Seminar No.2 (18 March 2016)】**

| Sr. | No. | Date      | Title  | Document     | In charge          |
|-----|-----|-----------|--|--------------|--------------------|
| 44  | 2   | 2016/3/18 | Innovative thinking in Investor Relations and Corporate Governance   | Presentation | Mr. Tatsuya Imade  |
| 45  | 3   |           | Optimizing capital markets through innovations - Lessons from the past & on-going initiatives in foreign markets | Presentation | Prof. Seiji Adachi |

**【IPO&DL Seminar No.3 (12 May 2017)】**

| Sr. | No. | Date      | Title  | Document     | In charge   |
|-----|-----|-----------|--|--------------|-------------|
| 46  | 1   | 2017/5/12 | Progress of JICA's Technical Assistance Project                      | Presentation | consultants |
| 47  | 2   |           | Redesigning Mongolian capital market: Rationale and technical issues | Presentation | consultants |
| 48  | 3   |           | Opportunities for Mongolian companies to raise capital in Japan      | Presentation | JPX         |

**【Investor Week Seminar (27 October 2016)】**

| Sr. | No. | Date       | Title  | Document     | In charge          |
|-----|-----|------------|--|--------------|--------------------|
| 49  | 1   | 2016/10/27 | How to activate equity trading - Lessons from Japanese experiences | Presentation | Prof. Seiji Adachi |

**【Training in Tokyo No.1 (October 2015)】**

| Sr. | No. | Date      | Title   | Document     | In charge        |
|-----|-----|-----------|---|--------------|------------------|
| 50  | 1   | 2015/10/1 | Overview of Japan Exchange Group (JPX) and recent developments in Japanese capital market           | Presentation | JPX              |
| 51  | 2   |           | Listing examination   | Presentation | JPX              |
| 52  | 3   |           | Listed company regulation & supervision - Maintaining & enhancing the quality of financial products | Presentation | JPX              |
| 53  | 4   |           | Corporate governance and disclosure   | Presentation | JPX              |
| 54  | 5   | 2015/10/2 | A brief explanation of market surveillance at Japan Exchange Regulation                             | Presentation | JPX              |
| 55  | 6   |           | Inspection on trading participants  | Presentation | JPX              |
| 56  | 7   | 2015/10/5 | Self regulatory function of Japan Securities Dealers Association (JSDA)                             | Presentation | JSDA             |
| 57  | 8   |           | JSDA rules for initial public offerings (IPOs)  | Presentation | JSDA             |
| 58  | 9   |           | The role of an underwriter in an IPO  | Presentation | consultants      |
| 59  | 10  | 2015/10/6 | Investor relations  | Presentation | Daiwa Securities |
| 60  | 11  |           | Listing standards and underwriters  | Presentation | consultants      |
| 61  | 12  | 2015/10/7 | Audit and internal control report system under the Financial Instruments and Exchange Act           | Presentation | FSA              |
| 62  | 13  |           | Supervision of large securities firms in Japan  | Presentation | FSA              |
| 63  | 14  | 2015/10/8 | An overview of the Securities and Exchange Surveillance Commission (SESC)                           | Presentation | FSA/SESC         |
| 64  | 15  |           | The inspection policy and inspection program  | Presentation | FSA/SESC         |
| 65  | 16  |           | Financial analysis  | Presentation | FSA/SESC         |

**【Training in Tokyo No.2 (April 2016)】**

| Sr. | No. | Date      | Title   | Document     | In charge   |
|-----|-----|-----------|---|--------------|-------------|
| 66  | 1   | 2016/4/11 | Listing requirements in Asia  | Presentation | consultants |
| 67  | 2   |           | Stock exchange in Asia  | Presentation | consultants |
| 68  | 3   | 2016/4/12 | Japan Exchange Group and recent developments in Japanese securities markets                           | Presentation | JPX         |
| 69  | 4   |           | International cooperation of Japan Exchange Group   | Presentation | JPX         |
| 70  | 5   |           | Disclosure and corporate governance   | Presentation | JPX         |
| 71  | 6   | 2016/4/13 | Listed company regulation & supervision - Maintaining and enhancing the quality of financial products | Presentation | JPX         |
| 72  | 7   |           | Inspection on trading participants  | Presentation | JPX         |
| 73  | 8   |           | A brief explanation of market surveillance at Japan Exchange Regulation                               | Presentation | JPX         |
| 74  | 9   |           | Listed companies' disclosure for investors  | Presentation | consultants |
| 75  | 10  |           | Accounting scandals and false reports   | Presentation | consultants |
| 76  | 11  | 2016/4/14 | Self regulatory function of Japan Securities Dealers Association (JSDA)                               | Presentation | JSDA        |
| 77  | 12  |           | Outline of qualification examinations, etc., implemented by JSDA                                      | Presentation | JSDA        |
| 78  | 13  |           | Case studies: Discoveries by recent member firm inspections   | Presentation | JSDA        |
| 79  | 14  |           | Disciplinary actions of JSDA  | Presentation | JSDA        |
| 80  | 15  | 2016/4/15 | Supervision of authorized financial instruments firms association                                     | Presentation | FSA         |
| 81  | 16  |           | Supervision systems of financial instruments markets  | Presentation | FSA         |
| 82  | 17  |           | Cooperation with self regulatory organizations (SROs)   | Presentation | FSA/SESC    |
| 83  | 18  |           | Capital market development in Myanmar   | Presentation | consultants |

**【Training in Tokyo No.3 (May 2017)】**

| Sr. | No. | Date      | Title   | Document     | In charge           |
|-----|-----|-----------|---|--------------|---------------------|
| 84  | 1   | 2017/5/18 | Eligibility for dual listing  | Presentation | consultants         |
| 85  | 2   |           | What we need for bond market  | Presentation | Daiwa Securities    |
| 86  | 3   |           | Introduction to Japan Commodity Clearing House (JCCH)   | Presentation | JCCH                |
| 87  | 4   |           | Introduction to Tokyo Commodity Exchange (TOCOM) Group  | Presentation | TOCOM               |
| 88  | 5   | 2017/5/19 | Overview of Japan Exchange Group  | Presentation | JPX                 |
| 89  | 6   |           | Listed company regulation & supervision - Maintaining and enhancing the quality of financial products | Presentation | JPX                 |
| 90  | 7   |           | Overview of Tokyo Stock Exchange (TSE) equity market  | Presentation | JPX                 |
| 91  | 8   |           | Overview of Japan Securities Clearing Corporation (JSCC)  | Presentation | JSCC                |
| 92  | 9   | 2017/5/22 | Self regulatory rules of JSDA   | Presentation | JSDA                |
| 93  | 10  |           | JSDA rules for IPOs   | Presentation | JSDA                |
| 94  | 11  | 2017/5/23 | Outline of the regulations on securities companies in Japan   | Presentation | FSA/SESC            |
| 95  | 12  |           | A summary of Japanese government bond (JGB) debt management   | Presentation | Ministry of Finance |

**【Other lecture materials and presentations】**

| Sr. | No. | Date       | Title  | Document     | In charge   |
|-----|-----|------------|--|--------------|-------------|
| 98  | 3   | 2015/5/19  | Lecture on Self Regulatory Organization (SRO) at Financial Regulatory Commission (FRC)             | Presentation | consultants |
| 99  | 4   | 2015/5/21  | Lecture on Self Regulatory Organization (SRO) at Mongolian Stock Exchange (MSE)                    | Presentation | consultants |
| 100 | 5   | 2015/6/9   | Lecture on improving financial literacy  | Presentation | consultants |
| 101 | 6   | 2015/6/30  | Listing rules  | Presentation | consultants |
| 102 | 7   | 2015/9/8   | Introduction of the Project for capacity development   | Presentation | consultants |
| 103 | 8   | 2015/11/23 | Requirements for listing and disclosure  | Presentation | consultants |
| 104 | 9   | 2016/1/15  | Financial Market - New investment environment: Challenges for potential issuers and intermediaries | Presentation | consultants |
| 106 | 11  | 2016/6/2   | Japanese experience on financial literacy  | Presentation | consultants |
| 107 | 12  | 2016/6/28  | Lecture on investor education  | Presentation | consultants |
| 108 | 13  | 2016/7/7   | Introduction to listing management   | Presentation | consultants |
| 109 | 15  | 2016/11/1  | Policy Committee   | Presentation | consultants |
| 110 | 14  | 2016/11/9  | Lecture for FRC Management Team (1)  | Presentation | consultants |
| 111 | 16  | 2016/11/9  | Lecture for FRC Management Team (2)  | Presentation | consultants |
| 112 | 17  | 2016/11/14 | Lecture for FRC Management Team (3)  | Presentation | consultants |
| 114 | 19  | 2017/2/20  | Privatization and IPO (1)  | Presentation | consultants |
| 115 | 20  | 2017/2/23  | Privatization and IPO (2)  | Presentation | consultants |
| 116 | 21  | 2018/4/13  | Investor Protection Fund   | Presentation | consultants |



# **Report on the Current Status of Mongolian Capital Market**

**April 2015**

**JICA Consultant Team**

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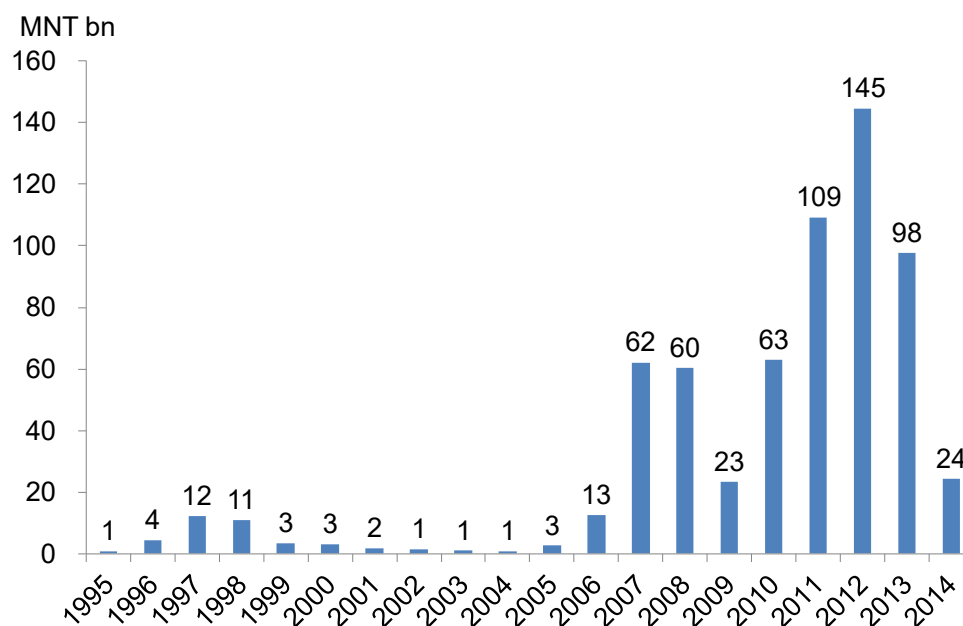
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## I. Overview of the Mongolian Capital Market

MSE faced another tough year in 2014. Trading value declined to MNT 24bn, down 75% from MNT 98bn for 2013. Market capitalization fell to MNT 1.4tn (US\$764m), which is **equivalent to 7% of Mongolia's GDP** at the end of Dec14. 7% to GDP is the second lowest in North and Southeast Asia, after Cambodia. By counter, APU is the largest in market capitalization at MNT 279bn (US\$150m), followed by Tavantolgoi's MNT 232bn.

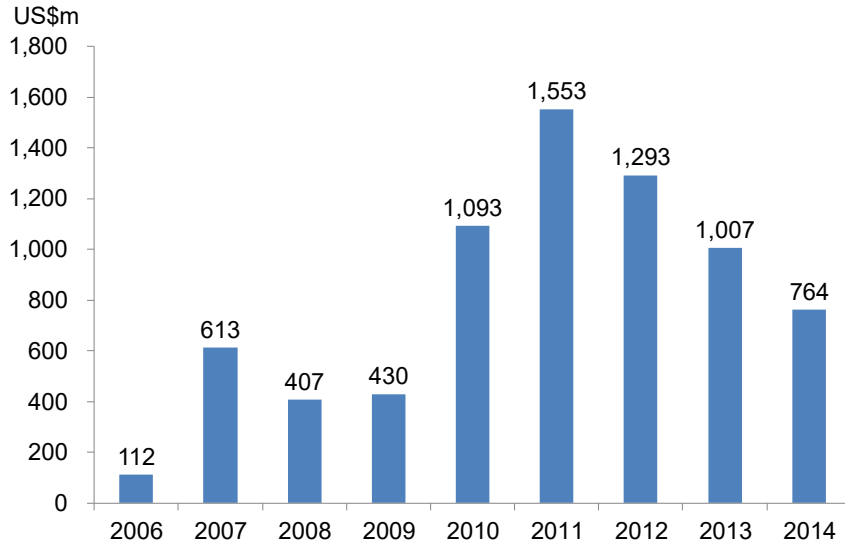
**Figure 1-1 Trading value at MSE**



Source: MSE

MSE's slow trading activities are attributed to structural issues as well as economic downturn. MSE is lack of blue chips. Floating rates for most of MSE stocks are too low at a single digit. Financial reports are sometimes not reliable. Disclosure is not favorable for investors for many cases. General public is not familiar with the stock market. In addition, Mongolia's economy has been hit by weak natural resource prices. Interest rates were raised to fight import inflation.

**Figure 1-2 MSE’s Market capitalization**



Source: MSE

**Table 1-1 Top10 companies by market capitalization, end-Dec14**

MNT bn

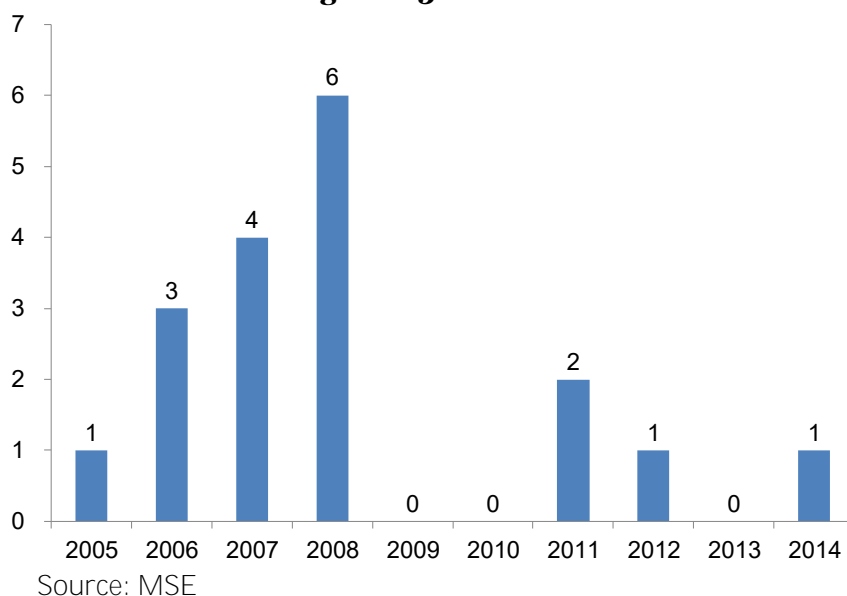
| Market cap |                   | 2014 |
|------------|-------------------|------|
| 1          | APU               | 279  |
| 2          | Tavantolgoi       | 232  |
| 3          | Berkh Uul         | 68   |
| 4          | Shivee Ovoo       | 67   |
| 5          | Sharyn Gol        | 62   |
| 6          | Baganuur          | 61   |
| 7          | Gobi              | 58   |
| 8          | UB Buk            | 48   |
| 9          | Suu               | 41   |
| 10         | Mongol Securities | 40   |

Source: MSE

**(1) Listed companies**

No of listed companies at MSE further decreased by 24 to 237 in 2014. The JICA Consultant team (the team) believes that delisting companies that do not meet listing requirements is a right action for MSE. Given that there have been only 18 IPO in the past, number of listed companies can potentially drop to less than 100, in our view.

**Figure 1-3 No of IPO**



Quite a few listed companies do not comply with corporate responsibility. Some of them even do not submit financial reports, according to a survey by FRC. There are some that do not hold an annual shareholders' meeting. Financial numbers are sometimes not reliable, according to accountants. There are only 10 or less listed companies that are audited by the big four international accounting firms. No of listed companies paying dividends are ranging from 15 to 40, depending on a year. The team believes that these facts definitely dampen market confidence, especially from overseas investors.

**Table 1-2 No of listed companies with corporate responsibility, 2013**

|   | # out of listed companies |
|---|---------------------------|
| <b>Paid dividends</b>                     | 30                        |
| <b>Submitted financial reports</b>        | 204                       |
| <b>Renewed company charter</b>            | 161                       |
| <b>Appointed independent directors</b>    | 122                       |
| <b>Held annual shareholders' meetings</b> | 150                       |

Source: FRC

In fact, many of major Mongolian corporate group of companies are unlisted. There are roughly 50 overseas-listed companies with Mongolian assets, mainly in Toronto, Australia and Hong Kong. The team also believes that promoting IPO for unlisted Mongolian companies with sound fundamentals and making dual-listing for Mongolian-related companies at TSX/TSV, ASX, HKEx, LSE etc. will be necessary for more active market. Privatization including ETT can be also a driver for MSE, in our view.

## **(2) Securities companies**

The team thinks that securities industry needs further development. It is quite obvious that there are too many small-sized securities companies. According to FRC, there are some that even do not own office space. No of licensees for brokers and dealers declined to 62 from 83 in the past one year, which the team believes is a right action. The team also expects a further decline in no of securities companies after Jul15, when minimum paid-up capital requirements for licenses will be raised.

**Table 1-3 No of licensees**

|               | Broker,<br>dealer | Underwriter | Investment<br>advisory |
|---------------|-------------------|-------------|------------------------|
| <b>Dec-13</b> | 83                | 25          | 16                     |
| <b>Jan-14</b> | 79                | 25          | 16                     |
| <b>Feb-14</b> | 79                | 25          | 16                     |
| <b>Mar-14</b> | 79                | 25          | 16                     |
| <b>Apr-14</b> | 79                | 25          | 16                     |
| <b>May-14</b> | 79                | 25          | 16                     |
| <b>Jun-14</b> | 79                | 25          | 16                     |
| <b>Jul-14</b> | 71                | 25          | 16                     |
| <b>Aug-14</b> | 71                | 25          | 16                     |
| <b>Sep-14</b> | 71                | 25          | 16                     |
| <b>Oct-14</b> | 65                | 25          | 16                     |
| <b>Nov-14</b> | 65                | 25          | 16                     |
| <b>Dec-14</b> | 62                | 25          | 16                     |

Source: MSE

BDSec is the largest securities company in Mongolia, with a brokerage market share of 32% for 2014. The company is also known as a major underwriter in Mongolia, which has a track record of 11 IPO out of 18.

**Table 1-4 Brokerage share by securities companies, 2014**

|                                   | 2014 |
|-----------------------------------|------|
| <b>1 BDSEC</b>                    | 32%  |
| <b>2 TDB CAPITAL</b>              | 20%  |
| <b>3 TULGAT CHANDMANI BAYAN</b>   | 8%   |
| <b>4 TENGER CAPITAL</b>           | 7%   |
| <b>5 GOLOMT SECURITIES</b>        | 6%   |
| <b>6 DELGERKHANGAI SECURITIES</b> | 4%   |
| <b>7 STANDARD INVESTMENT</b>      | 3%   |
| <b>8 MONSEC</b>                   | 3%   |
| <b>9 GENDEX</b>                   | 3%   |
| <b>10 ASIA PACIFIC SECURITIES</b> | 2%   |
| <b>Top10 total</b>                | 89%  |

Source: MSE

Nevertheless BDBSec is considered to be a small-sized securities company with employees of 50. Operating revenues for 2012 and 2013 were MNT 5.9bn and MNT 2.6bn, which are translated into US\$4.4m and US\$1.7m, respectively.

**Table 1-5 Summary of BDBSec's financial data**

MNT m

|                               | 2012  | 2013  |
|-------------------------------|-------|-------|
| <b>Cash and equivalents</b>   | 661   | 858   |
| <b>Short-term investments</b> | 3,801 | 3,684 |
| <b>Total assets</b>           | 9,750 | 9,750 |
| <b>Liabilities</b>            | 281   | 832   |
| <b>Shareholders' equity</b>   | 9,469 | 8,918 |

|                          |       |       |
|--------------------------|-------|-------|
| <b>Operating income</b>  | 5,952 | 2,636 |
| <b>Gross profit</b>      | 4,859 | 1,986 |
| <b>Income before tax</b> | 1,666 | 323   |
| <b>Net income</b>        | 1,491 | 288   |

Source: BDSec

**Table 1-6 List of IPO**

MNT m

| Ticker     | Listed company                  | Listing date | IPO amount | Underwriter                         |
|------------|---------------------------------|--------------|------------|-------------------------------------|
| <b>MSH</b> | Hotel Mongolia JSC              | 25-May-05    | 800        | BDSec                               |
| <b>JTB</b> | Genco Tour Bureau JSC           | 17-Jan-06    | 8,259      | BDSec                               |
| <b>520</b> | Zoos Bank JSC                   | 2006         | 2,023      | <i>Ace and T Capital (Worldkey)</i> |
| <b>BDS</b> | BDSec JSC                       | 22-Jun-06    | 750        | BDSec                               |
| <b>MIB</b> | Moninjbar JSC                   | 2007         | 1,000      | BDSec                               |
| <b>HBO</b> | HBOil JSC                       | 2-May-07     | 400        | BDSec                               |
| <b>OLL</b> | Olloo JSC                       | 12-Sep-07    | 582        | n.a.                                |
| <b>MDR</b> | Mongolian Development Resources | Dec-07       | 13,200     | BDSec                               |
| <b>HRM</b> | Hermes Centre JSC               | 16-May-08    | 2,356      | Bats Invest                         |
| <b>529</b> | Anod Bank JSC                   | 2008         | 20,171     | <i>without underwriter</i>          |
| <b>RMC</b> | Remicon JSC                     | 19-May-08    | 5,049      | Gauli (DCF)                         |
| <b>NKT</b> | Nako Fuel JSC                   | 24-Jun-08    | 900        | BDSec                               |
| <b>HGN</b> | Khuh Gan JSC                    | 30-Jul-08    | 3,195      | BDSec                               |
| <b>533</b> | Mon Fresh JSC                   | 2008         | -          | MICC (cancelled)                    |
| <b>SIL</b> | Silicat JSC                     | 1-Aug-11     | 3,650      | BDSec                               |
| <b>SHG</b> | Sharyn Gol JSC                  | 2011         | 18,300     | BDSec                               |
| <b>ETR</b> | E-Trans logistics JSC           | 9-Apr-12     | 924        | BDSec                               |
| <b>MRX</b> | Merex JSC                       | 14-Jan-14    | 2,600      | Standard Investment                 |

Note: Zoos Bank and Anod Bank were delisted  
Source: BDSEc, MSEC etc.

The team thinks that industry consolidation is necessary for Mongolia's securities industry. Current average size of securities companies is too small for operation, including investor education. Potential leaders in the industry are those under banking groups, in our opinion. Figure 7 shows that securities companies under banking groups ranked #2, #4 and #5 in the brokerage market share. The team also observes that there are attempts by bank-related

securities companies for expansion.

**Table 1-7 Mongolia's big four banks and securities business**

|                              | Khan Bank                   | Golomt Bank  | Trade Development Bank        | Xac Bank                           |
|------------------------------|-----------------------------|--|-------------------------------|------------------------------------|
| <b>Total assets, 2013</b>    | MNT 4.8tn                   | MNT 3.7tn  | MNT 5.1tn                     | MNT 1.8tn                          |
| <b>Securities subsidiary</b> | -                           | Golomt Securities<br>(subsidiary)                    | TDB Capital<br>(subsidiary)   | Tenger Capital<br>(sister company) |
| <b>Securities license</b>    | Underwriting<br>(Khan Bank) | Brokerage (Golomt Sec)<br>Underwriting (Golomt Bank) | Underwriting<br>(TDB Capital) | Underwriting<br>(Tenger Capital)   |

Source: Khan Bank, Golomt Bank, Trade Development Bank, Xac Bank

Bank-related securities companies are also major players in the retail government bond market. Tenger Capital gains 68% of share in accumulated amount for the period of 23 Dec-24Feb. TDB Capital and Golomt Securities are ranked #3 and #4, respectively.

**Table 1-8 Trading value of retail government bonds, 23 Dec 14-24 Mar 15**

|                          | Sales  | M/S |
|--------------------------|--------|-----|
| <b>Tenger Capital</b>    | 75,937 | 64% |
| <b>TDB Capital</b>       | 17,735 | 15% |
| <b>Ard Capital</b>       | 10,004 | 8%  |
| <b>Golomt Securities</b> | 7,820  | 7%  |
| <b>BDSec</b>             | 4,106  | 3%  |

Source: MSE

### **(3) Investors**

Activities by Mongolian investors were slower for 2014. Although there are around 780,000 accounts at MSCH&CD, most of them are account holders that are allocated ETT shares, in our understanding. There are roughly 20,000 retail investors, but only 10,000 active investors, according to Mongolian Association of Securities Dealers.

There are almost no domestic institutional investors in Mongolia. Potential domestic institutional investors are insurance companies, but insurance companies do not have any exposure to shares so far. US-based Firebird is known as one of major overseas institutional investors in Mongolia, but overseas investors activities are also limited, due mainly to the current inactive market.

### **(4) MSE**

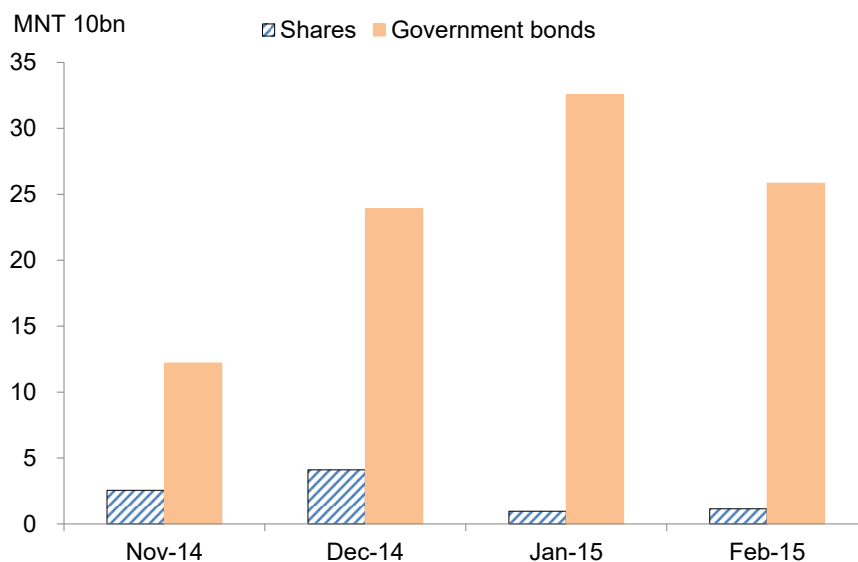
Since Jun14, MOF becomes controls MSE as its sole shareholder, replacing SPC. MOF and MSE appear to have discussions closely for revitalization of MSE. For 2014, the team forecasts that MSE incurred loss for the third consecutive year, as a result of weak market sentiment.

MSE has taken a couple of new measures in the past year, in an effort to reform the market. First, MSE categorized all listed stocks in three groups. Companies under Classification 1 will be regarded as globally-comparable quality stocks. Those under Classification 2 are mid-sized stocks, while stocks under Classification 3 are small cap counters and companies that do not meet requirements. There is none for Classification 1, 89 for Classification 2 and 148 for Classification 3.

Second, retail government bonds are now sold and traded at MSE. Government bonds which are auctioned in a preceding week, are sold at MSE for retail investors since Nov14. Secondary trading of retail government bonds started in Jan15. Currently there are three

maturities of 12, 28 and 52 weeks for retail government bonds, and they attract retail investors with a high-yield of 14-16%, which is sometimes slightly higher than bank deposit rates. In fact, amount of retail government bond sales exceeds that of shares in the past four months.

**Figure 1-4 Trading value of shares and retail government bonds**



Source: MSE

MSE is considering commodity futures and currency futures as new products. MSE apparently thinks that Commodity futures have potential, given relatively active Mongolia Agriculture Commodity Exchange. For currency futures, the team has impression that MSE studies Kazakhstan Stock Exchange’s experiences. KASE’s trading value for 1Q14 reached US\$65bn, 74% out of which was derived by currency futures, according to KASE.

**Table 1-9 Mongolian Agriculture Commodity Exchange**

| Description                 |   |
|-----------------------------|---|
| <b>Established</b>          | 2013                                      |
| <b>Trading value, 1H14</b>  | MNT 450bn                                 |
| <b>Products</b>             | Cashmere (90% of total), wool, oilseeds   |
| <b>Responsible agencies</b> | Ministry of Industry and Agriculture, FRC |

Source: various

**Table 1-10 Breakdown of trading value at Kazakhstan Stock Exchange, 1Q14**

|                                     |      |
|-------------------------------------|------|
| <b>Currency</b>                     | 74%  |
| <b>Shares</b>                       | 0%   |
| <b>Corporate bonds</b>              | 0%   |
| <b>Government securities</b>        | 2%   |
| <b>Repo (corporate securities)</b>  | 1%   |
| <b>Repo (government securities)</b> | 24%  |
| <b>Total</b>                        | 100% |

Source: Kazakhstan Stock Exchange

## II. Five expected outcomes and JICA Consultant team's cooperation

### 1. Effective Policy Committee for vitalization of the capital markets

#### (1) Review on the current situation in Mongolia

FRC has established the Non-standing Policy Committee in September 2014 by the order of the Chairman of FRC as shown in the below. Main role of the Non-standing Policy Committee is to have deliberation on important issues on the capital market development, policy, regulations and other related matters, and to issue recommendation on such issues.

There are thirteen members in the Committee. According to what we heard in January 2015, Vice Chairman of the FRC took a role as the Head of the Committee. Senior Supervisor of the Securities Market Department and the head of Capital Market Policy Planning Division, was the secretary of the Committee. The members were assigned by FRC Chairman's order as shown below.

#### **Order of the FRC Chairman. About establishing the Policy Committee:**

According to the items 3.2, 4.2 of the Charter of FRC, approved by the Parliament Resolution #45 of 2006, it is ORDERED that:

1. In order to discuss the issues on capital market development, policy, regulations and other related matters, to elaborate recommendation and comments on necessary issues, establish the non-standing Policy Committee for Capital markets with below persons:

Head of the Policy Committee: Daajamba B. FRC Commissioner and Vice Director  
Members of the Policy Committee:

|                 |  |
|-----------------|--|
| Jambaajamts T.  | Acting head of the Securities department of FRC                        |
| Ganbat D.       | Head of the Supervision Department, Bank of Mongolia                   |
| Nyamaa B.       | Head of the Capital markets and insurance policy department, MoF       |
| Angar D.        | Acting CEO of MSE  |
| Gandulam T.     | CEO of MSCH &CD  |
| Ulziibayar B.   | Board member of MASD   |
| Burenjargal Ts. | CEO of MASD  |
| Lkhagvadorj B.  | Board Chairman of BDSec  |
| Altantsetseg B. | Economics teacher of Economics School, National University of Mongolia |
| Ganzorig A.     | Economics teacher of Economics School, National University of Mongolia |
| Unenbat J.      | CEO of Corporate Governance Development Center                         |
| Ganzorig U.     | President of the Capital Markets Association                           |

Secretary: Tumenbayar Sh., Senior Supervisor, CM Policy and Planning Division, Securities Department of FRC

2. Assign the Head of the Policy Committee /Daajamba B./ to take necessary measure for establishing and enacting the committee.
3. Assign the Head of the Policy Committee /Daajamba B./ to provide guidance and supervision on the committee activities and report and present the necessary issues to FRC Meeting.

By Chairman of FRC

Mr. Bayarsaikhan D.



Although the team does not have the latest member list of Policy Committee, the new responsible department for the committee is Market Development Department.

By January 2015, four meetings have been held since the establishment of the Committee. The first meeting was to make an introduction of members and role of the Committee to all members. The other three meetings were held on ad-hoc basis, depending on the current and urgent issues which FRC thought should be discussed among the major stakeholders and the academic experts. The topics of discussion and recommendation in the Committee are: split of function of CSD, tax policy to promote the capital market, privatization of state owned companies listed in MSE, private pension funds, etc. (see Appendix 1)

According to a member of the Committee, a couple days before the meeting being held, related documents for discussion are sent to each member by FRC. Summary of the meetings is disclosed on the FRC website in Mongolian but not in English<sup>1</sup>.

Although FRC submitted recommendations of the Committee to the Parliament and the Government, it seems that these recommendations are not considered very seriously by them, and none of these recommendations has come into effect up to now. This is because the Policy Committee is regarded as non-standing and is not officially institutionalized yet, and also, perhaps more importantly, thorough discussion with a wide range of viewpoints has not been made within a very short time-frame of the past meetings.

Hence, it will be very important for FRC to formalize the Policy Committee as an influential advisory institution in the capital market and to improve operation of the Committee in more effective manner.

## **(2) Possible solutions**

Taking into account the fact that the capital market in Mongolia is at a very early stage of development and a wide variety of issues needs to be discussed and resolved by only a limited number of people who have sufficient knowledge and experience on the capital market, the team has to say it would be difficult for FRC to emulate the structure and operations of the Financial System Council in Japan (described in Appendix 2) entirely. However, in order for FRC to strengthen the authority of the Policy Committee and to **improve the Committee's operation**, the team believes the following measures should be considered to be taken in the near future.

### **a) To institutionalize the Policy Committee as a formal and independent advisory body for the FRC**

Firstly, it is important to institutionalize the Policy Committee as a standing body, and some type of rules or regulations on roles & functions of the Committee should be issued when necessary. As illustrated in the case of Financial System Council in Japan, such rules or regulations should stipulates major tasks, organization, appointment of members, etc. of the Committee.

Also, such Committee should be regarded as an independent body which would make recommendation to the government from the perspective of the third party. In this regard, it would be desirable that the head of the Policy Committee be a person with an independent standpoint.

---

<sup>1</sup> Bank of Mongolia (BOM) has Monetary Policy Committee consisted of 14 members including 7 BOM management people, 3 academic experts and 1 MOF official and 3 from the financial industry associations. Monetary Policy Committee was held four times in 2014, and "statement" or decision in the Committee is disclosed on BOM's website both in Mongolia and in English.

**b) To set up an appropriate meeting schedule which enables the members to analyze a specific issue and deliberate it thoroughly**

As indicated in the current operations of the Financial System Council, its Sectional Committees and several Working Groups in Japan, the team supposes that members of the Policy Committee need to have more time and wider-ranging viewpoints to make thorough discussion and deliver an opinion which is effective and constructive for the development of the capital market in Mongolia. In other words, the Policy Committee needs to have sufficient consensus building process, especially for important issues which are very new to the Mongolian capital market or which could have large influence on the current and future market players. For a certain type of issue, it would be more effective to invite industry professionals who make presentation or explanation on the current situation of the issue, in order for the members to have better understanding on the issue. Each issue should be discussed in the Committee at least [three] times within a certain time frame before submitting a recommendation or a report to the Chairmen of FRC.

**c) To enlarge the members of the Policy Committee**

It would be difficult for each member of the Committee to have thorough understanding and give an independent opinion of all the issues discussed in the Committee. At the same time, considering a limited number of professional people and academic experts of the capital market in Mongolia at this stage, it would not be realistic to have Sub Committee or Working Group for each of a specific issue.

Hence, the team believe that it would be important to enlarge the members of the Committee so that at least some member(s) could have profound knowledge and actual business experience (either in Mongolia or abroad) on an issue. Inviting more professionals from the private sector including large companies listed at MSE or at overseas stock exchange, institutional investors, banks, law firms, etc. could be an option. Also, including expatriates or foreign professionals working in Ulaanbaatar could be considered to learn from experiences abroad.

**d) To disclose minutes of the Policy Committee both in Mongolian and in English**

It will get more and more important for FRC as a regulator to earn stronger trust from the financial industry and the public. In order to achieve that, FRC needs to be more transparent when making an important decision which affects the current and future businesses of players in the capital market. Sharing information on the current progress of a specific issue could also be helpful to enhance knowledge level of professionals in the capital market.

In this regard, the team believes that it would be important to disclose information of the Policy Committee as much as possible, including minutes and relevant documents of meetings, both in Mongolian and in English.

**(3) Probable technical cooperation activities under JICA program**

In this JICA project, a FSA person, who is in charge of the Financial System Council in Japan, will be able to provide helpful information to FRC on its experiences and efforts in operating the Council since 1998.

In addition, depending on a specific topic discussed in the Policy Committee, FSA, an industry professional or an academic expert will be sent from Japan as an outside lecturer (or as a non-standing member) of the Committee.

The JICA consulting team will help FRC to institutionalize the Policy Committee as an independent advisory body, give advice on appropriate and effective operation of the Policy

Committee and suggest possible outside lecturer from Japan.

Based on discussions with FRC, MSE and the market participants, possible issues to be discussed further in the Policy Committee are:

- Taxation related to the securities market
- Introduction of derivative products in MSE

Enhancing research and planning capability at Market Development Department is an additional request that FRC expects support from the team. The team will discuss with JICA on this matter.

## **Appendix 1: Recommendations by the Policy Committee in the past meetings**

### **Recommendation #1**

In regard to the Government Resolution # 292, dated on September 18, 2014, **about the measures to be taken for the “MSCH & CD” LLC.**, the Policy Committee recommends following:

1. **Separating some of the functions of the “MSCH & CD”, and transferring them** to the new entity will bring significant changes in the securities clearing, settlement and deposit in the country, and the impact on the overall market infrastructure may be significant. Therefore, in order to avoid any systemic risk, any distortion or confusion in the market, and any damage to clients and investors, it is recommended that there should be a Working Group established and shall be composed of the representatives from the professional institutions and all other market participants, and the implementation of the resolution shall be conducted based on the comments and conclusions of that Working Group, and if deemed necessary, the implementation shall be done by stages/phases.
2. **The “MSCH & CD” is a special object that contains secret and confidential** information of the State as well as individuals and thus it is under the protection of State security guards. It is recommended that the Government shall resolve the due care issues to make sure there is no leakage of any confidential information to any third party during the process of transferring some of its functions to the new entity.
3. Although it is appropriate to separate the securities settlement function as an independent entity as stated in the item 4 of the abovementioned resolution, it is not appropriate to have it under 100% control of a securities trading organization. Instead, the Government and Ministry of Finance should own its shares, and coordinate and direct those three companies of securities trading, central depository of securities and securities settlements. Because, the securities settlement entity will not only conduct MSE trading settlements, but also the settlements for other trades that are conducted on the Commodity exchange and OTC market. Therefore it is inappropriate to have the MSE own all of its shares.
4. To ensure that there is no increase in the fees charged from market participants, investors and clients due to shifting the securities settlement function to a separate entity.
5. Keeping its main activities (settlement, title registration, safekeeping of securities) that require a lot of work to transfer at the current company, and separate other activities by shifting them to the new entity is the key leverage for maintaining the normal flow of the company and also avoid any potential systemic risk. In other words, the current company shall continue to undertake the safekeeping of securities, registration of titles to the securities, and the securities settlement function shall be transferred to the new entity. This will be the optimal solution for the time being, and if necessary, the relevant decisions should be altered accordingly.

### **Recommendation #2**

In order to stimulate the capital market development, the Government should

implement a policy on increasing the demand and supply in the capital market products, and in this regard, the Policy Committee is recommending the followings to the Parliament and the Government:

### **One: Promoting supply and demand in the market through tax/fiscal policy**

It is recommended to offer tax credits or discounts for IPO companies.

#### 1.1. For the Issuing company:

- 1.1.1. To offer a corporate income tax discount or scaled tax rate for an IPO company depending on its trading volume during the first 3 years since IPO. Example: for a company that raised 10 billion by issuing securities (either IPO or bond), a 5% corporate income tax can be levied during the first 3 years, and if the raised fund exceeds 10 billion, then the tax is waived during the first 3 years. Or, for new securities offering, a discount tax rate for the first 3 years, and furthermore, the current 10% and 25% rates can be lowered to 5% and 10%.
- 1.1.2. For businesses that are based on public interests (i.e. banks, mining companies, telecommunication companies), if they become a listed company, a tax waive can be applied for certain period of time.
- 1.1.3. The current 10% tax on **capital gain is discouraging the investors' interest** in this type of financial products. Thus, the tax on capital gain shall be waived until January 1<sup>st</sup> of 2021, or for capital gains earned over up to 2 years of holding period, the tax rate should be 5%, and for capital gains earned over 2 and more years of holding period, the tax should be waived, or the rate should be lowered depending on the length of holding period.
- 1.1.4. For companies, the tax on dividend income earned by investing in a public company shares should be waived until January 1<sup>st</sup> 2021.

#### 1.2. For Individual Investors:

- 1.2.1. The capital gain tax for individual investors shall be waived until January 1<sup>st</sup> of 2021, or for capital gains earned over up to 2 years of holding period, the tax rate should be 5%, and for capital gains earned over 2 and more years of holding period, the tax should be waived, or the rate should be lowered depending on the length of holding period.
- 1.2.2. For individual investors, the tax on dividend income earned by investing in a public company shares should be waived until January 1<sup>st</sup> 2021.

### **Two: Trading of the shares of State Owned Companies that are listed on MSE**

According to an official survey, there are 1,965,759,932 shares of 21 companies that are 100% State owned; and 72,552,967 shares of 16 companies that have state ownership to some degree. However, there is no market capitalization calculated for the 100% state owned companies. The State ownership portion in those partially state-owned companies constitutes 31% of the total market capitalization of the securities market. This is something we need to pay attention to.

Although abovementioned companies are listed on the MSE, their shares are not traded. The actions to start trading these shares need to be taken. By trading the

shares owned by the State, the total trading volume of the market, investment activities and the number of investors in the market will increase, and it will enable an environment for determining more accurate market value of the securities, and thus furthermore lead to better corporate governance practices, and evolvement of large national companies.

**Three: Use of the securities market infrastructure and ensuring higher valuation of the shares when conducting the privatization activities of the State owned companies**

The development of the securities market is related to the privatization program of the country. Conducting the privatization of the state owned companies through MSE, using its infrastructure and systems will enable significant fund raising by attracting many investors. Moreover, it will help stimulating the market activities and thus contribute to the economy.

It is not sufficient to privatize only 4 companies out of the 22 state-owned companies included in the privatization list submitted by the Government to the Parliament. It is recommended to increase the number of state-owned companies to be privatized.

It is resolved to trade the Government bonds via MSE, and offering the shares of the state-owned companies in the same manner will help boosting the investor confidence.

**Four: About Private Pension Fund activities**

It is an international common practice to put the idle funds of pension funds into the securities market. We need to do the same, by moving some of the idle fund of the pension fund that are invested as deposits at commercial banks and earning less return. We need to do this urgently. For this, it is recommended to modify the investment policy of the fund, stating specifically that the fund should invest only in the shares of those companies that have stable operations and are in compliance with the international standards of corporate governance. Pension funds are usually the biggest investors and also they monitor the company operations well. With the presence of this type of large investors, confidence of the minority shareholders can be increased and thus stimulate the market activities and improve the liquidity of the shares.

On the other side, the need to adopt a law on private pension fund arises along with the capital market development. Establishing the ground for private pension funds will enable the evolvement of large, sophisticated investors. Promoting the presence of large professional / sophisticated investors in the market will bring in a lot of progress in the development of the market.

**Five: Ensuring the sustainability of the macro-economy**

It is considered that macro-economic situation is the key indicator of the state of a **country's financial sector. Mongolian economy is facing a slowdown during last year, double digit inflation, MNT depreciation and these factors are increasing the investment risks.**

The development and stability of the securities market help addressing the financial matters of the businesses in real sector and also attract foreign investors. These will, in turn, contribute to the sustainability and the long-term growth of the economy.

The Policy Committee hopes that the Government will take actions according to

these recommendations.

## Appendix 2: Financial System Council under FSA in Japan

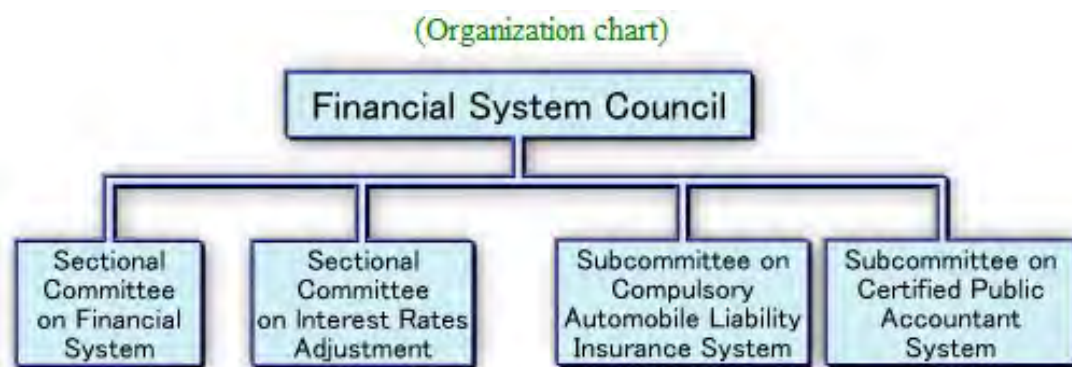
### Overview of Financial System Council

Financial System Council was established in 1998 based on Financial Services Agency Establishment Act.

According to Article 7 of the Act, main role and functions of Financial System Council is (1) to have deliberation on important issues related to financial system improvement, etc. based on a request from the Prime Minister, the Commissioner of FSA or the Minister of Finance, (2) to deliver an opinion on the above issues to the Prime Minister, the Commissioner of FSA or the Minister of Finance, and (3) to have deliberation on important issues related to Compulsory Automobile Liability Insurance System with request from the **Prime Minister or the Commissioner of FSA. In addition, the Council's role is to deliver an opinion** on interest rate adjustment to the Prime Minister, the Commissioner of FSA, the Minister of Finance or Policy Board of the Bank of Japan, and to have deliberation on issues related to Certified Public Accountant System with request from Prime Minister or the Commissioner of FSA.

Members of the Financial System Council are appointed by the Prime Minister with approval from the both houses of the Diet, and the members should exercise their authorities independently from major stakeholders, and each member must not be a board member of any political organizations. Term of the members is three years. Deliberation process should be disclosed annually.

The following is an organization chart of Financial System Council, and there are four sectional committees, each focusing on different and specific issues.



Source: FSA's website

### Financial System Council Order

Under Article 7 of the Financial Services Agency Establishment Act, there is Financial System Council Order which stipulates organization, appointment of members, etc. of the Financial System Council.

According to the Order, the Financial System Council should be organized with less than thirty members, and an ad hoc member or an expert member could be included in the Council when needed.

Chairman of the Council should be chosen by the members of the Council. Term of

members is two years. Also, Chairman of the Sectional Committee on Financial System and on Interest Rate Adjustment should be chosen by the members of the Sectional Committee. Working Group could be organized under the Council or the Sectional Committee. Members of the Working Group should be chosen by the Chairman of the Council or the Sectional Committee.

The Financial System Council cannot hold a meeting and make a decision without majority of the members.

In order to carry out its task, the Council is able to request cooperation to the top of related governmental organization for submitting documents, providing a relevant explanation, etc.

### **Current operation of the Financial System Council**

Currently, there are seventeen members in the Financial System Council. Professor Naoyuki Yoshino of Keio University Economics Department is the Chairman of the Council. Ten members including Professor Yoshino are academic experts, two from consulting companies (Boston Consulting Group and Nomura Research Institute), two from private companies (Mitsui Sumitomo Insurance and Mitsubishi Corp), one lawyer, one from Japanese Trade Union Confederation, and one from voluntary consumer organization. The Financial System Council and the Sectional Committee of Financial System are held twice or three times a year. Recently, the Council and the Sectional Committee have been held concurrently. As of January 2015, there has been thirty-three meetings for the Financial System Council and twenty-one meetings for the Sectional Committee of Financial System. Minutes and **discussion materials of meeting are disclosed on FSA's website.**

There are several Working Groups under the Financial System Council or Sectional Committees, including Working Group on Investment Management, Working Group on Sophistication of Payment and Settlement Operations, Working Group on the Mid- and Long-Term Roadmap of the Financial Industry in Japan, Working Group on the Provision of Risk Money to Emerging and Growing Companies, Working Group on the Provision of Insurance Products/Services, etc. Generally, such working groups are held more frequently compared to the Financial System Council. For example, Working Group on Investment Management which started October 2014 has been held five times in three months. Also, in case of the Working Group on the Provision of Risk Money to Emerging and Growing Companies, before finalizing the draft report, eleven meetings were held within six months. Similar with the Financial System Council, minutes and discussion materials of every meeting are disclosed.

The chart below is a summary of operations of the recent Working Groups.

| <b>Name of the Working Group (WG)</b> | <b>Term / # of meetings</b> | <b># of members / Head of the Group</b>                                    | <b>examples of outside lecturers</b>  |
|---------------------------------------|-----------------------------|--|---|
| <b>WG: Investment Management</b>      | Oct 2014 - / 6              | 17 / Mr. Kanda, prof., Univ. of Tokyo, Graduate school of law and politics | Nomura Institute of Capital Markets Research, SESC, National Consumer Affairs Center, Nippon Technology Venture Partners, The Japan Academic Society for Ventures and Entrepreneurs, Japan Federation of Bar Associations, Japan Venture Capital Assoc., etc. |

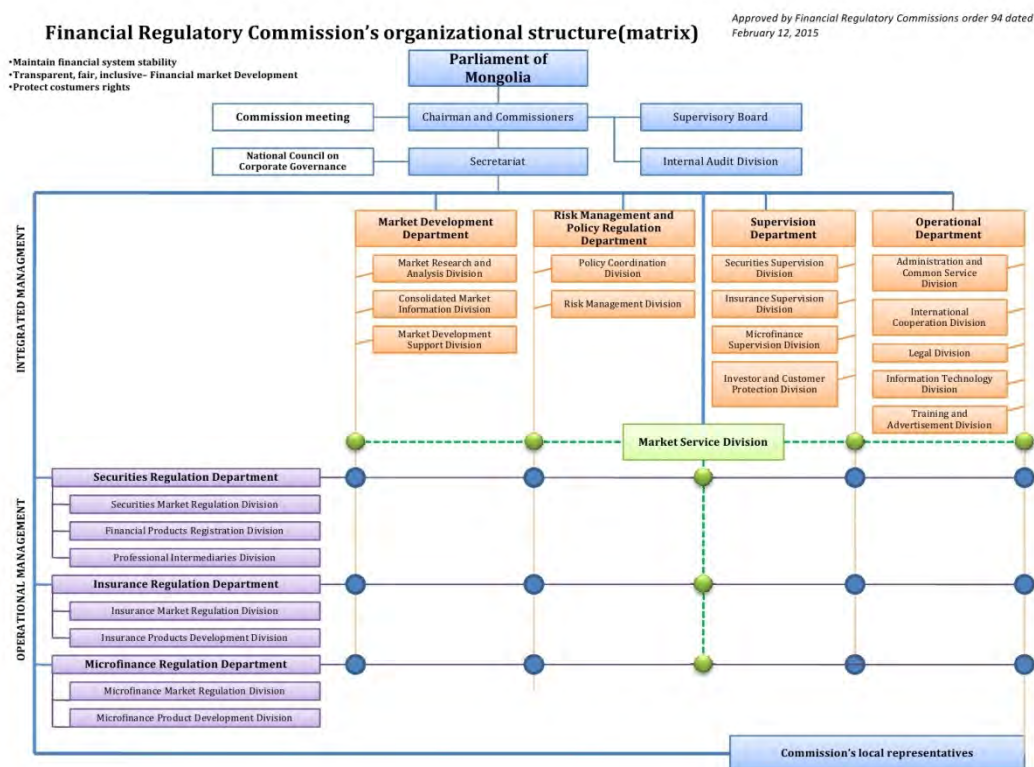


|  |                          |  |  |
|--|--------------------------|--|--|
| <b>WG: Sophistication of Payment and Settlement Operations</b>           | Oct 2014- / 10           | 23 / Mr. Iwahara, prof., Waseda Univ. Law School                           | NTT Data Group, Japan Bankers Assoc., The Japan Research Institute, Fujitsu, Bank of Japan (BoJ), Deloitte Tomatsu Consulting, JCCI, National Consumer Affairs Center, The Center for Financial Industry Information Systems, etc.   |
| <b>WG: Mid- and Long-Term Roadmap of the Financial Industry in Japan</b> | Jun 2011 – May 2012 / 14 | 21 / Mr. Yoshino, prof., Kelo Univ. Economics Dept.                        | Bank of Tokyo-Mitsubishi UFJ, Tokio Marine Holdings, Daiwa Securities, Japan Center for Int'l Finance, Sumitomo Chemical, Mitsubishi Corp., HSBC, JPMorgan, Goldman Sachs, Citigroup, BoJ, Dogan Advisors, The Kagoshima Bank, Sumitomo Mitsui Asset Management, Japan Assoc. for Financial Planners, MorningStar, Carlyle Japan, A.T.Kearney, Nomura Research Institute, etc. |
| <b>WG: Regulation on Insider Trading</b>                                 | Jul 2011– Dec 201 / 5    | 16 / Mr. Kanda, prof., Univ. of Tokyo, Graduate school of law and politics | Tokyo Stock Exchange, Tokio Marine Holdings, JX Holdings, Keidanren, etc.  |
| <b>WG: Regulation on Investment Trust and Investment Corporation</b>     | Mar 2012-Dec 2012 / 13   | 18 / Mr. Kanda, prof., Univ. of Tokyo, Graduate school of law and politics | NRI, Nomura Institute of Capital Markets Research, Deutsche Bank Group, Assoc. for Real Estate Securitization, SMBC Nikko, etc.  |

## 2. Improving FRC's capacity for regulation and supervision of capital markets

### (1) Review on the current situation in Mongolia

Regulation and supervision for market intermediaries, including securities brokers/dealers, underwriters, investment funds etc., used to be covered by FRC's Capital Market Intermediaries Division under Securities Department, but now its responsible department is newly-established Supervision Department. Capital market intermediaries are to be supervised by Securities Supervision Division (SSD) under Supervision Department.



SSD conducts on-site monitoring for major intermediaries, from time to time. It appears that frequency of on-site monitoring is not fixed, typically once in a couple of years. Main purpose of on-site monitoring is to inspect capital market intermediaries if they comply with laws, rules and regulations.

Financial data is not scrutinized by its off-site monitoring. SSD does not have access to capital **market intermediaries'** financial data, except for semi-annual/annual financial reports submitted by intermediaries. Resolution No.457, issued in November 2013, defines data that securities companies need to submit on a monthly basis, but it is mostly trading data and does not key financial numbers.

Moreover, no of staff in SSD is only 9, compared to 62 brokers/dealers, 25 underwriters and 16 investment advisory companies. In addition, SSD is also responsible for supervision of around 300 listed companies, in addition to intermediaries including securities companies, custodian banks, commodity brokers, MSE and MSCH&CD.

### (2) Possible solutions

For better results by its limited staff count at SSD, FRC plans to change its supervision to risk-based supervision from compliance-based. Risk-based supervision is increasingly

common for financial regulators globally, and the team thinks that FRC's attempt to implement risk-based supervision is a positive move. By risk-based supervision, regulators are supposed to supervise high risk-profiled targets (securities companies, for instance) more than those who are low risk-profiled. Although FRC received some support from World Bank for risk-based supervision in the past, that was more or less theoretical inputs, and the team observes that SSD needs further support for what to do in implementing risk-based supervision.

### **(3) Probable technical cooperation activities under JICA program**

The team suggests that a training course will be necessary for FRC to understand basics for risk-based supervision. The team believes that it will be a simple formula for the time-being, given that Mongolian securities companies' operations are mostly brokerage of shares and sales of government bonds, while underwriting and dealing activities are limited.

The team proposes that the first training course on this matter should include the basic framework of risk-based supervision, what kind of data and materials FRC needs to collect from securities companies, and basic financial data analysis. Eventually manuals on risk-based supervision will be necessary. The team understands that a manual for on-site supervision is being developed by Risk Management and Policy Regulation Department.

The team believes that FSA will dispatch its experts for a training course on risk-based supervision to share knowledge and their experiences with FRC. The first training course in Mongolia is tentatively scheduled for 27 April to 1 May 2015. The team proposes that the course will consist of three topics: a) basic framework of risk-based supervision and FSA's experiences; 2) data/materials collection from capital market intermediaries; and 3) introduction to financial data analysis of capital market intermediaries.

In addition, technical cooperation by the team, FSA and other Japanese experts is expected in the area of the following issues:

- a) Rules and guidelines under Securities Market Law and Investment Fund Law
- b) Law enforcement
- c) New financial products
- d) Supervision of custodian banks
- e) Implementing alternative dispute resolution
- f) Improving disclosure for listed companies
- g) Better quality of client services by securities companies

## **Appendix: Guidelines for on-site inspection/supervision of securities firms (brokerage and dealer firms)**

1. General
  - 1.1. The purpose of the supervision is to ensure the compliance of the regulated entities to the Securities market law and other related laws and regulations, and to assess and correct any incompliance if any.
  - 1.2. Inspection has to be conducted by the inspectors in accordance with this guideline.  
Inspection team:  
Head of the team:  
Members of the team:  
  
The time period covered by the inspection:  
The dates/period of the inspection to be conducted:
  - 1.3. The head of the team will be in charge of organizing the team (working group), ensuring the coverage of all the aspects stated in the guideline, conducting the inspection well, and timely reporting the results to FRC.
  - 1.4. The management of the regulated entity will let the inspection team to conduct the inspection, and provide the necessary information in a timely and complete manner.
2. Preparation of the inspection
  - 2.1. Prior to the inspection, the person in charge of the company shall provide following documents to the inspection team:
    - 2.1.1. **Company charter and operation's manual**
    - 2.1.2. Findings on off-site supervision on the company
    - 2.1.3. Any petition, complaints received from clients about the damages they incurred due to the wrongdoings of the company and/or its employees.
    - 2.1.4. **Previous feedbacks and responses given from FRC to the company's financial statements and filings.**
3. The scope of the inspection activity
  - 3.1. Regarding the enforced rules and regulations
    - 3.1.1. Check whether the company charter is registered at the state registration and any amendments are approved by the relevant authority, and the version that is kept at the company is the same as the one kept at FRC (shall have no discrepancy between those copies).
    - 3.1.2. Check whether the internal rule and code of the company that are required by FRC are in compliance with the relevant laws and regulations, and are followed/ enforced accordingly in its operations.
    - 3.1.3. Check whether the internal audit function of the company is efficient and in accordance with the relevant regulations.
    - 3.1.4. Check whether the company paid the required fees
    - 3.1.5. Check whether the company adopted a rule on Anti-money-laundering, and is complying with the rule in its operations.
    - 3.1.6. Check whether the company is reporting to the Financial Information office in **accordance with the FRC regulation on "Client identification Process and reporting of suspicious transactions" which was approved by the FRC resolution # 253, dated on November 23, 2009, and amended by the FRC resolution # 272 of 2010.**
    - 3.1.7. If the inspection was being conducted due to any issue reporting to FRC, the scope of the inspection should be determined, and the inspection shall be conducted accordingly.

- 3.1.8. The inspection team shall advise and inform the company management about any updates or amendments on relevant laws, regulations and also new rules and regulations.
- 3.2. Regarding the main activities / operations
  - 3.2.1. Check whether the company is in compliance with the documentation requirements of all the processes that range from receiving client orders to recording and accounting of the securities transactions, set by FRC, and properly kept and secured the risk of loss and damage to those documents/files.
  - 3.2.2. Check whether the activities such as receiving orders, conducting and canceling of orders are in compliance with the relevant laws and regulations, and there is a daily internal control function on monitoring the orders received/given during the trading process, the price of the securities etc.
  - 3.2.3. Check whether the company provided information about its employees and related parties to the database of the FRC, and whether the company conducts any control and monitoring on the use of inside information, and prevents any exploitation of such information.
  - 3.2.4. Check whether the company ensures the safety and confidentiality of information.
  - 3.2.5. **Check whether the company is submitting the required information to the FRC's** information database, and keeping the required forms and records.
  - 3.2.6. Check whether the company is providing the clients with necessary information, whether the company is doing any activities to help the clients have better understanding of the market.
  - 3.2.7. Check whether the company is providing any services for organizing the shareholder meeting, dividend distribution, share repurchases./if so, the content of that service agreement is in compliance with the relevant laws and regulations/
  - 3.2.8. Check whether the company is addressing the complaints from the clients
  - 3.2.9. Check how the company is keeping the record of **“power of attorney”, and check whether the time period and the scope of all the “power of attorney” are still valid.**
  - 3.2.10. Check whether the company is providing the information stated in the Article 57 of the Securities Law to FRC and the clients.
  - 3.2.11. In terms of publicly disclosed information, check whether the company is in **compliance with the FRC regulation on “Marketing activities of a regulated entity”,** approved by the FRC resolution # 370 of 2013.
  - 3.2.12. In terms of archiving of accounting and bookkeeping records, check whether the company is in compliance with the clause 52.2 of the Securities Law.
  - 3.2.13. Check whether the company has a contract with an audit firm that is registered at FRC according to the clause 53.1 of Securities Law, and whether the audit firm is in compliance with the clause 53.2 of the Securities Law.
  - 3.2.14. Check whether the information disclosed to public is proper, accurate, and the resource and distribution channels are in compliance with the RC regulation.
  - 3.2.15. Inform and warn the company about the amendment in the Criminal Law about imposing criminal sanction on actions such as trading on the insider information, market manipulation, initiating transactions with no change of owners, providing fake information, starting from February 09, 2014.
- 3.3. Regarding Financing, Equipment and HR matters
  - 3.3.1. Check whether the company is in compliance with the prudential ratio criteria
  - 3.3.2. Check whether the loss reserve/provision is sufficient to the level set by FRC, and whether the company rule on compensating any damage to the clients from the loss reserve is effectively enforced.
  - 3.3.3. Check whether the management, internal audit personnel, and employees of the company are licensed by FRC and obtained the professional indemnity insurances.
  - 3.3.4. Check whether the workplace, equipment, software meet the standard/requirement **set by the regulation on “Licensing of regulated entity”, approved by FRC resolution**

- #506 of 2013, and the **regulation on “Operations of a regulated entity”**, approved by the FRC resolution #7 of 2014.
- 3.3.5. Check whether the documentation of accounting and bookkeeping activities are in compliance with the relevant laws, regulations, and IFRS standards.
  - 3.3.6. Check whether the company regularly submitted its financial statements in a timely manner in accordance with the regulation approved by FRC resolution #454 of 2013.
  - 3.3.7. If the regulated entity is undertaking other types of regulated activities, check whether the other activities meet the requirements set by the Securities law, and FRC regulations.
4. Reporting the result of the inspection
    - 4.1. The report of the inspection shall be finalized within 10 working days since the end of the inspection and be presented to the Head of the Securities Department.
    - 4.2. Recommendations on correcting any incompliance revealed during the inspection shall be given to the company with a specified timeframe to correct. This recommendation shall be attached to the inspection report. The head of the inspection team will report the fulfillment of the recommended actions given with the specified timeframe to the Head of the Securities Department in a consolidated manner.
    - 4.3. The reports of inspections made in 2014 shall be presented to FRC.

#### SECURITIES DEPARTMENT

### **3. Writing a concept paper on self-regulatory organization**

#### **(1) Review on the current situation in Mongolia**

Under the Securities Market Law, MSE is designated as one of the SRO; however, the actual transformation process of MSE as an organization into SRO has not yet started.

There are differences in how the stock exchanges act as a self-regulatory body depending on the country, but generally can be classified into two groups: 1) regulation on listing, and 2) regulation on trading.

The first classification involves activities related to listing probation and activities related to examine the adequacy of those companies listed. The activities related to listing probation for instance in JPX is rather a ceremonial event where final screenings take place including official meeting with management of soon-to-be-listed companies since most of the necessary check-ups regarding listing requirements are conducted by underwriters. It will also be ideal for MSE to act such way given its capacity; however, the current surrounding situations such as the limited capacities on the securities houses and limited staff count in MSE are the bottlenecks. On the other hand, the activities concerning verification of the adequacy of those already listed companies should be conducted effectively by the MSE with reasonable responsibility, it can be achieved via modifying and/or implementing its mandates stipulated on the relevant law.

Activities regarding regulation on trading include monitoring activities towards member **securities companies' financial** soundness and whether they are complying with laws, rules **and regulations, as well as checking investors' wrong**-doings. It is advisable to demarcate the actual details during the monitoring process of securities companies with those of FRC. Monitoring of investors has been enhanced via the MIT surveillance system which was implemented in 2012.

In addition to MSE, Mongolian Association of Securities Dealers (MASD) is expected to play a major role in regulating the market as an SRO. The team understands that MASD is preparing rules and regulations as an SRO. Given that MASD is an association of securities companies, the team expects for MASD to self-regulate member companies' behavior, especially that of sales representatives. Sharing ethics with securities sales representatives is important to improve investors' confidence.

#### **(2) Possible solution**

The team thinks that the first step should be building consensus for SRO among Mongolia's stakeholders. Setting up a working group is a good idea to discuss roles of each regulatory organization – FRC, MSE and MASD. FRC is a regulator, MSE and MASD are SROs. A concept paper on SRO will be prepared and shared by stakeholders, when the working group reaches consensus.

#### **(3) Probable technical cooperation activities under JICA program**

After assisting the working group for SRO and writing the concept paper, the team plans to hold a training course in Mongolia as well as in Japan for relevant stakeholders. Main beneficiaries will be MSE, MASD and FRC, but the team believes that other stakeholders including listed companies also need to learn about the new regulatory framework for the capital market. The team also plans to host a seminar on SRO.

The team expects supports by experts from Japan Exchange Group (JPX) and Japan Securities Dealers' Association (JASD). JPX separated its SRO function to another organization called Japan Exchange Regulation (JPX-Regulation) in 2008 (then called Tokyo Stock Exchange Regulation) and the team believe that it will be helpful for MSE to learn from JPX-Regulation how the company managed to enhance its SRO function. The

team also thinks that JASD will be able to provide plenty of useful knowledge and experiences as an SRO, which continues to enhance its function in light of variable securities market.



#### 4. Increasing IPO and promoting dual-listing of Mongolian companies

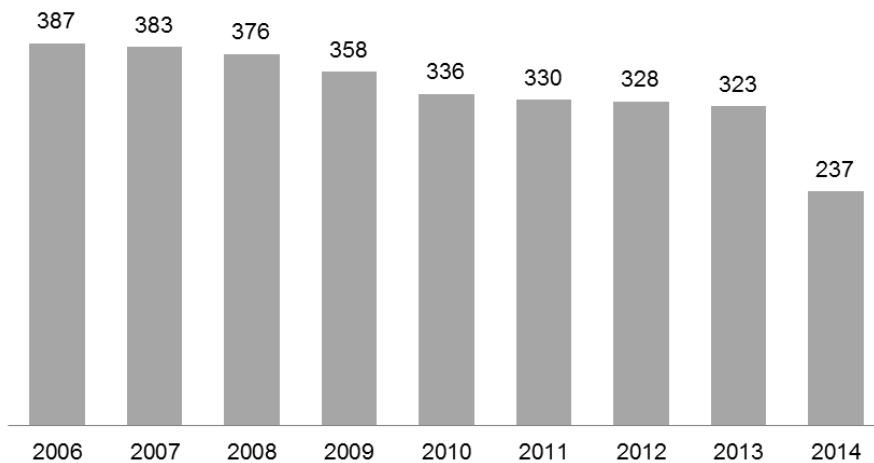
##### (1) Review on the current situation in Mongolia

Equity financing activities through MSE have been stagnant in recent years and there seems to be almost no immediate deals in the pipeline, even after the introduction of the new Securities Market Law in January 2014. This is due not only to the macroeconomic momentum affecting the investor sentiment, but also to several fundamental issues inherent in the current capital markets in Mongolia. In this section, observations by JICA Consultant team (**hereafter** ‘the team’) on the current situation of equity financing in the Mongolian are introduced from five perspectives --- security issuers (listed companies and potential issuers), investors (institutional and retail), intermediaries (brokerage firms and underwriters), stock exchange (MSE) and the regulator (FRC).

##### a) Listed companies

As of the end of 2014, there are 237 listed companies at MSE, 150 less than the end of 2006 (Figure 2-1). The decrease is due largely to the recent effort by FRC and MSE to delist the companies which failed to fulfill the legal requirements to stay listed. In 2013 and 2014, 68 and 25 companies were delisted, respectively. (See also Table 2-1 and 2-2 for the complete list of the companies listed at, and delisted from, MSE. Definitions of three classifications in Table 2-1 are detailed in (d) MSE, later in this section.)

**Figure 2-1 Number of companies listed at MSE**



Source: MSE

**Table 2-1 Listed companies by classification (as of February 20, 2015)**

| I Classification |        |                                | II Classification |        |   | III Classification |        |   |
|------------------|--------|--------------------------------|-------------------|--------|---|--------------------|--------|---|
| №                | Symbol | Company name<br>(None)         | №                 | Symbol | Company name  | №                  | Symbol | Company name                              |
| 1                | AAR    | Autozam                        | 1                 | AZZ    | AZZAN   | 68                 | JGV    | Juulchin Gobi                             |
| 2                | AOI    | Autoimpex                      | 2                 | ERD    | Ajlyn Khuvtas   | 69                 | BLG    | Zavkhan Bayalag                           |
| 3                | ATI    | Agrotechimpex                  | 3                 | ALD    | Azyk  | 70                 | ZVH    | Zavkhan teever                            |
| 4                | ADL    | Aduunchuluun                   | 4                 | ALM    | Almaas  | 71                 | ORG    | Zavkhan teekh                             |
| 5                | APP    | Asia Pacific Properties        | 5                 | ALA    | Altai   | 72                 | ZSB    | Zoos bank                                 |
| 6                | APU    | APU                            | 6                 | AZH    | Altai zam   | 73                 | ZOO    | Zoos goyol                                |
| 7                | EER    | Arig gal                       | 7                 | ANO    | Anod bank   | 74                 | INT    | Ingettolgoi                               |
| 8                | ATR    | Atar-Urguu                     | 8                 | ABH    | Ar Bayankhangai   | 75                 | IHN    | Ikh nuur                                  |
| 9                | BAN    | Baganuur                       | 9                 | ART    | Ar tarkhi   | 76                 | IHU    | Ikh uusgel                                |
| 10               | BNG    | Bayangol Hotel                 | 10                | ARJ    | Arvijikh  | 77                 | MNG    | Mandalgobi impex                          |
| 11               | BTG    | Bayanteeg                      | 11                | ALI    | Arijaa Impex  | 78                 | MMH    | Machine mechanism                         |
| 12               | BDS    | B D Sec                        | 12                | CND    | ASBI  | 79                 | MNB    | Mon Nab                                   |
| 13               | HHC    | Bishrelt Industrial            | 13                | NOG    | Achit alkaby  | 80                 | MDZ    | Mongol diesel                             |
| 14               | BHL    | Buunii hudaldaa                | 14                | ARG    | Aerogeodezi   | 81                 | MSR    | Mongol Shir                               |
| 15               | BHG    | Bukhug                         | 15                | BZO    | Baganuur, zuun umnut busiin<br>tsakhilgaan tugeekh suljee | 82                 | MEG    | Mongol EEG                                |
| 16               | GTJ    | Guril tejeel Bulgan            | 16                | BRC    | Barilga Corporation                                       | 83                 | MTZ    | Mongolian railway                         |
| 17               | BEU    | Berkh Uul                      | 17                | BNB    | Bayalag Nalaikh   | 84                 | HAM    | Mongolin khugij undesnii negdel           |
| 18               | SUL    | Gazar Suljmel                  | 18                | BLS    | Bayalag Shar. Gol   | 85                 | HBJ    | Mongolyn hurungiin birj                   |
| 19               | GHC    | Gan khiits                     | 19                | BAJ    | Bayalag Sumber  | 86                 | MSV    | Monsav                                    |
| 20               | HZB    | Gan Kherlen                    | 20                | VIK    | Bayan Aldar   | 87                 | AZA    | Munkh Jim                                 |
| 21               | HRM    | Hermes centre                  | 21                | BBD    | Bayanbogd   | 88                 | NDS    | Nalaikhyn dulaany stants                  |
| 22               | GOV    | Gobi                           | 22                | BTL    | Bayantalbai   | 89                 | NIE    | Noyot Khairkhan                           |
| 23               | GTL    | Gutal                          | 23                | BAL    | Bayantolgoi   | 90                 | TGS    | Nomin Khishig                             |
| 24               | DZG    | Darkhan Hotel                  | 24                | BTR    | Bayantooroi   | 91                 | ORI    | Orgil Gobi-Altai                          |
| 25               | NEH    | Darkhan Nekhii                 | 25                | BHR    | Binse   | 92                 | UAA    | Uv-Uujuulagch                             |
| 26               | DHU    | Darkhan Khuns                  | 26                | BSKY   | Bluesky Securities  | 93                 | ULZ    | Ulzii-Dundgobi                            |
| 27               | DRN    | Dornod                         | 27                | BOR    | Bornuur   | 94                 | ONH    | Undurkhaan                                |
| 28               | DES    | Dornod Khudakdaa               | 28                | BRO    | Boroogijn Uildver   | 95                 | OEE    | Urgun Khereglee                           |
| 29               | SOI    | Eurofeu Asia                   | 29                | BUN    | Bulgan Undarga  | 96                 | GTU    | Sav shim                                  |
| 30               | JTB    | Genco tour bureau              | 30                | CCA    | Buudain Tsatsal   | 97                 | ARH    | Selenge Ar D"huvc                         |
| 31               | IBA    | Ikh Barilga                    | 31                | BYN    | Buyan   | 98                 | DLH    | Selenge Dulaankhaan                       |
| 32               | MIE    | Materialimpex                  | 32                | BUT    | Buteel  | 99                 | SEM    | Selenge Impex                             |
| 33               | MMX    | Makhimpex                      | 33                | BLC    | Buteelch Uils   | 100                | SES    | Selenge sureg                             |
| 34               | MRX    | Merex JSC                      | 34                | BRM    | Beren mining  | 101                | TVL    | Tavilga                                   |
| 35               | BDL    | Mogoin gol                     | 35                | GTR    | Gan teerem  | 102                | TAL    | Talyn Gal                                 |
| 36               | ASA    | Mon-Asar                       | 36                | DLA    | Gantumurt   | 103                | UST    | Tuv Us                                    |
| 37               | MBG    | Mon It Buligar                 | 37                | HML    | Global mongolia holdings                                  | 104                | TLP    | Tulpar                                    |
| 38               | MOG    | Mongeo                         | 38                | JGL    | Govin Undur   | 105                | ACL    | Teever-Achlah                             |
| 39               | ERS    | Mongol Alt                     | 39                | GFG    | Gobi Financial Group                                      | 106                | HUN    | Uvs Khuns                                 |
| 40               | KEK    | Mongol Keramik                 | 40                | GNR    | Gonir   | 107                | UDS    | Ulaanbaatar dulaany suljee                |
| 41               | DLG    | Mongol makh expo               | 41                | GUR    | Guril   | 108                | UTS    | Ulaanbaatar tsakhilgaan tugeekh<br>suljee |
| 42               | MNH    | Mongol nekhmel                 | 42                | DBL    | Davaanbulag   | 109                | UNS    | Ulaansan                                  |
| 43               | UYN    | Mongol savkhi                  | 43                | DZS    | Dalanzagad DTsS   | 110                | LJA    | Uliastai tegsh                            |
| 44               | MSC    | Mongol Securities              | 44                | DAR    | Darkhan guril tejeel                                      | 111                | UND    | Undarga Umnugobi                          |
| 45               | MVO    | Mongol shevro                  | 45                | HSH    | Darkhan makh-expo   | 112                | UBA    | Uran Barilga                              |
| 46               | MSH    | Mongol shiltgeen               | 46                | DSS    | Darkhan Selengiin tsakhilgaan<br>tugeekh suljee           | 113                | CMD    | Usjuulakh                                 |
| 47               | MDR    | Mongolia development resources | 47                | DTU    | Darkhan Metallurgical Plant                               | 114                | SOH    | Uujim Khangai                             |
| 48               | GGE    | Mongolyn Gegee                 | 48                | DUS    | Darkhan us suvag  | 115                | HBZ    | KHAAABZ                                   |
| 49               | MCH    | Telecom Mongolia               | 49                | DAH    | Darkhan Khuvun  | 116                | HGL    | Khangal                                   |
| 50               | MIB    | Moninjbar                      | 50                | DDS    | Darkhany dulaany suljee                                   | 117                | AVH    | Kharshim Gegee                            |
| 51               | MNS    | Monnoos                        | 51                | DAS    | Darkhan dulaany tsakhilgaan stants                        | 118                | CHE    | Khorgo Khairkhan                          |
| 52               | MUDX   | MUDIX                          | 52                | DZU    | DZUZG   | 119                | SDT    | Khot development                          |
| 53               | NKT    | Naco tulsh                     | 53                | BAZ    | Digital catalist  | 120                | ADU    | Khuvsgul altan duulga                     |
| 54               | NUR    | Niislel Urguu                  | 54                | DAZ    | Dornod autozam  | 121                | HUV    | Khuvsgul Geology                          |
| 55               | NXE    | Nekheesgui Edlel               | 55                | DIM    | Dornod Impex  | 122                | HUZ    | Khuvsgul usan zam                         |
| 56               | OLL    | Olloo                          | 56                | DOT    | Dornod Teever   | 123                | HVL    | Khuvsgul                                  |
| 57               | ORD    | Orkhondalai                    | 57                | DHS    | Dornod Khuns  | 124                | HHS    | Khuvsgul khuns                            |
| 58               | RMC    | Remicon                        | 58                | DRU    | Durvun-Uul  | 125                | HUT    | Khuduugiin Teever                         |
| 59               | SIL    | Silicate                       | 59                | DSH    | Dulaan sharyn gol   | 126                | HBT    | Khungun beton                             |
| 60               | SSG    | Songolon Barmat                | 60                | DKS    | Dulaany tsakhilgaan stants II                             | 127                | HSG    | Khusug Trade                              |
| 61               | SOR    | Sor                            | 61                | DGS    | Dulaany tsakhilgaan stants III                            | 128                | HTS    | Khutulin cement shokhoi                   |
| 62               | SUU    | Suu                            | 62                | DSD    | Dulaany tsakhilgaan stants IV                             | 129                | DAO    | Khurtai                                   |
| 63               | TAV    | Tav                            | 63                | DMA    | Devshil Mandal  | 130                | HAH    | Khuns-Arkhangai                           |
| 64               | TTL    | Tavantolgoi                    | 64                | SUN    | Euroasia Capital Holding JSC                              | 131                | HRD    | Khurd                                     |
| 65               | TCK    | Talkh-Chikher                  | 65                | JLT    | Jargalant uils  | 132                | HRL    | Kherlen Khivs                             |
| 66               | TAH    | Takhi Ko                       | 66                | JST    | Jinst   | 133                | HLG    | Khyalganat                                |
| 67               | TEX    | Technicimport                  | 67                | JIV    | Jinst-Uvs   | 134                | HJL    | Tsuutaj                                   |
| 68               | TMZ    | Tumriin Zavod                  |                   |        |   | 135                | CDU    | Chandmani dundgobi                        |
| 69               | TUS    | Tushig Uul                     |                   |        |   | 136                | CAD    | Chandmani uul                             |
| 70               | TEE    | Teever Darkhan                 |                   |        |   | 137                | SIM    | Shim                                      |
| 71               | BUK    | UB-BUK                         |                   |        |   | 138                | AMT    | Shimtleeg                                 |
| 72               | CHR    | Uvs Chatsargana                |                   |        |   | 139                | NRS    | Shinest                                   |
| 73               | UBH    | Ulaanbaatar khivs              |                   |        |   | 140                | SCL    | Shimechlel Invest                         |
| 74               | UID    | Ulsyn ikh delguur              |                   |        |   | 141                | JRG    | Evlel                                     |
| 75               | HBO    | HBOil                          |                   |        |   | 142                | EAZ    | Erdenet Autozam                           |
| 76               | HMK    | Khanyn Material                |                   |        |   | 143                | EUD    | Erdenet us, dulaan tugeekh suljee         |
| 77               | TVT    | Khar tarvagatai                |                   |        |   | 144                | TAS    | Erdenet Khuns                             |
| 78               | HAG    | Khargia                        |                   |        |   | 145                | EDS    | Erdenetiin dulaany tsakhilgaan stants     |
|                  |        |                                |                   |        |   | 146                | BOE    | Erchim Bayan-Ulgii                        |
|                  |        |                                |                   |        |   | 147                | ECV    | Ereentsav                                 |
|                  |        |                                |                   |        |   | 148                | ESG    | Esgii Gutal                               |

Source: MSE

**Table 2-2 Companies delisted from MSE**

| №  | Symbol | Company name         | Date delisted | №   | Symbol | Company name       | Date delisted | №   | Symbol | Company name           | Date delisted |
|----|--------|----------------------|---------------|-----|--------|--------------------|---------------|-----|--------|------------------------|---------------|
| 1  | ULN    | Ulaanbaatar Hotel    | 2014/11/24    | 53  | HNG    | Khangai            | 2013/8/23     | 105 | IAR    | Ich-Arkhanga           | 2010/7/9      |
| 2  | CSU    | TSaSTU               | 2014/11/24    | 54  | HUJ    | Khujirt Urguu      | 2013/8/23     | 106 | ERH    | Erdenet khivs          | 2010/6/24     |
| 3  | MEL    | Monel                | 2014/11/24    | 55  | SHR    | Shar Khooloi       | 2013/8/23     | 107 | NIC    | NIC                    | 2010/5/27     |
| 4  | RIN    | RIN                  | 2014/11/24    | 56  | ETL    | Erdenetolgoi tuv   | 2013/8/23     | 108 | ATK    | Avto kombinat          | 2010/5/19     |
| 5  | BNT    | Tuul bayan           | 2014/11/24    | 57  | JIM    | Urgun Jim          | 2013/8/23     | 109 | AVT    | Khorinmaindugaar Baaz  | 2010/4/22     |
| 6  | DLM    | Modlog               | 2014/11/24    | 58  | MAN    | Mandal             | 2013/8/23     | 110 | SBB    | Spirit Bal Buram       | 2010/4/16     |
| 7  | CHI    | Chimbai              | 2014/11/24    | 59  | ZOS    | Zoos trade         | 2013/8/23     | 111 | HOR    | Khash Ord              | 2010/4/16     |
| 8  | OTL    | Orkhon bulag         | 2014/10/3     | 60  | OZT    | Shakhait khairkhan | 2013/8/23     | 112 | OGU    | Uguuj-Sumber           | 2010/4/8      |
| 9  | OZM    | Uguumur uul          | 2014/9/4      | 61  | BNR    | Bayankhongor       | 2013/8/23     | 113 | NHT    | Khotgor                | 2010/3/5      |
| 10 | HAL    | Tegsh                | 2014/6/13     | 62  | SAI    | Sainshand          | 2013/8/23     | 114 | MNF    | Monfresh Juice         | 2010/3/4      |
| 11 | ALT    | Altan Taria          | 2014/5/21     | 63  | UVN    | Uvs                | 2013/8/23     | 115 | BJT    | Buyant                 | 2010/2/26     |
| 12 | DRI    | Darkhan Impex        | 2014/5/9      | 64  | ASG    | Asgat              | 2013/8/23     | 116 | CCL    | Tsatsral Mon           | 2010/2/24     |
| 13 | MTS    | Khorol-Erdene        | 2014/1/24     | 65  | JRT    | Jargalant Tuv      | 2013/8/23     | 117 | UDV    | Undur Dov              | 2010/2/23     |
| 14 | DNU    | Dornod noos          | 2014/1/14     | 66  | BBS    | Bayanbulag         | 2013/8/23     | 118 | AYN    | Ayanchin               | 2010/2/23     |
| 15 | IBU    | Torgon ur            | 2014/1/14     | 67  | MER    | Merei              | 2013/8/23     | 119 | EHB    | EKHBUT                 | 2010/2/23     |
| 16 | ULH    | Ulaan khotgor        | 2014/1/14     | 68  | HBB    | Buyantbulag        | 2013/8/23     | 120 | SHO    | Shoroon ord            | 2010/2/23     |
| 17 | TEV    | Teever tuv           | 2014/1/14     | 69  | HDS    | Selenge Khurd      | 2013/8/23     | 121 | MZR    | Manzushir              | 2010/2/23     |
| 18 | ARI    | Arijaa               | 2014/1/14     | 70  | BUR    | Ij Buren           | 2013/8/23     | 122 | KER    | Ceramzit               | 2010/2/23     |
| 19 | DRZ    | Dar Zam              | 2014/1/14     | 71  | OBL    | Ikh daats          | 2013/8/23     | 123 | BUL    | Bayan-Uul              | 2010/2/23     |
| 20 | JNN    | Jinchin              | 2014/1/14     | 72  | CNR    | Teever tsagaannuur | 2013/8/23     | 124 | DTT    | Mon khulug             | 2009/12/18    |
| 21 | ULB    | Ulbaa                | 2014/1/14     | 73  | AHD    | Autoteever-27      | 2013/8/23     | 125 | SBU    | Bilgekhi bayanburd     | 2009/11/12    |
| 22 | AHM    | Altai khayn material | 2014/1/14     | 74  | ADC    | Autodaats          | 2013/8/23     | 126 | DEE    | Deej                   | 2009/11/12    |
| 23 | OZH    | Mandal Orgil         | 2014/1/14     | 75  | HII    | Khiits-Uvs         | 2013/8/23     | 127 | DLB    | Delgertrade            | 2009/11/12    |
| 24 | SUO    | Sumber-Ulzii         | 2014/1/14     | 76  | TBE    | Jonshit teever     | 2013/8/23     | 128 | BUS    | Baruun-Urt Us          | 2009/11/12    |
| 25 | GOS    | Gobi sumber          | 2014/1/14     | 77  | TRN    | Turuun             | 2013/8/23     | 129 | SVN    | Savan trade            | 2009/9/4      |
| 26 | HIE    | Khereglee-impex      | 2013/12/16    | 78  | MED    | Mongol Ed Impex    | 2013/8/23     | 130 | ZMS    | ZGMS                   | 2009/9/2      |
| 27 | UGT    | Ugtaal tuv           | 2013/8/23     | 79  | DDL    | Khalkh buudai      | 2013/8/23     | 131 | ORL    | Tuv orgil              | 2009/7/1      |
| 28 | AGA    | Agro-Amgalan         | 2013/8/23     | 80  | ATA    | Atar tuv           | 2013/8/23     | 132 | SNH    | Shankh                 | 2009/6/8      |
| 29 | CHA    | Chandgan             | 2013/8/23     | 81  | NUL    | Khangain Tsaram    | 2013/8/23     | 133 | NDR    | Naid                   | 2009/6/8      |
| 30 | THA    | Takhilgat            | 2013/8/23     | 82  | GGL    | Gun Galuut         | 2013/8/23     | 134 | ARL    | Darkhan khudalmaa      | 2009/6/8      |
| 31 | SNO    | Shine Urguu          | 2013/8/23     | 83  | UAR    | Us-Arkhanga        | 2013/8/23     | 135 | EHT    | Ed khereglegchdiin tuv | 2009/6/8      |
| 32 | NLO    | Nalaikh Ugruu        | 2013/8/23     | 84  | ASH    | Asralt khairkhan   | 2013/8/19     | 136 | TGD    | Zurkh uul              | 2009/6/8      |
| 33 | ARZ    | Ardyn Zorig          | 2013/8/23     | 85  | SHS    | Shines             | 2013/8/19     | 137 | UUG    | Jirmen suljee          | 2009/6/8      |
| 34 | BNM    | Bayanmod-Uul         | 2013/8/23     | 86  | MSD    | Mongol Shudenz     | 2013/7/25     | 138 | SSR    | Munkhsansar            | 2009/6/8      |
| 35 | BNH    | Bayankhan            | 2013/8/23     | 87  | HCH    | Javkhant kharaa    | 2013/7/25     | 139 | URC    | Mon Urgats             | 2009/6/8      |
| 36 | ZES    | Bat Khiits           | 2013/8/23     | 88  | OJN    | Orkhon jims nogoo  | 2013/7/25     | 140 | MGG    | Magsarjav              | 2009/6/8      |
| 37 | BND    | Bayandukhum          | 2013/8/23     | 89  | ERZ    | Erdene zam         | 2013/7/25     | 141 | URT    | Ikh Urguu              | 2009/3/10     |
| 38 | JMT    | Jimst                | 2013/8/23     | 90  | DHM    | Deed Buyan         | 2013/7/25     | 142 | ATG    | Altan joloo-gobi       | 2009/1/24     |
| 39 | CGC    | Tsagaanchuluut       | 2013/8/23     | 91  | ITL    | Bayan-Itegel       | 2013/6/21     | 143 | BNZ    | Urgats uguuj           | 2008/12/26    |
| 40 | BRD    | Gobi shand           | 2013/8/23     | 92  | TLG    | Tulga              | 2013/5/6      | 144 | HHB    | Dornin bers            | 2008/12/12    |
| 41 | BBG    | Del Bayanbulag       | 2013/8/23     | 93  | MEI    | Mongol Em Impex    | 2013/4/22     | 145 | SIT    | Dornod SiTo            | 2008/10/29    |
| 42 | TSN    | Tsagaannuur          | 2013/8/23     | 94  | HRH    | Khurkh gol         | 2012/12/27    | 146 | GNL    | Gan negdel             | 2008/10/14    |
| 43 | AYG    | Altan Useg           | 2013/8/23     | 95  | DHO    | Delgerekh khuns    | 2012/12/14    | 147 | DER    | Darkhan urguu          | 2008/9/4      |
| 44 | HTO    | Khuns Tuv            | 2013/8/23     | 96  | BGL    | Baiguulamj         | 2012/7/17     | 148 | ACH    | Atar chandgan          | 2008/8/26     |
| 45 | HRA    | Altanduulga          | 2013/8/23     | 97  | MEZ    | Monenzim           | 2012/4/9      | 149 | ATE    | Achaa teever           | 2008/8/26     |
| 46 | SGT    | Selenge Guril Tejeel | 2013/8/23     | 98  | JOL    | Jol                | 2011/11/30    | 150 | BLA    | Monmoid                | 2008/7/4      |
| 47 | UDR    | Undram               | 2013/8/23     | 99  | CNT    | Chandmani tal      | 2011/11/9     | 151 | ENT    | Emnelgin Technique     | 2008/6/6      |
| 48 | ZNR    | Zuunkharaa-Urguu     | 2013/8/23     | 100 | OHR    | Ord kharsh         | 2011/6/16     | 152 | MSL    | Suljee                 | 2008/4/24     |
| 49 | NSD    | Noyon Shand          | 2013/8/23     | 101 | MNM    | Mongol Nom         | 2011/5/12     | 153 | DBZ    | Damjlaga baaz          | 2008/3/31     |
| 50 | BBH    | Bayanbadrakh         | 2013/8/23     | 102 | BRL    | Khash urguu        | 2011/5/5      | 154 | LZB    | Janna D Ark            | 2008/2/26     |
| 51 | ORH    | Orkhon               | 2013/8/23     | 103 | HST    | Khailaast          | 2010/9/23     | 155 | TNV    | Tenkheg-Us             | 2008/2/22     |
| 52 | ZAL    | Zaluuchud            | 2013/8/23     | 104 | ARX    | Ardiin erk         | 2010/9/21     | 156 | HZH    | Khazna                 | 2008/1/3      |

Source: MSE

According to the 2013 Annual Report of FRC, among 323 listed companies (as of the end-2013), 23 companies are state-owned, 30 are parastatal, 193 are private companies with over 75% ownership concentration and 77 are with less than 75% concentration. This high concentration of ownership of listed companies implies very thin trading activities<sup>2</sup>. Coupled with the recent economic downturn in Mongolia, share trading value at MSE has been declining dramatically for the past two years, as mentioned in “I. Overview of the Mongolia’s Capital Markets”

According to the market participants interviewed by the team, there are many listed

<sup>2</sup> According to the 2013 Annual Report, 99% of trading amount and 98% of traded volume were of 30 stocks that were most actively traded. This indicates almost 300 listed companies were poorly traded or were not traded at all in 2013.

companies which have not been traded at all. However, due to the lack of explicit delisting rules and weak enforcement at FRC and MSE, many of these companies are still on the board. FRC, MSE and the market participants share the view that such companies should be delisted as soon as possible for MSE to gain confidence both from domestic and international investors.

Due to this inactive market with low liquidity and very thin investor base, it is generally regarded by Mongolian companies, including those already listed, that economic and social benefits of being listed at MSE are quite limited.

Under such circumstances, the level of the corporate governance and information disclosure of the listed companies have been at a low level, despite the efforts by FRC and the **development partners (DPs)**. According to the **“Corporate Governance Scorecard 2011”** provided by IFC in 2013, even for the 20 largest listed companies surveyed in this report, the overall mean score was 27.5%<sup>3</sup>, **implying ‘poor application of good corporate governance practices.’** Based on the evaluation of the report, among the five major areas of company corporate governance --- **1) shareholders’ rights, 2) equitable treatment of shareholders, 3) stakeholders’ roles in corporate governance, 4) disclosure and transparency and 5) the responsibilities of the board** --- 3), 4) and 5) should be given much more attention by the companies.

FRC, as the government agency in charge of regulations related to corporate governance, will need to make additional efforts to improve corporate governance and information disclosure of the listed companies.

Table 2-3 is the list of companies included in MSE Top 20 Index (as in October 2013) and their market capitalization up to date. Out of the 20 companies, 6 are mining-related, mainly in the coal mining, followed by 3 in the food and hospitality sectors, respectively. Market capitalization of the mining sector has decreased substantially due to the turbulent economic conditions, although some signs of recovery can be observed on the back of the expectation on another move going forward. Performance of other sectors varies to a great extent.

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<sup>3</sup> Based on similar studies by IFC for other Asian countries, the overall mean scores are: Vietnam 43.9% (2009), Hong Kong 72% (2008), Thailand 50% (2001) and 77% (2011), Philippines 53% (2004) and 72% (2008).

**Table 2-3 Market capitalization of the companies included in MSE Top 20 Index**

| №  | Symbol | Company name                   | Industry  | Market capitalization (MNT billion) |                  |                  | Change  |         |
|----|--------|--------------------------------|---|-------------------------------------|------------------|------------------|---------|---------|
|    |        |                                |   | 2011/5/18<br>(A)                    | 2013/10/1<br>(B) | 2015/2/18<br>(C) | (A)→(B) | (B)→(C) |
| 1  | APU    | APU                            | food  | 222.9                               | 282.5            | 267.7            | 27%     | -5%     |
| 2  | BAN    | Baganuur                       | coal mining   | 398.6                               | 83.9             | 48.2             | -79%    | -43%    |
| 3  | BNG    | Bayangol Hotel                 | hospitality industry                                  | 16.1                                | 20.3             | 23.5             | 26%     | 16%     |
| 4  | BDS    | BDSec                          | broker, dealer, underwriter,<br>investment consulting | 44.0                                | 33.0             | 34.0             | -25%    | 3%      |
| 5  | GOV    | Gobi                           | textile   | 41.0                                | 37.4             | 56.9             | -9%     | 52%     |
| 6  | JTB    | Genco tour bureau              | hospitality industry                                  | 9.4                                 | 8.5              | 8.8              | -10%    | 4%      |
| 7  | BDL    | Mogoin gol                     | coal mining   | 34.8                                | 9.4              | 7.2              | -73%    | -23%    |
| 8  | MSH    | Mongol shiltgeen               | hospitality industry                                  | n.a.                                | 8.5              | 7.0              | n.a.    | -18%    |
| 9  | MDR    | Mongolia development resources | real estate   | 23.4                                | 8.1              | 6.5              | -65%    | -19%    |
| 10 | MCH    | Telecom Mongolia               | telecommunication                                     | 75.8                                | 34.1             | 31.0             | -55%    | -9%     |
| 11 | RMC    | Remicon                        | construction material<br>manufacturing                | 15.1                                | 13.8             | 7.2              | -9%     | -48%    |
| 12 | SIL    | Silicate                       | chalk refining  | n.a.                                | 9.2              | 10.4             | n.a.    | 14%     |
| 13 | SUU    | Suu                            | food  | n.a.                                | 27.5             | 31.2             | n.a.    | 14%     |
| 14 | TTL    | Tavantolgoi                    | coal mining and trade                                 | 416.1                               | 168.5            | 202.8            | -59%    | 20%     |
| 15 | TCK    | Talkh-Chikher                  | food  | n.a.                                | 12.9             | 20.0             | n.a.    | 55%     |
| 16 | ULN    | Ulaanbaatar Hotel              | real estate   | 15.4                                | 26.8             | (Delisted)       | 74%     | n.a.    |
| 17 | UID    | Ulsyn ikh delguur              |   | 12.7                                | 15.5             | 19.4             | 22%     | 25%     |
| 18 | HGN    | Khukh gan                      | iron concentrate                                      | 19.3                                | 13.0             | 12.0             | -33%    | -8%     |
| 19 | SHG    | Sharyn Gol                     | coal mining   | 123.0                               | 76.7             | 57.3             | -38%    | -25%    |
| 20 | SHV    | Shivee Ovoo                    | coal mining   | 322.1                               | 73.8             | 83.2             | -77%    | 13%     |

Source: MSE

Turning to the IPO/SPO markets, the track records in recent years are quite limited, with only two IPOs and six SPOs in the past 6 years (Table 2-4). Among these, three are mining-related, two from construction materials and three from others (finance, logistics and petro importing). Sector-wise, in the team's observation, financing needs tend to be skewed to those with revenue potential outside the country, due partly to the limited size of the domestic demand. Among the domestic demand-oriented sectors, construction has greater presence than others, possibly reflecting the heating real estate market.

**Table 2-4 Past public offerings at MSE**

**IPOs since 2005**

| №  | Symbol | Name of JSCs            | Industry                                | Listed date | Amount (MNT)  |
|----|--------|-------------------------|---|-------------|---------------|
| 1  | MRX    | "Merex" JSC             | construction material                   | 2014/1/14   | 2,600,000,000 |
| 2  | ETR    | "E-Trans logistics" JSC | cargo reloading service                 | 2012/4/9    | 924,000,000   |
| 3  | HGN    | "Khukh gan" JSC         | mining                                  | 2008/7/30   | 3,195,456,280 |
| 4  | NKT    | "Nako Fuel" JSC         | semi-coke processing                    | 2008/6/24   | -             |
| 5  | RMC    | "Remicon" JSC           | cement & concrete product manufacturing | 2008/5/19   | 5,048,820,200 |
| 6  | HRM    | "Hermes Centre" JSC     | owner of shopping center                | 2008/5/16   | 2,356,290,000 |
| 7  | OLL    | "Olloo" JSC             | leading portal website                  | 2007/9/12   | 582,029,900   |
| 8  | HBO    | "Hai Bi Oil" JSC        | importing petroleum & oil               | 2007/5/2    | 400,000,000   |
| 9  | BDS    | "BDSec" JSC             | securities                              | 2006/6/22   | 750,000,000   |
| 10 | JTB    | "Jenco Tour Bureau" JSC | tourism                                 | 2006/1/17   | 8,259,239,676 |
| 11 | MSH    | "Mongol Shiltgeen" JSC  | hotel, restaurant                       | 2005/5/25   | 800,000,000   |

### SPOs since 2007

| No | Symbol | Name of JSCs     | Industry                             | Listed date | Amount (MNT)   |
|----|--------|------------------|--------------------------------------|-------------|----------------|
| 1  | BDS    | "BDSec" JSC      | securities                           | -           | -              |
| 2  | SHG    | "Sharyn gol" JSC | coal mining                          | 2011/10/13  | 18,301,439,069 |
| 3  | SIL    | "Silikat" JSC    | manufacturing lime & concrete blocks | 2011/5/6    | 3,650,017,500  |
| 4  | SHG    | "Sharyn gol" JSC | coal mining                          | 2011/1/13   | -              |
| 5  | HBO    | "Hai Bi Oil" JSC | importing petroleum & oil            | 2010/8/25   | 728,474,814    |
| 6  | NKT    | "Nako Fuel" JSC  | semi-coke processing                 | 2010/8/25   | 270,264,655    |
| 7  | BDS    | "BDSec" JSC      | securities                           | 2008/6/12   | 2,625,346,500  |
| 8  | HBO    | "Hai Bi Oil" JSC | importing petroleum & oil            | 2007/11/29  | -              |
| 9  | MIB    | "Moninjbar" JSC  | construction                         | 2007/1/16   | 1,000,000,000  |

Source: MSE

Based on our discussions with the industry experts, potential issuers on the MSE will be state-owned companies (hereafter 'SOCs', including those in the mining sector, MIAT, Mongolian Railways, power plants, etc.), medium-sized growing companies in such sectors as the agriculture, tourism, construction and real estate, and financial institutions.

As for SOCs, the government of Mongolia (hereafter 'GOM', including SPC and other relevant line ministries) has its basic policy that percentage of the future government ownership shall be determined by industry and plans to sell the remaining shares to the market going forward. GOM maintains and updates the list of companies to be privatized for the coming years, which is approved by the Parliament. Once the latest list becomes available, the team shall review and examine it for possible incorporation into this TA.

Another catalyst for further activating the capital market will be IPO of the major private corporate groups such as MCS Holding LLC (having consumer goods, real estate, telecom and energy businesses under the group. Its coal mining subsidiary was listed on HKEx.) and Tavan Bogd Group (having Khan Bank, hotel, travel agency, Gobi Corporations listed on MSE, etc.). While these conglomerates face hurdles on financing from the domestic banks regulated by the Bank of Mongolia, they generally have negative views on utilizing the domestic capital market as an alternative due to the lack of market liquidity, and tend to finance more efficiently from international organizations such as EBRD or through capital markets abroad. It is also pointed out that these corporate groups tend to be owned and managed by the founders who typically hesitate to sell their shares to the third parties.

As for the listing abroad, there are - more than 40 companies listed on the foreign stock exchanges (Table 2-5). Under the new Securities Market Law, as well as the requirement of the Minerals Law on the strategic deposits as introduced later in this section, listing of these companies at MSE could possibly be further promoted.

**Table 2-5 Overseas-listed companies with assets/businesses in Mongolia**

| Company                              | Ticker | Market | Prices    | Market cap | Sector          | Main business       |
|--------------------------------------|--------|--------|-----------|------------|-----------------|---------------------|
|                                      |        |        | 31-Dec-14 | US\$m      |                 |                     |
| Aspire Mining                        | AKM    | ASX    | AUD 0.033 | 19         | Metals & Mining | Coking coal         |
| Blina Minerals                       | BDI    | ASX    | AUD 0.001 | 1          | Metals & Mining | Copper              |
| Carajas Copper                       | CJC    | ASX    | AUD 0.001 | 1          | Metals & Mining | Copper, Gold        |
| Cougar Energy                        | CGM    | ASX    | AUD 0.002 | 1          | Metals & Mining | Coal                |
| Draig Resources                      | DRG    | ASX    | AUD 0.013 | 1          | Metals & Mining | Coal                |
| Eumeralla Resources                  | EUM    | ASX    | AUD 0.055 | 2          | Metals & Mining | Tungsten            |
| FeOre                                | FEO    | ASX    | AUD 0.026 | 2          | Metals & Mining | Iron ore            |
| General Mining Corp                  | GMM    | ASX    | AUD 0.005 | 1          | Metals & Mining | Metals              |
| Guildford Coal                       | GUF    | ASX    | AUD 0.036 | 27         | Energy          | Coal                |
| Haranga Resource                     | HAR    | ASX    | AUD 0.014 | 3          | Metals & Mining | Iron ore            |
| Modun Resources                      | MOU    | ASX    | AUD 0.003 | 176        | Energy          | Thermal coal        |
| Mongolian Resources - suspended      | MJB    | ASX    | AUD 0.023 | 108        | Metals & Mining | Gold                |
| Newera Resources                     | NRU    | ASX    | AUD 0.002 | 81         | Energy          | Coal                |
| Tian Poh Resources                   | TPO    | ASX    | AUD 0.200 | 198        | Metals & Mining | Coal, Copper        |
| Viking Mines                         | VKA    | ASX    | AUD 0.020 | 166        | Metals & Mining | Coal, Zinc          |
| Wolf Petroleum                       | WOF    | ASX    | AUD 0.045 | 446        | Energy          | Oil                 |
| Xanadu Mines                         | XAM    | ASX    | AUD 0.100 | 1,203      | Metals & Mining | Copper, Gold        |
|                                      |        |        | 31-Dec-14 | US\$m      |                 |                     |
| Asia Coal                            | 835    | HKEx   | HKD 0.14  | 163        | Metals & Mining | Coal                |
| China Daye Non-Ferrous Metals Mining | 661    | HKEx   | HKD 0.14  | 315        | Metals & Mining | Molybdenum          |
| CNNC International                   | 2302   | HKEx   | HKD 2.85  | 180        | Metals & Mining | Uranium             |
| Mongolia Energy Corp                 | 276    | HKEx   | HKD 0.41  | 88         | Metals & Mining | Coal                |
| Mongolian Mining Corp                | 975    | HKEx   | HKD 0.36  | 424        | Metals & Mining | Coking coal         |
| North Asia Resources                 | 61     | HKEx   | HKD 0.15  | 117        | Metals & Mining | Gold                |
| Peacemap Holding                     | 402    | HKEx   | HKD 0.34  | 295        | Metals & Mining | Coal                |
| SouthGobi Resources                  | 1878   | HKEx   | HKD 3.87  | 109        | Metals & Mining | Coal                |
| Winsway Coking Coal                  | 1733   | HKEx   | HKD 0.26  | 124        | Metals & Mining | Coking coal         |
|                                      |        |        | 31-Dec-14 | US\$m      |                 |                     |
| Central Asia Metals                  | CAML   | AIM    | £1.83     | 319        | Metals & Mining | Molybdenum, Gold    |
| Origo Partners                       | OPP    | AIM    | £0.06     | 34         | Private equity  | Coking coal, Mo, Cu |
| Petro Matad                          | MATD   | AIM    | £0.02     | 9          | Energy          | Oil                 |
|                                      |        |        | 31-Dec-14 | US\$m      |                 |                     |
| Altan Rio Minerals                   | AMO    | TSXV   | CAD 0.020 | 2          | Metals & Mining | Copper, Gold        |
| Centerra Gold                        | CG     | TSXV   | CAD 6.040 | 1,235      | Metals & Mining | Gold                |
| Denison Mines Corp                   | DML    | TSX    | CAD 1.130 | 494        | Metals & Mining | Uranium             |
| East Asia Minerals Corp              | EAS    | TSXV   | CAD 0.010 | 1          | Metals & Mining | Gold                |
| Entrée Gold                          | ETG    | TSX    | CAD 0.205 | 26         | Metals & Mining | Copper, Gold        |
| Erdene Resource Development Corp     | ERD    | TSX    | CAD 0.105 | 8          | Metals & Mining | Gold, Mo, Cu        |
| Lundin Gold                          | LUG    | TSX    | CAD 4.300 | 376        | Metals & Mining | Copper etc.         |
| Minecorp Energy                      | GMZ    | TSXV   | CAD 0.025 | 2          | Metals & Mining | Coal                |
| Kincora Copper                       | KCC    | TSXV   | CAD 0.025 | 7          | Metals & Mining | Copper              |
| Khan Resources                       | KRI    | CSX    | CAD 0.485 | 29         | Metals & Mining | Uranium             |
| Lucky Strike Resources               | LKY    | TSXV   | CAD 0.015 | 1          | Metals & Mining | Uranium             |
| MNP Petroleum                        | MNP    | TSX    | CAD 0.095 | 14         | Energy          | Oil                 |
| Mongolia Growth Group                | YAK    | TSXV   | CAD 0.740 | 22         | Property        |                     |
| Prophecy Development Corp            | PCY    | TSX    | CAD 0.050 | 13         | Metals & Mining | Coal                |
| Turquoise Hill Resources             | TRQ    | TSX    | CAD 3.590 | 6,247      | Metals & Mining | Copper, Gold        |
|                                      |        |        | 31-Dec-14 | US\$m      |                 |                     |
| Banpu                                | BANPU  | SET    | THB 24.90 | 1,941      | Metals & Mining | Coal                |

Source: JICA Consultant team

In order to check information disclosure of the companies listed at MSE, the team have picked up 5 companies among those in the Top 20 Index and looked into their websites to find English annual reports (Table 2-6). For these companies, no English annual reports were found. Given the importance for the Mongolian capital market to broaden international investor base in the future, it should be noted that without prompt and proper information disclosure by listed companies, international players would hesitate to invest in the Mongolian capital markets. Hence, more proactive attitude toward information disclosure by the MSE listed companies should be regarded as the urgent issue.

**Table 2-6 Availability of English disclosures for the companies in Top 20 Index**

|           | website in English | Availability of financial reports in English |
|-----------|--------------------|--|
| Company A | ○                  | ×  |
| Company B | ○                  | ×  |
| Company C | ×                  | ×  |
| Company D | ×                  | ×  |
| Company E | ○                  | ×  |

**b) Investors**

**Institutional investors:** Table 2-7 summarizes an overview of the institutional investors, both of foreign and domestic, trading at MSE.

**Table 2-7 Overview of foreign and domestic investors, end-September 2013**

|                   | Number of accounts |                 | Trading volume (2013) |         |
|-------------------|--------------------|-----------------|-----------------------|---------|
|                   | entity             | citizen         | entity                | Citizen |
| Local investors   | 2,388 (0.3%)       | 769,037 (99.5%) | 32%                   | 17%     |
| Foreign investors | 155 (0.0%)         | 1,706 (0.2%)    | 44%                   | 7%      |

Source: “Overview of MSCH&CD operations” (October 9, 2013)

Domestic entities include commercial banks and companies under major conglomerates. Commercial banks invest mainly in bond products especially the government bonds, and **tend to hold them to maturity rather than trading them actively. Commercial banks’ investments in stocks are limited due to the regulation on banks’ shareholding in the Banking Law.** The insurance industry is still at the infant stage and the companies are still small in size as shown in Table 2-8. The insurance companies are not regarded as the institutional investors, since their experience and expertise in fund management are very **limited and they put most of their fund in bank deposits under FRC’s regulations on fund operations.** There is a hope for the future development of the industry with an enactment of the Private Pension Law and the Sovereign Wealth Fund (SWF) for managing the national revenue from the mining sector, although it should take some time for them to gain enough presence as institutional investors in the Mongolian capital markets.



**Table 2-8 Total assets of insurance companies**

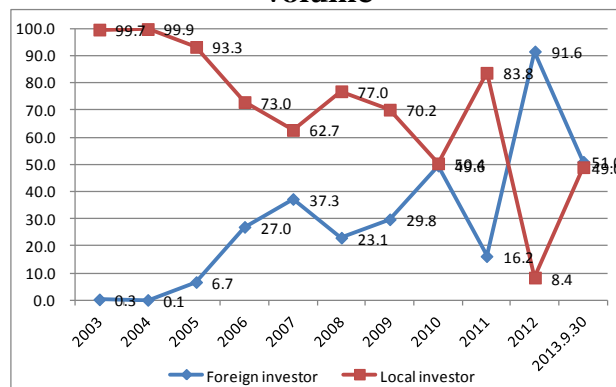
(MNT million)

| insurance companies            | 2010          | %           |    | 2012           | %           |
|--------------------------------|---------------|-------------|----|----------------|-------------|
| 1 Mongol daatgal               | 16,058        | 28%         | 1  | 21,274         | 20%         |
| 2 Bodi daatgal                 | 5,072         | 9%          | 2  | 10,937         | 10%         |
| 3 Tenger daatgal               | 4,310         | 8%          | 4  | 7,412          | 7%          |
| 4 Practical daatgal            | 4,184         | 7%          | 3  | 7,728          | 7%          |
| Mandal                         |               |             | 5  | 7,271          | 7%          |
| 5 Mig daatgal                  | 4,104         | 7%          | 6  | 6,655          | 6%          |
| 6 Nomin daatgal                | 3,029         | 5%          | 9  | 5,993          | 6%          |
| 7 Ard daatgal                  | 2,983         | 5%          | 8  | 6,345          | 6%          |
| 8 Soyombo daatgal              | 2,438         | 4%          | 7  | 6,366          | 6%          |
| 9 National life daatgal        | 2,143         | 4%          | 10 | 4,683          | 4%          |
| 10 Ganzam daatgal              | 2,032         | 4%          | 15 | 3,144          | 3%          |
| 11 Monre daatgal               | 1,695         | 3%          | 11 | 3,600          | 3%          |
| 12 Mongoltrust holding daatgal | 1,678         | 3%          |    |                |             |
| 13 Ulaanbaatar city daatgal    | 1,656         | 3%          | 13 | 3,263          | 3%          |
| 14 Munkh daatgal               | 1,527         | 3%          | 14 | 3,166          | 3%          |
| 15 Jonon daatgal               | 1,409         | 2%          | 18 | 1,646          | 2%          |
| 16 Grand daatgal               | 1,402         | 2%          |    |                |             |
| Ger daatgal                    |               |             | 16 | 2,584          | 2%          |
| 17 Monnis daatgal              | 1,046         | 2%          | 12 | 3,283          | 3%          |
| 18 Khan daatgal                |               |             | 17 | 2,255          | 2%          |
| <b>Total</b>                   | <b>56,764</b> | <b>100%</b> |    | <b>107,605</b> | <b>100%</b> |

Source: 2010, 2012 Annual Report of FRC

As for foreign entities, investment funds focusing on the frontier markets are major players in the Mongolian market. According to an industry expert, just one U.S. investment fund is considered to have occupied most of the trading value by foreign institutional investors, implying that there are not many active foreign investors in the market. As shown in Figure 2-2, foreign investors' presence in terms of trading volume has been fluctuating dramatically. Small capital markets with dominant share of foreign investors tend to be more volatile due to possible speculative activities by such foreign investors. Hence, the regulatory authority of the capital market will need to monitor carefully the investment activities by foreign investors. Also custodian services, currently prepared by some of the commercial banks, are expected to prompt the benefit of foreign investors, which eventually contribute to expanding the investor base.

**Figure 2-2 Percentage of foreign vs domestic investors in terms of trading volume**



Source: "Overview of MSCH&CD operations" (October 9, 2013)

**Retail investors:** As shown in Figure 2-3, the number of accounts held by Mongolian citizens reaches almost 770 thousand, meaning that 27.5% of the total population or every household has an investment account. However, most of these accounts are likely to be inactive, as they were opened when vouchers were distributed in early 1990s and in 2011.

Currently commercial banks in Mongolia offer a deposit interest rate at around 15% p.a., which tends to drive local citizens to leave their money in the deposit as the safest and the most accessible investment. Due also to the perception of the general public that stocks are illiquid and risky, participation of local citizens in the capital markets is very limited in Mongolia except for a few wealthy individuals.

Given all these, as well as the small population in Mongolia, the upside for the retail investor base shall be rather limited for the time being. However, there should be some rooms for increase in individual investors, if there are more opportunities for financial educations and if new financial products such as investment trust fund are marketed effectively through distribution channel of commercial banks, considering high percentage of adults holding investment accounts as mentioned above. This can also be supported by an introduction of preferential tax treatment for securities investment by individuals.

**Figure 2-3 Percentage of adults (age 15+) with an account at a formal financial institution**



Source: The World Bank

### c) Securities intermediaries

The history of securities companies in Mongolia goes back to 1991, when 29 state-owned brokers were established in each 21 provinces and Ulaanbaatar City to distribute stocks of SOCs to the people. They were privatized later, and many others were established when stocks of Erdenes Tavan Tolgoi LLC (ETT) were distributed to the public.

As of the end-2013, there are 26 security companies with the underwriting license and 91 with the brokerage license. The number of brokerage firms increased by 40 in 2011, when shares of Erdenes Tavan Tolgoi LLC (ETT) were distributed to the general public in Mongolia. However, according to the interviews with the market participants, there are only a few security firms which have actual underwriting capability<sup>4</sup>, and there are many small-sized brokers which have been dormant. In its 2013 Annual Report, FRC analyzes

<sup>4</sup> A market participant commented that only BD Sec and couple of others have underwriting capacity.

that a lack of skilled human resources and financial constraints of security intermediaries were part of the reasons behind the decline in the market capitalization.

**Table 2-9 Number of capital market licensees**

| Year | Underwriting | Investment Advisory | Professional Intermediaries |
|------|--------------|---------------------|-----------------------------|
| 2006 | 2            | 0                   | 25                          |
| 2007 | 8            | 8                   | 36                          |
| 2008 | 17           | 4                   | 46                          |
| 2009 | 15           | 5                   | 48                          |
| 2010 | 16           | 8                   | 52                          |
| 2011 | 22           | 16                  | 92                          |
| 2012 | 25           | 18                  | 97                          |
| 2013 | 26           | 18                  | 91                          |

Source: FRC

In order to ensure the soundness and stability of the security industry, FRC planned to raise the minimum capital requirement, starting from July 1, 2014. When a company cannot clear the requirement in three-month grace period, FRC will cancel the license of such company. However, facing strong objections from the security companies and the industry association (MASD), FRC decided to postpone the enforcement to July 2015. The actual enforcement of the new rule is likely to throw many security companies out of business.

FRC also examines possibility of introducing ‘capital adequacy ratio’ as an important indicator to measure financial soundness of securities companies. It will be necessary for the Mongolian securities industry to introduce and utilize financial soundness indicators effectively, and hence, to realize sustainable development of the industry. However, after introducing financial soundness measures, there will be restructuring and consolidation of the industry, including withdrawals of small brokers that cannot meet the minimum requirements. Such process will be inevitable for the entire industry to become sounder and more competitive with players above a certain level of business base and financial stability. Therefore, it will be very important for FRC to foresee the future image of the securities industry, and to respond to the industry restructuring in a careful manner to avoid the turmoil.

**Table 2-10 Minimum capital requirements for security-related business licenses**

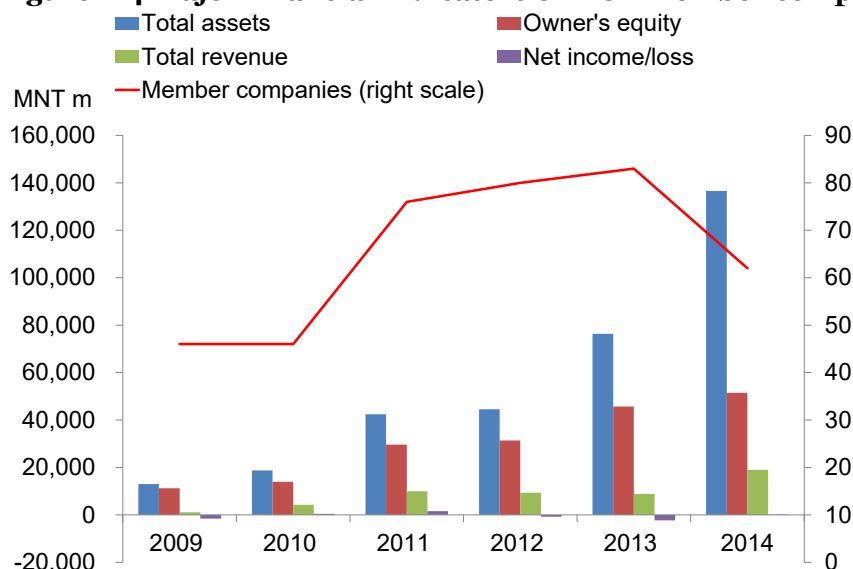
|                                 | Current minimum capital based on the present Security Market Law (article 27 & 28) | Revised Minimum capital |
|---------------------------------|--|-------------------------|
| Brokers                         | MNT 50 million   | MNT 200 million         |
| Dealers                         |  | MNT 300 million         |
| Brokers & Dealers               |  | MNT 500 million         |
| Underwriters                    | MNT 200 million  | MNT 1,000 million       |
| Brokers, Dealers & Underwriters |  | MNT 1,500 million       |

Source: FRC

Figure 2-4 illustrates major financial indicators of the total MSE member companies. With increase in the number of securities companies when stocks of ETT were distributed, total assets, owner’s equity, and total revenue of the securities industry increased substantially in

2011. However, total revenue has been stagnant and the net profit has been sluggish since then. 35 companies out of 76 in total in 2011, and 60 out of 80 in 2012 reported net loss. More than half of securities companies continued making loss for 2013 and 2014.

**Figure 2-4 Major financial indicators of MSE member companies**



Source: MSE's website

Ability to plan and develop financial products will be a very important factor for the future growth of the industry. With the implementation of Investment Fund Law in 2014, new financial products such as investment fund and mortgage-backed securities (MBS) can be designed and marketed, which can contribute to broadening the investor base in Mongolia. To take advantage of this opportunity, securities companies need to build up their expertise to deal with such new products.

Also strengthening marketing/distribution network will be critical. Currently a limited number of active companies are dependent on the relationship with particular foreign investors or wealthy local individuals, and there are only a few securities companies that have broad marketing/distribution networks for the mass market. It will be important to expand the network with clients including potential investors, in order for new products to penetrate in the market.

#### **d) MSE**

**Listing rules:** In line with the enforcement of the new Securities Market Law by FRC, MSE has revised its listing rule in October 2014 to make the stock exchange comply with the international standards, to gain confidence from the investors, to improve credibility of listed companies and to increase IPOs by SMEs and growing companies in Mongolia. Comparing the criteria of Classification 1 with that of the former listing rule, minimum percentage of floating shares has decreased from 30% to 25%, minimum operating years increased from 1 to 3 years, and numerical criteria for revenue and profit has been introduced as well as qualitative requirements for the management. According to MSE, there is currently no listed company that meets all requirements for Classification 1. Classification 2 has looser criteria than the former rule, in the sense that its minimum floating shares percentage is 15%, minimum market capitalization is MNT 1 billion (instead of MNT 10 billion in the former rule) and there is no requirements for the profit size. According to the MSE website, 89 listed companies out of 237 fall into this category. Classification 3 is designed for professional investors and more IPO activities by SMEs, but there is no IPO up to now. Also, MSE intends to delist a part of the 148 companies falling

into this category step by step.

**Table 2-11 Listing rules for MSE**

**Classification 1**

| <b>Nº</b> |  | <b>Criteria for the Issuer</b>   |
|-----------|--|--|
| 1         | Operating years  | At least 3 years   |
| 2         | Accounting Standard  | IFRS, GAAP, last 3 years   |
| 3         | Profit   | Revenue - above MNT 10 billion<br>Net Profit - above MNT 1 billion   |
| 4         | Requirements for Board, Management, and controlling shareholders | <ul style="list-style-type: none"> <li>- All debt and other liabilities must be disclosed in the prospectus. Must NOT have significant past-due loans</li> <li>- There should be no changes in 2/3<sup>rd</sup> of the management team within the last 2 years. There should be no significant changes in the composition of the controlling shareholders within the last 1 year.</li> <li>- Top management must possess relevant experiences to the business</li> </ul> |
| 5         | Corporate Governance   | Must be compliant with the local (FRC CG Codex) or international codes   |
| 6         | Market intermediary  | Must have an underwriter or have an agreement signed with an underwriter   |
| <b>Nº</b> |  | <b>Criteria for the Security</b>   |
| 7         | Market capitalization  | Above 10 billion MNT   |
| 8         | Floating %   | At least 25% of the total shares   |
| 9         | MSE listed period / trading history                              | At least 2 years   |

**Classification 2**

| <b>Nº</b> |                             | <b>Criteria for the Issuer</b>   |
|-----------|-----------------------------|--|
| 1         | Operating years             | At least 2 years   |
| 2         | Accounting Standard         | IFRS, GAAP, last 2 years   |
| 3         | Working Capital             | Must have sufficient working capital for at least 12 months of operation   |
| 4         | Requirements for Management | <ul style="list-style-type: none"> <li>- All debt and other liabilities must be disclosed in the prospectus. Must NOT have significant past-due loans</li> <li>- Top management must possess relevant experiences to the business</li> </ul> |
| 5         | Corporate Governance        | Should be compliant with the local (FRC CG Codex) or international codes   |
| 6         | Market intermediary         | Must have an underwriter or have an agreement signed with an underwriter   |
| <b>Nº</b> |                             | <b>Criteria for the Security</b>   |
| 7         | Market capitalization       | Above MNT 1 billion  |
| 8         | Floating %                  | At least 15% of the total shares   |

**Classification 3**

| <b>Nº</b> |                             | <b>Criteria for the Issuer</b>   |
|-----------|-----------------------------|--|
| 1         | Requirements for Management | <ul style="list-style-type: none"> <li>- All debt and other liabilities must be disclosed in the prospectus. Must NOT have significant past-due loans</li> <li>- Top management must possess relevant experiences to the business</li> </ul> |
| 2         | Corporate Governance        | Should be compliant with the local (FRC CG Codex) or international codes   |
| 3         | Market intermediary         | Must have an underwriter or have an agreement signed with an underwriter   |

| № |                       | Criteria for the Security   |
|---|-----------------------|---|
| 4 | Market capitalization | MSE will decide based on its other requirements   |
| 5 | Investor base         | Professional investors, and other sophisticated and informed investors, who understand the risks of this type of securities |

**Table 2-12 Listing examination criteria**

| № | Requirement criteria   | General  | Specific *        |
|---|--|--|-------------------|
| 1 | Shareholder equity   | more than MNT 10M  | more than MNT 10M |
| 2 | Non-current asset size in the price of a security to be listed | more than 10%  | more than 20%     |
| 3 | Number of shareholders**                                       | more than 50   | more than 50      |
| 4 | Percentage of common stock that are publicly offered**         | more than 30%  | more than 10%     |
| 5 | Years of running a business operation**                        | more than 1 year   | more than 3 years |
| 6 | Profit size**  | Shall generate a profit. If incurred a loss, the loss size shall be no more the 30% of an equity capital   | No requirement    |
| 7 | Others   | <ol style="list-style-type: none"> <li>1. Company shall adopt and comply with its governance rules and regulations under internationally standardized practice and guidance.</li> <li>2. Financial reports, securities transaction, price, trading data, influential information and operational information of the company and management shall be distributed transparently to the public and MSE as soon as possible.</li> <li>3. Companies must have a specialist who is responsible for securities trading.</li> <li>4. <b>Announce and arrange the shareholders'</b> meeting to the public within the term stated in the Law. These include meeting notes and resolution to be provided to MSE within the time frame.</li> </ol> |                   |

Note:

\* Companies that have a significant role to the sector with infrastructural and strategic importance for the economy shall be reviewed under specific listing criteria.

\*\* Requirement criteria 5 and 6 are not applicable to companies founded under project implementation, requirement criteria 3, 4 and 6 are not applicable to companies being privatized by the state.

Source: MSE website

According to the market participants, examination process for IPOs conducted both by MSE and FRC is quite time-consuming (usually taking 9 to 11 months)<sup>5</sup>, and getting loans from commercial banks is much easier for most companies. After the introduction of the new listing rule which is more friendly and realistic to IPO candidates, it is now very important for MSE to implement the rule in more efficient and effective manner.

<sup>5</sup> Article 7 of the MSE's new listing rule stipulates that "after receiving all the necessary documents and application from the securities issuer, MSE shall conduct inspection and revision of submitted documents within 20 working days."

**Corporate governance:** MSE introduced a new function in charge of corporate governance of listed companies in September 2014. MSE is now conducting a survey on corporate governance and information disclosure of MSE Top 20 companies, in which MSE prepares “self-assessment check list” of 90 questions related to the management, board of directors, information disclosure, accounting standards of these companies. According to the interview with the staff in charge at MSE, the result of survey will be announced in the near future.

**Business planning:** Market Development Department of MSE has prepared the business plan of 2015, and the plan is now under discussion with the government. In this plan, the target number of IPOs in 2015 is set at five, although there is no concrete potential deal as of today.

#### **e) FRC**

Securities Regulation Department is in charge of examining listing companies and monitoring the listed companies in MSE. Some of the functions that FRC used to have in checking IPO applicant have been transferred to MSE as well as the third parties including auditing firm, law firm and evaluators, with the enforcement of new Securities Market Law and MSE’s new listing rule. However, FRC still has authority to approve registration of prospectus of each IPO candidate in MSE. In other words, IPO candidates need to apply to both FRC and MSE for IPO examination process, and there seems to be some overlapping work<sup>6</sup> between FRC and MSE in their examination process, which could lead to complaint about time consuming procedure by underwriters and listing companies. Also, in monitoring work of MSE listed companies, there could be some overlap between FRC and MSE<sup>7</sup>.

According to the Division manager, under the current limitation of the number of staff (nine in total), it is not possible for FRC to monitor all of the 237 listed companies. FRC cooperates with auditing firms to conduct on-site inspection for the listed companies, but FRC would need to prepare some type of inspection manual to receive appropriate results from the work of auditing firms.

Also, the National Council on Corporate Governance which was established under FRC as the institution implementing corporate governance policy has been working with MSE and MSE Top 20 companies to improve understanding and practices on better corporate governance and information disclosure.

As commented earlier, IPO examination process partly covered by FRC is time-consuming, and such situation should be resolved as early as possible.

#### **f) Relevant laws and regulations**

**Securities Market Law:** The Securities Market Law was initially enacted in 2002, which was amended to a large extent in May 2013 and took effect on January 1, 2014, with the main purpose of providing an effective regulatory environment for further developing the securities market. Table 2-13 and 2-14 summarize the basic structure and the changes from the previous version, for which the parts closely related to IPO and dual-listing are marked.

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<sup>6</sup> According to former Securities Issuer Division of FRC, in IPO examination process, FRC mainly focuses on accuracy of content in prospectus including information on management, financial conditions, business plan, methodology of public offering, etc., while MSE need to check criteria set in each Category.

<sup>7</sup> According to former Securities Issuer Division of FRC, monitoring work of MSE listed companies has been mainly conducted by FRC up until now due to capacity limitation of MSE.

**Table 2-13 Structure of the Amended Securities Market Law**

**Chapter 1: General provisions**

|   |  |
|---|--|
| Article 1. Purpose of the Law<br>Article 2. Legislation relating to the securities market | Article 3. Scope of application of the Law<br>Article 4. Definitions of terms used in this Law |
|---|--|

**Chapter 2: Issue and trading of securities**

|   |  |
|---|--|
| Article 5. Securities<br>Article 6. Issue of securities<br>Article 7. Securities issuers<br>Article 8. Procedures for issuing securities by way of public offer<br>Article 9. Registration of securities and approval of public offer<br>Article 10. Securities prospectus<br>Article 11. Public offer of securities<br>Article 12. Selling securities on the primary securities market and related reporting<br>Article 13. Depositary receipt | Article 14. Mongolian depositary receipts<br>Article 15. Global depositary receipts<br>Article 16. Company debt instruments<br>Article 17. Issue of securities in a foreign jurisdiction by a company listed on the stock exchange<br>Article 18. Issuing of securities in Mongolia by a legal entity registered in a foreign jurisdiction<br>Article 19. Issuing derivative financial instruments<br>Article 20. General obligations of the issuer<br>Article 21. Demand of information relating to securities issuers and submission of claims |
|---|--|

**Chapter 3: Purchasing all or a controlling block of the shares of a company**

|   |
|---|
| Article 22. Making of an offer to purchase the shares of a company<br>Article 23. Procedures for the purchase the shares of a company |
|---|

**Chapter 4: Regulated activities**

|  |  |
|--|--|
| <p><b>Sub-chapter 1: General regulations</b><br/>Article 24. Regulated activities<br/>Article 25. Principles to be observed when undertaking regulated activities<br/>Article 26. Regulations for regulated activities</p> <p><b>Sub-chapter 2: Issuing and registering licenses to legal entities to undertake regulated activities</b><br/>Article 27. Applications for licenses<br/>Article 28. Granting a license<br/>Article 29. Suspension of a license<br/>Article 30. Revocation of a license<br/>Article 31. Consequences of suspension or revocation of a license<br/>Article 32. Measures to be taken and implemented by the FRC in connection with suspending, restoring, and revoking a license<br/>Article 33. Regulated activities to be undertaken on the basis of registration<br/>Article 34. Right to make a complaint</p> <p><b>Sub-chapter 3: Professional certification</b><br/>Article 35. Professional certification</p> | <p><b>Sub-chapter 4: Types of regulated activities</b><br/>Article 36. Securities broker activities<br/>Article 37. Securities dealing activities<br/>Article 38. Investment fund activities<br/>Article 39. Securities investment advisory activities<br/>Article 40. Security nominee activities<br/>Article 41. Underwriting activities<br/>Article 42. Securities ownership rights registration activities<br/>Article 43. Securities clearing activities<br/>Article 44. Securities trade settlement activities<br/>Article 45. Securities central depository activities<br/>Article 46. Custodial services<br/>Article 47. Securities trading activities<br/>Article 48. Participating in trading on the stock exchange<br/>Article 49. Conditions and requirements for stock exchange activities<br/>Article 50. Credit rating activities<br/>Article 51. Concurrently conducting regulated activities</p> <p><b>Sub-chapter 5: Accounting and auditing</b></p> |
|--|--|



|  |  |
|--|--|
|  | Article 52. Keeping accounting registers<br>Article 53. Auditing<br>Article 54. Audit inspection |
|--|--|

**Chapter 5: Securities market information**

|  |  |
|--|--|
| Article 55. Primary securities market information<br>Article 56. Secondary securities market information<br>Article 57. Information regarding regulated entities | Article 58. Investor information<br>Article 59. FRC information<br>Article 60. Receiving of information by the FRC |
|--|--|

**Chapter 6: Securities market regulation**

|  |  |
|--|--|
| <p><b>Sub-chapter 1: State regulation of securities market</b></p> <p>Article 61. The central state administrative body in charge of finance and budget matters<br/>Article 62. Organization in charge of implementing state regulation in the securities market<br/>Article 63. Authority of the FRC<br/>Article 64. Cooperation with competent regulatory bodies of foreign jurisdictions and international organizations<br/>Article 65. Issuing recommendations<br/>Article 66. Issuing instructions<br/>Article 67. The register of regulated entities<br/>Article 68. Determining suitable persons</p> | <p><b>Sub-chapter 2: Self-regulatory organizations of the securities market</b></p> <p>Article 69. Self-regulatory organizations<br/>Article 70. Authority of a self-regulatory organization<br/>Article 71. Registration of a self-regulatory organization<br/>Article 72. The charter and by-laws of a self-regulatory organization<br/>Article 73. Management and organizational structure of self-regulatory organizations<br/>Article 74. Relations between the FRC and self-regulatory organizations<br/>Article 75. Supervising the operations of self-regulatory organizations</p> |
|--|--|

**Chapter 7: Prohibited activities in the securities market**

|  |  |
|--|--|
| <p><b>Sub-chapter 1: Activities prohibited to a holder of inside information</b></p> <p>Article 76. Inside information<br/>Article 77. Holders of inside information<br/>Article 78. Prohibition on participation in trading activities using inside information<br/>Article 79. Disclosing inside information to the public</p> | <p><b>Sub-chapter 2: Market abuse</b></p> <p>Article 80. Prohibition on market abuse<br/>Article 81. Obligation to compensate damage</p> |
|--|--|

**Chapter 8: Supervision and inspection of the securities market**

|  |  |
|--|--|
| Article 82. Demand of information<br>Article 83. Regular supervision<br>Article 84. Inspection of the activities of regulated entities | Article 85. Authority of the State Inspector of the FRC<br>Article 86. Prohibition on obstruction of inspections<br>Article 87. Emergency situations |
|--|--|

**Chapter 9: Miscellaneous**

|  |
|--|
| Article 88. The Dispute Resolution Board<br>Article 89. Sanctions for violations<br>Article 90. Entry into Force |
|--|

**Table 2-14 Changes in the Securities Market Law and their purposes<sup>8</sup>**

| <b>Change</b>  | <b>Purpose</b>   |
|--|--|
| <p><b>1. Implementation of segregation between legitimate ownership and beneficial ownership</b><br/>                     In Mongolian law, a legitimate owner used to mean a beneficial owner and the concept of titular ownership did not exist. The amendment introduced the difference between legitimate and beneficial ownerships.</p>   | <p>To make it possible for local banks to operate custody businesses so that depository and relevant process are conducted in Mongolia, while the beneficial ownership remains with foreign investors.<br/>                     If there are no reliable local banks which can operate custody business, foreign institutional investors may not invest in the market.<br/>                     To enable local banks to operate custody business and to accelerate investment in Mongolia from foreign institutional investors.</p>   |
| <p><b>2. Dual listing and depository receipts (DRs)</b><br/>                     Old law mentioned the possibility of dual listing, but there were no detailed rules. The amended law explicitly stipulates that dual listing of both Mongolia and foreign listed companies are allowed. Also the definition of eligible securities for trading has been expanded to cover DRs.</p>  | <p>Currently, Mongolian securities market is not deep enough to fulfil the financing needs of companies. As a realistic solution, raising a certain part of the funds in foreign markets, besides domestic financing, can be considered. The amendment clarifies the availability of dual listing. It also aims at encouraging the usage of domestic capital market.<br/>                     Introduction of DR aims at 1) facilitating dual listing of Mongolian companies by listing their securities in foreign markets, and 2) making it easier for foreign blue chips to be listed at MSE. 2) is especially designed to enhance the status of the Mongolian market with more foreign company listings.</p> |
| <p><b>3. Strengthening information disclosure</b><br/>                     Requirements of 1) issuance disclosure and 2) periodic disclosure will need to be enhanced. For 1), details of financial statements, stakeholders list, financing/ investment plans, and risk management plans should be provided in a prospectus. Disclosed Information must be audited by a certified public accountant and verified by a legal professional.<br/>                     While the old law used to require listed companies to disclose all the information required in the relevant laws, the amended law clearly defines a limited scope of disclosure and obliges them to disclose facts such as the certain forms of reorganization, significant changes in shareholder</p> | <p>Under the old law, many listed companies failed to disclose important information such as annual reports and financial statements. The amendment aims at improving the reliability of the market by enhancing the transparency of the market through enforcing the disclosure of the listed companies.</p>  |

<sup>8</sup> Study team used Hogan Lovells "Mongolia Adopts An Amended Securities Market Law, July 2013" as reference to make this table.

|   |  |
|---|--|
| <p>composition and other information that may affect its stock price within one business day from the occurrence. Immediate disclosure is also required for certain situations. In addition, MSE must post information on its website which its listed companies need to disclose.</p>  |  |
| <p><b>4. Preventing unfair trading</b><br/>The amended law includes more detailed provisions prohibiting insider trading &amp; market abuse.</p>  | <p>It aims at aligning with the global standard on prevention of unfair trading to ensure fairness/ transparency and enhance the market reliability.</p>                                 |
| <p><b>5. Enhancing supervision by FRC</b><br/>The amended law defines greater number of securities market operations than the old one, enabling FRC to supervise a broader range of securities businesses. In addition, asset valuation companies, audit firms and law firms need to be registered with FRC to provide their services for the listed companies. Relevant regulations are being prepared by FRC.</p> | <p>FRC is going to ensure fairness &amp; transparency in the securities market and protect investors by imposing stricter responsibilities &amp; obligations on market participants.</p> |
| <p><b>6. Introduction of SRO</b><br/>Stock exchanges, securities depository organizations and regulatory business organizations can be registered as SRO under the amended law. SROs will be responsible for a certain level of oversight of its market participants.</p>   | <p>Introduction of SRO is intended to implement a framework for self-regulation among its members.</p>   |
| <p><b>7. Implementation of a Dispute Resolution Board</b><br/>The amended law mentions that a Dispute Resolution Board will be established within FRC to deal with disputes among relevant regulators, listed companies, and investors.</p>   | <p>Instead of taking judicial action, a Dispute Resolution Board can provide services for faster, less expensive, undisclosed and more satisfactory dispute resolution.</p>              |

In connection with the enforcement of the amended Securities Market Law, 34 regulations (shown in Table 2-15 below) have already been issued.

**Table 2-15 New regulations under the amended Securities Market law**

|  |
|--|
| Record of publicly offered securities in Mongolia, IPO & trading   |
| Opening securities trading account, disposition & transaction of the securities & cash assets from the account                                   |
| Custodian licensing and operations   |
| Regulated activities in securities market  |
| Granting, extending, suspending, reinstating & revoking license, and actions that will be taken in case of revocation/suspension of the license; |
| <b>Regulated entities'/market intermediaries/operation</b>   |
| Accounting operation   |
| Determination of the cap for the service charge & fee charged by regulated entities  |
| Submitting information to FRC and informing to the public & its surveillance   |
| 10. Advertisement of regulated entities & securities issuers   |
| <b>Receiving and completing the client's order</b>   |
| . Nominating the authorized person at regulated entities and determining fit & proper person   |
| . Collection, maintenance and transfer of archive documents of regulated persons   |
| . Instructions on submitting information & reports to FRC  |
| . Setting the fee for regulated operations payable by regulated persons  |
| . Brokerage service of the securities on foreign capital market  |
| . Record and trading of Depositary Receipts  |
| . Inside information of listed company   |
| . Delivering information from listed company to shareholders   |
| . Buying all shares or a controlling block of share of a listed company  |
| . SROs   |
| . Adjustment in emergency circumstance of regulated legal body in security market  |
| . Preventing market manipulation   |
| . Issuing financial derivatives  |
| . Code of corporate governance   |
| . Registering a legal body conducting legal advisory service for securities market participants  |
| . Registering a legal body conducting auditing service for securities market participants  |
| . Registering a legal body conducting asset valuation service for securities market participants   |
| . Trustee management operation of securities   |
| . Conducting qualification examination of securities market and granting suspending and revoking the qualification license of individuals        |
| . Investments funds  |
| . Investment Management Company  |
| . Defining the financial strength ratings operation  |
| 34. Council settling dispute   |

Source: FRC

**Investment Law:** Given the recent decline in FDIs, the Investment Law was enacted in November 2013 in place of the Foreign Investment Law and relevant regulations, with a view to securing stable investments in strategically important sectors, both from foreign and domestic investors. Under this law, domestic and foreign investors are treated in the same way, and the provisions regarding the investment in sectors of strategic importance were removed, although they are still subject to the approvals under other sector-specific laws and regulations, where state involvement are required for business approval in some cases.

**Investment Fund Law:** The Investment Fund Law, which came into effect on January 1, 2014, is the first comprehensive law for investment funds and provides the enabling framework. It aims to pool small-lot funds to nurture new institutional investors and invite wealthy individuals to invest in domestic securities through Private Funds. It also aims to

attract investment from abroad by providing more convenient investment schemes.

It details the types, establishment, operation, management, accounting records and liquidation of investment funds, as well as the investment management companies and custodian banks, with FRC as the main regulator. The law defines two types of investment funds; mutual funds (open-ended or closed-ended) and private funds, which can be established by investment management companies for a period of up to 10 years. Investment incomes are exempt from Mongolian corporate income tax, but no other tax benefits are provided.

According to FRC, the following sub rules have been established or revised in connection with the enforcement of the law.

|  |
|--|
| Establishing investment fund   |
| Investment fund operation and supervision  |
| Member record-keeping of investment fund law   |
| Calling investment fund member meeting   |
| Investment fund accounting, requirement for financial report, investment fund activities and its valuation |
| Investment fund information and advertisement  |
| Liquidating investment fund  |
| Asset/investment management operation  |
| Custodian operation  |
| Set of detailed regulations on investment fund operation   |
| Investment fund registered in foreign countries  |
| Merger and consolidation of investment fund  |
| 13. Defining fit and proper candidates   |

Source: FRC

**Minerals Law:** The Minerals Law, aiming at regulating mineral exploration/extraction within the jurisdiction of Mongolia, has a provision related to the securities market activities. For example, Article 5.6 stipulates that a legal person holding a mining license for a mineral deposit of strategic importance shall float no less than 10% of its shares at MSE. While this is based on the idea that even 10% of such promising businesses should have substantial positive impact on domestic capital market, there is no penalty for incompliance with this rule at this point.

## (2) Possible solutions

Provided the development stage of Mongolian capital markets as detailed above, potential demands and the strategy of assistance for IPO/dual listing can be summarized as follows.

The basic idea is how to present the potential sectors/companies to the investors (especially foreign investors for the time being) in this difficult time of macroeconomic instability. In order to do that efficiently and effectively, the main focus should be marketing the Mongolian capital markets as a transparent one in line with the global standard, which can provide full investment opportunities attractive enough for global investors interested in high growth emerging markets. This is a reasonable and rational approach, particularly as a short-term strategy, as it takes much longer time to broaden the domestic investor base. (See the target image for the short-term in Figure 2-5, which was prepared by the JICA Study Team for the ‘Data Collecting Survey for Development of Financial and Capital Market, and Capacity Building of its Regulation and Supervision in Mongolia’, as a basis of this TA.)

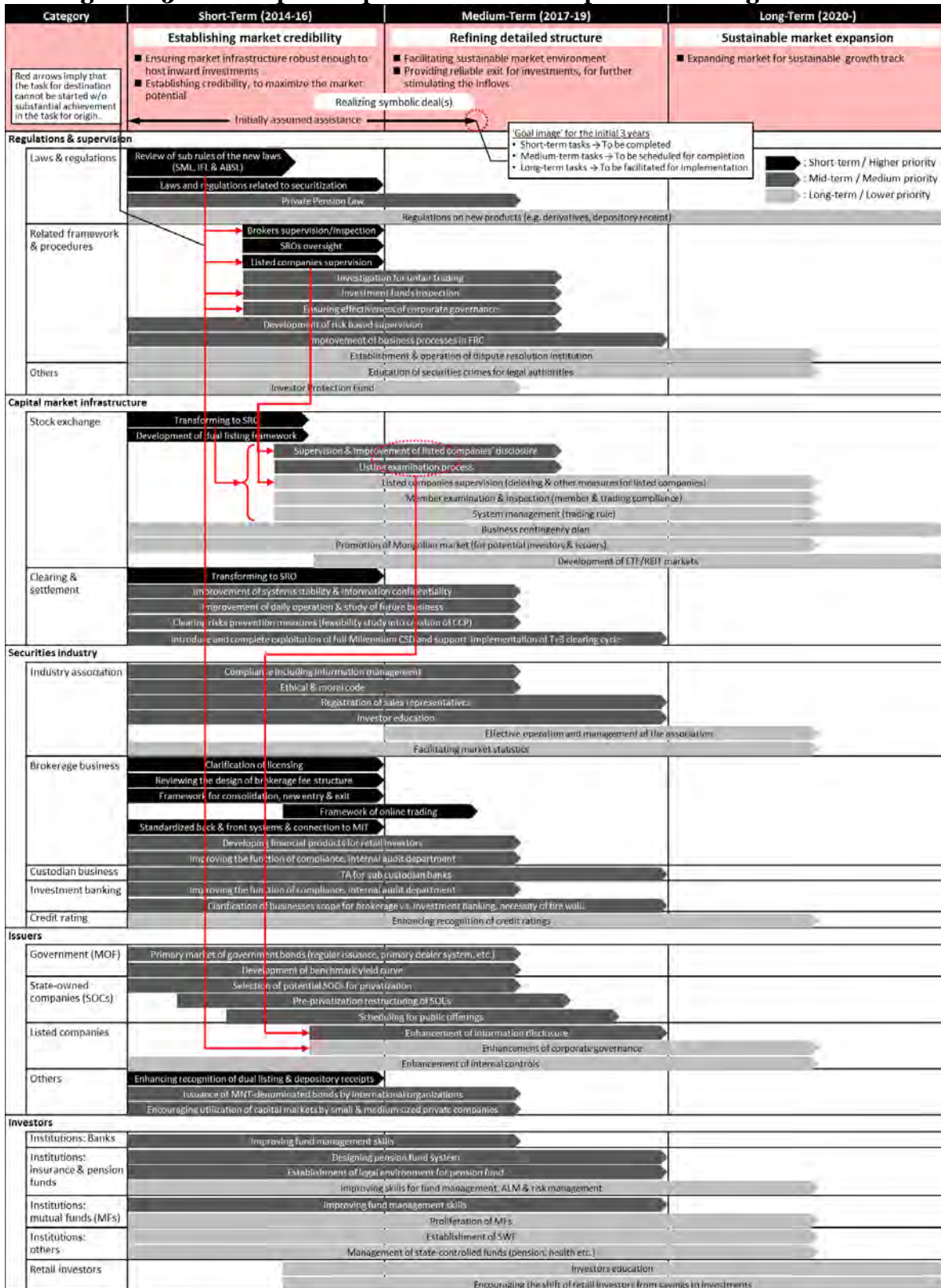
More specifically, the key for the success is to ‘remove uncertainty’ for the investors as

much as possible. In this regard, introduction of the new laws, such as Securities Market Law and Investment Fund Law, had quite positive impact on the investor sentiment, which was, unfortunately, more than offset by the recent macroeconomic downturn. Going forward, it is critical to keep pushing the implementation of these laws and the relevant regulations, introducing the new products, and providing reliable market infrastructure which contribute to reducing the transaction costs.

At the same time, it is necessary to address the longer-term objectives and to start working on their basis, although immediate result cannot be expected. These challenges include retail investor education, fostering institutional investors through training investment professionals and investment deregulation (although they are not included in the target outputs of this TA), and expanding the variety of the capital market products, etc.

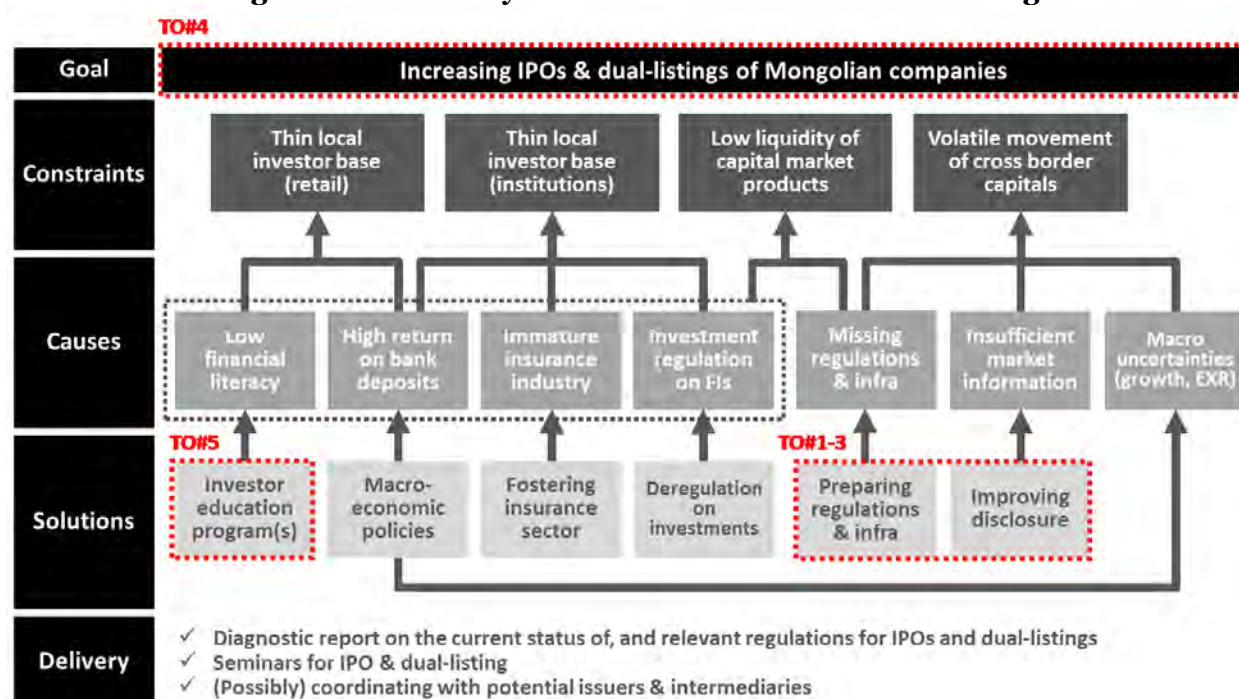
These issues and challenges are summarized in Figure2-6, which shows that IPO/dual listing component of this TA (target outcome #4) is a complex outcome of the measures for other targets (#1, 2 3 and 5). In the rest of this section, relevant measures are listed for the same categories as the previous section --- issuers, investors, intermediaries, stock exchange and the regulator.

**Figure 2-5 Roadmap for capital market development in Mongolia**



Source: JICA Study Team for the 'Data Collecting Survey for Development of Financial and Capital Market, and Capacity Building of its Regulation and Supervision in Mongolia' (2013-14)

**Figure 2-6 Summary of the issues on IPO and dual listing**



Source: JICA Expert Team

### a) Issuers

As discussed earlier, in order for MSE to receive more confidence of the market participants, the most imperative issue is to clean up some of the existing listed companies by delisting those not traded at all. In doing so, it is necessary for FRC and MSE to make rule of delisting rule explicit<sup>9</sup> and to enforce it properly.

In addition, the listed companies will need to make more effort to improve its corporate governance and information disclosure. As for this issue, appropriate cooperation with other DPs and local institutions should be carefully considered to avoiding overlaps, since DPs including the World Bank and IFC have conducted projects on this issue before, and there are local institutions specialized in corporate governance including the National Council on Corporate Governance and Corporate Governance Development Center.

More importantly, it would be helpful to have symbolic IPO deal(s) in drawing attention of the stakeholders and driving relevant resources toward the success of the actual deal(s). In general, potential demand can be classified into the following three groups.

➤ **Needs for privatizing state owned companies (SOCs)** – Currently the State Property Committee (SPC) is in the process of preparing the list of around 20 candidates for privatization and restructuring for 2015-16. Specifically, additional floating of the power plant companies and coal mining companies such as Baganuur and Shivee Ovoo (both under Erdenes MGL), IPO of MSE, Agricultural Commodity Exchange and other mining-related companies, are being considered. For the IPO candidates, feasibility studies and pre-privatization restructuring are the main emphasis, whereas the possibility of re-listing has been sought for some of the companies delisted so far.

<sup>9</sup> In the MSE's new listing rule, there is an article (Article 23) stipulating conditions and procedures on suspension of trading activity and delisting of securities.



- **Financing needs by medium-sized non-mining private sector companies** – On the domestic-demand oriented side, some of the prospective sectors include infrastructure- related, agro/food processing, telecommunication and import substitution sectors such as construction materials.
- **Financing needs by major banks** – Due to the lack of successful cases in the past, most of the commercial banks are cautious about IPO, and are likely to seek bond financing outside Mongolia. But greater usage of domestic capital markets is expected in the longer-term, as the market impact cannot be ignored once they decide to go for IPO.

## **b) Investors**

**Foreign investors:** Investor demography in Mongolia, with relatively large share of the limited number of foreign institutions/individuals as well as the thin domestic investor base, is less likely to go through immediate change in the near future. Especially considering the growing attention of Western institutional investors on Mongolia as one of the strategic emerging markets, this trend is likely to be strengthened, especially once the current macroeconomic uncertainty is removed.

**Domestic investors:** While the pace of the growth is likely to be slow, gradual changes are necessary. For the retail investors, as one of the focuses of this TA, fund flows into the markets are currently limited, given the high deposit interest rates and the lack of knowledge/ confidence in capital markets. It will become necessary, in the long run, to expand the needs for more active capital markets through guiding the investors from ‘savings’ to ‘investments’ with a view to diversifying their assets. Measures such as tax incentives (e.g. those focusing on IPO deals) shall be considered based on other countries practices, including those in Japan.

## **c) Securities intermediaries**

Most of securities companies in Mongolia do not have actual experience and sufficient expertise to achieve successful IPO transactions. Even the most experienced underwriter in Mongolia, BD Sec, commented during the interviews by the team that they need to have better understanding on the international standards of IPO prospectus. In order to increase the number of IPO deals in MSE, capacity building of securities companies is one of the indispensable component to be included in this TA. In addition to building up overall financial strength of the securities companies, capacity development in underwriting businesses will be needed, not only as an additional source for the securities companies, but also for the sustainable growth of the overall capital markets in Mongolia.

## **d) MSE**

It will be important for MSE to enforce the new listing rule effectively and properly. In addition, MSE will need to strengthen its capacity of analyzing the current and future prospect of business, corporate governance and financial conditions, and of examining the related documents from IPO applicants effectively and efficiently.

## **e) FRC**

As discussed earlier, there are some overlaps between FRC and MSE in supervising newly listing and the already listed companies. FRC will need to streamline its roles and functions of monitoring the listed companies and examining IPO applicants, in coordination with MSE.

## **(3) Probable technical cooperation activities under JICA program**

### **a) Listed companies**

New Chair of FRC commented in the meeting with JICA Expert Team on January 15, 2015 that the target output #4 (increasing IPOs and promoting dual listing of Mongolian companies) is the top priority which FRC expects from this TA project. Even one successful

and symbolic IPO deal could vitalize the current stagnant market through further attracting the investors and candidate issuers at MSE.

In order to accelerate this positive cycle, JICA Consultant team is planning to work closely with FRC, MSE, SPC, MOF, relevant line ministries and underwriters to identify the candidates for IPO at MSE, as well as for dual listing at other exchanges. Especially, the team shall take advantage of the close communications with these stakeholders in;

1. Matching the financing needs with intermediaries, and
2. Identifying the constraints/obstacles in the process of preparing for IPO/dual listing, with a view to feeding them back into the process of revising the existing systems,

on a real time basis. While the direct support for specific issuers and securities companies is beyond the scope of this TA, it is critically important to have a close look at the problems and issues faced by individual players to improve the quality of the feedbacks to FRC, MSE and other stakeholders.

As for the currently listed companies at MSE, improvement in corporate governance and **information disclosure is considered as one of the most urgent issues to restore investors' confidence**. JPX will be able to provide information and training programs on their practices or experiences in the field of corporate governance and information disclosure.

## **b) Investors**

See “5. Enhancing financial literacy for general public”

## **c) Securities intermediaries**

In order to strengthen capacity and expertise in underwriting, the team, with the support of Japanese major securities companies including Daiwa Securities, will be able to provide information and training programs on the roles and functions of underwriters in the process of IPO and dual listing. The delivery shall take the form of seminars involving both potential issuers and intermediaries, and the possible topics include:

- Benefit of IPO/dual listing (by),
- Global trend of IPO/dual listing ( - do - ),
- **Underwriter's roles in IPO/dual listing ( - do - )**,
- Relevant laws/regulations/institutional framework in Japan (by FSA)
- Listing rules and examinations (by JPX), and
- Preparation and procedure for IPO/dual listing (by securities companies and MSE),

with an emphasis on the implications on the capital market in Mongolia.

## **d) MSE**

In this TA project, JPX will play the most important role in strengthening the capacity of MSE in its examination of IPO candidates and monitoring of the listed companies. MSE will also need more marketing activities to broaden international investor base including those from Japan. The team and JPX will work together to hold seminars for MSE, covering these issues.

## **e) FRC**

With a view to ensuring the sustainable securities industry which can accommodate future IPO/dual listing deals, FRC will need to focus on designing the securities industry, including optimal size, number of players, etc., in addition to developing the framework of risk-based supervision discussed in the previous chapter. Specifically, it will become necessary to prepare future consolidation scenario of the industry after enforcing new minimum capital requirements. FSA and the team shall provide information on policy experiences in Japan and implications for Mongolia regarding the industry consolidation. Also for stimulating the appetite for IPO shares, tax measures can be examined and

adjusted, with the inputs from FSA based on the experiences/practices in Japan and other countries.

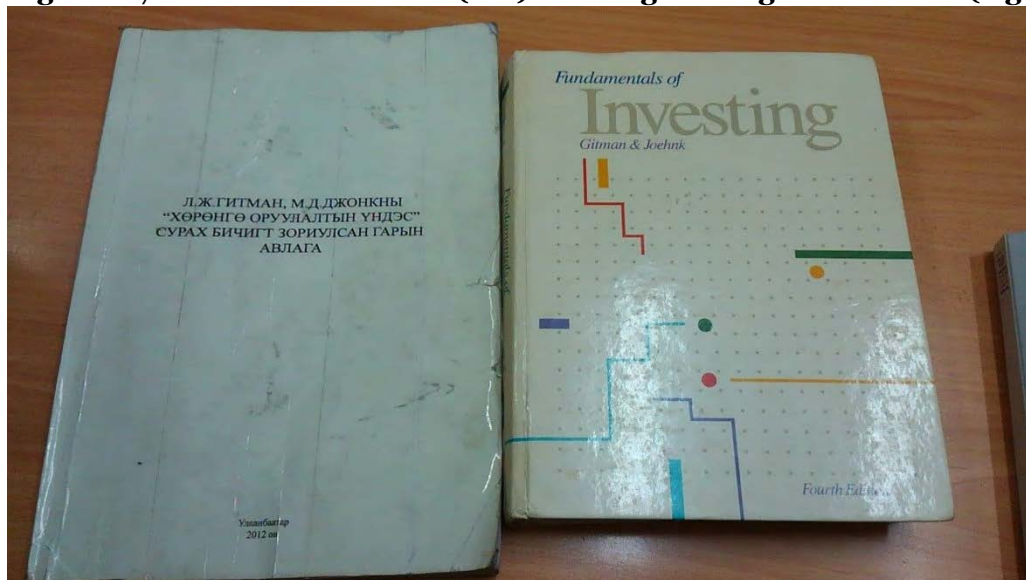
## 5. Enhancing financial literacy for general public

### (1) Review on the current situation in Mongolia

In Mongolia, there is neither specific education nor training focused on improving financial literacy including the investor education open for the public in general.

At middle school and high school age, there are no curriculum that aims on money education and courses that teach financial terms, while only occasion that is related securities industry is the study tour to the MSE during the excursions to UB. Even at the higher education for instance, there is no finance textbook written in Mongolian language used amongst the faculties of Economics Department at the National University of Mongolia a prestigious university in Mongolia. Given the situation, some of the professors prepare translated version of the English textbooks obtained from abroad as handout materials.

**Figure 2-7 Translated textbook (left) and original English textbook (right)**



Source: JICA Consultant team

Similarly, the investor education channels available to the retail investors are also scarce. FRC provides very brief explanation of knowledge and concepts regarding the capital markets in Mongolia on their website. At MSE, some basic knowledge on securities and investment are shown on their website and in addition, short basic training courses on securities trading are offered to the general public. Few securities companies provide capital markets related half-day seminars in several occasions and one of them also provide some knowledge and awareness via its publications. Moreover, currently there exist no platform of financial knowledge and jargons available to the public to fully understand and meet their interests towards capital markets and securities trading.

**Figure 2-8 Publication by one of the securities company**



Source: JICA Consultant team

Likewise, structured educational and training programs for the financial professionals are also limited in Mongolia. MSE provides series of training courses for the prospective professionals and examination for dealers and brokers. Mongolian Association of Securities Dealers (MASD) also provides internal training to those 45 (out of 71 securities dealers/brokerage licensed firms) member companies however, the trainings are conducted on an ad-hoc basis due to limited trainers and 26 non-members to the association do not usually participate. In addition, the Financial Markets Association (FMA) offers training courses to the professionals but the contents and frequencies are both insufficient due to limited capacity.

Given the current situation, the World Bank has been supporting the Mongolian government as well as the financial regulators including BoM and FRC to draft “National Strategy for Financial Literacy” in order to improve awareness and financial literacy of the general public. This strategy is aiming to be implemented by the end of 2015 and the actual financial education and training programs will start from the following year. In addition, ADB has been supporting relevant institutions to create a series of TV drama aiming to educate the general public and started broadcasting since December 2014. However, these programs provided by the international donors have more focuses on financial inclusion rather than the

Luxembourg Agency for Development Cooperation (Lux Dev) has been providing technical cooperation programs targeting more specifically FRC and financial institutions since 2012. As one of their key outputs, Lux-Dev supported the FRC to publicize three booklets on capital markets, insurance business, and microfinance all with financial terms and glossaries in local language. These booklets however are limited only amongst the relevant counterparties such as the financial authorities and financial institutions such as banks, insurance companies and NGOs. The training programs are also not specifically focused on the actual operations regarding capital markets and securities trading but rather more emphasis on institutional capacity buildings aspects.

**Figure 2-9 Publication by Luxembourg Development**



Source: JICA Consultant team

## (2) Possible solutions

Based on the current situation and the necessities for the capacity buildings to improve financial literacy and awareness amongst the relevant parties such as the regulators and financial institutions as well as the public, the consultants propose several technical cooperation activities as follows:

- Provide series of seminars / lectures: target audiences and the contents shall be determined at the necessary basis with prioritizations along with the level of difficulties.
- Assist in structuring the national framework regarding the financial literacy: this includes who takes the initiative and what sort of knowledge and information to be disseminated to the public from which platform.
- **Support in drafting “media mix strategy” to promote financial literacy: primary focus on the delivery channels via social network services (SNS), TV shows, radio program, newspapers, magazines, websites, educational institutions, etc.**

## (3) Probable technical cooperation activities under JICA program

Further details of the activities are subject to consultation with the FRC as well as JICA.



Japan International Cooperation Agency

# **Self Regulatory Organization:**

## **A concept paper**

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15 December 2016

JICA Consultant Team

### **Contents**

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- 1. What is an SRO?**
- 2. MSE as an exchange SRO**
- 3. MASD as an association SRO**

## 1. What is an SRO? - Overview

---

### Overview

- ✓ Self Regulatory Organization (SRO) is **an organization that is organized to regulate the market operations and the ethical standards of practice and business conducts of its members** as for the purpose to promote investor protection and market development.
- ✓ SROs are usually stipulated by relevant laws, and registered or regulated by the government authorities.
- ✓ SROs function as a semi-regulator as they monitor the market operations to minimize any wrong doings and frauds .
- ✓ SROs also function as a promoter of industry development via providing necessary trainings and education to those professionals working for the industry.

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## 1. What is an SRO? - IOSCO's principles

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### IOSCO's principles

- ✓ The regulatory regime should make appropriate use of SROs that exercise **some direct oversight responsibility** for their respective areas of competence and to the extent appropriate to the size and complexity of the markets.
- ✓ SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.



## 1. What is an SRO? - Benefits from SROs

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### Benefits from SROs

- ✓ SROs may require the observance of ethical standards which go beyond government regulations.
- ✓ SROs may offer considerable depth and expertise regarding market operations and practices, and may be able to respond more quickly and flexibly than the government authority to changing market conditions.

Source: IOSCO, *Objectives and Principles Of Securities Regulation, May 2003*

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## 1. What is an SRO? - SRO categories

---

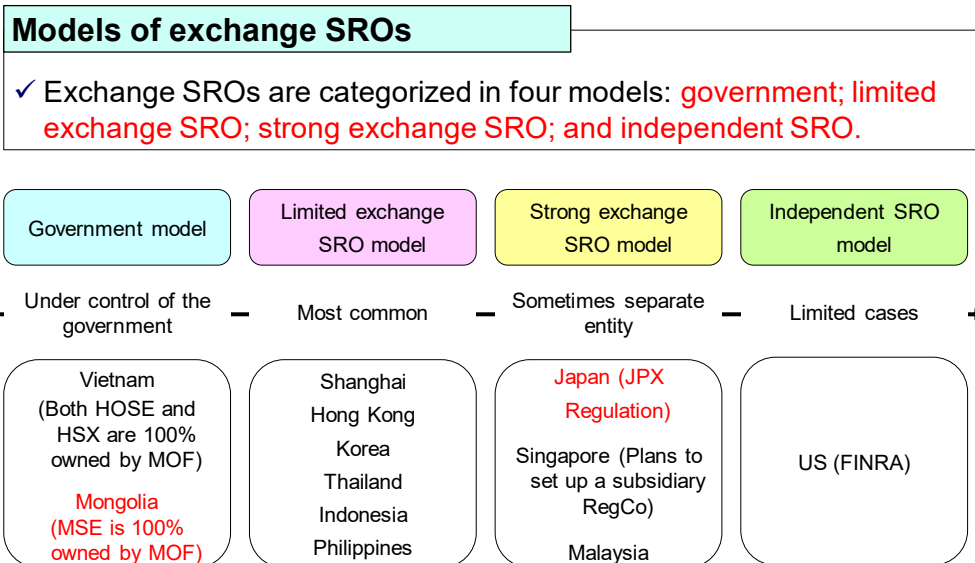
### Types of SROs

- ✓ There are mainly two types of SROs in the capital markets, each with different functions and responsibilities: **exchange SROs**; and **association SROs**.
- ✓ FRC approved MASD, then MSE as an SRO in 2015.

| Categories              | Major functions  |
|-------------------------|--|
| <b>Exchange SROs</b>    | <ul style="list-style-type: none"><li>✓ Management of listed companies' eligibility</li><li>✓ Monitor trading activities</li><li>✓ Monitor trading participants</li></ul>  |
| <b>Association SROs</b> | <ul style="list-style-type: none"><li>✓ Promote standards and ethical practices for member companies and sales representatives</li><li>✓ Provide guidelines and best practices</li><li>✓ Educate and train sales representatives</li></ul> |

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## 1. What is an SRO? - Exchange SROs



Source: Clemente L. del Valle, *The Future of Self-Regulation in Securities Markets*, April 2010, JICA Consultant Team

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## 1. What is an SRO? - Association SROs

Association SROs - list of securities industry associations in Asia

| Country     | Association  | Regulated by  | SRO |
|-------------|--|---|-----|
| Japan       | Japan Securities Dealers Association                     | Financial Instruments and Exchange Act                | Yes |
| China       | Securities Association of China                          | Law of the People's Republic of China on Securities   | Yes |
| Hong Kong   | Hong Kong Securities Association                         | -   | No  |
| Korea       | Korea Financial Investment Association                   | Financial Investment Services and Capital Markets Act | Yes |
| Taiwan      | Taiwan Securities Association                            | Securities and Exchange Act                           | Yes |
| Singapore   | Securities Association of Singapore                      | -   | No  |
| Malaysia    | Association of Stockbroking Companies Malaysia           | Societies Act   | No  |
| Thailand    | Association of Thai Securities Companies                 | Securities and Exchange Act                           | No  |
|             | Thai Bond Market Association                             | Securities and Exchange Act                           | Yes |
| Indonesia   | Association of Indonesian Securities Companies           | -   | No  |
| Philippines | Philippine Association of Securities Brokers and Dealers | Securities Regulation Code                            | No  |
| Vietnam     | Vietnam Association of Securities Business               | Ministry of Home Affairs Decree                       | No  |
|             | Vietnam Bond Market Association                          | Ministry of Home Affairs Decree                       | No  |
| Mongolia    | Mongolian Association of Securities Dealers              | Securities Market Law                                 | Yes |

Source: 6<sup>th</sup> Comparative Analysis of Asian Securities Regulators & SROs and Market Characteristics

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## 1. What is an SRO? - SROs' major responsibilities

---

Regulatory responsibilities by SROs

| Level of regulation       | Responsibilities  | Regulatory activities   |
|---------------------------|---|---|
| Overall market regulation | Overall supervision of markets and intermediaries' market conduct and trading practices       | <ul style="list-style-type: none"> <li>• Rule making</li> <li>• Supervision</li> <li>• Enforcement</li> </ul>                                     |
| Market conduct standards  | Principles of fair dealing, regulation of insider trading, deceptive and manipulative trading | <ul style="list-style-type: none"> <li>• Rule making</li> <li>• Supervision</li> <li>• Enforcement</li> </ul>                                     |
| Exchange trading rules    | Market integrity rules and trading practice rules for each marketplace                        | <ul style="list-style-type: none"> <li>• Rule making</li> <li>• Supervision</li> <li>• Enforcement</li> </ul>                                     |
| Market surveillance       | Monitoring of trading in each marketplace for compliance with rules                           | <ul style="list-style-type: none"> <li>• Supervision (market surveillance, trading analysis)</li> <li>• Investigations and enforcement</li> </ul> |

Source: The World Bank, *Self-Regulation in Securities Markets*, January 2011

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## 2. MSE as an exchange SRO - Responsibilities

---

### Responsibilities as an SRO

- ✓ We believe that there will be **no major changes** in MSE's operations. MSE's major operations are **1) listing management, and 2) monitoring trades**.
- ✓ A major change is that MSE is now **a responsible entity** to make the rules, supervise, and enforce them. MSE is responsible for listing and trading matters in the stock market, instead of FRC.
- ✓ FRC supervises MSE. Approval of the rules made by MSE is FRC's responsibility.

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## 2. MSE as an exchange SRO - Listing management

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### Listing management

- ✓ We believe that improving listing management is **top priority** for MSE. MSE's SRO activities should be focused on listing management, in our view.
- ✓ Tighter control of listing management helps **separating quality companies with good disclosure** from those with weak fundamentals or those not meeting the current listing requirements.



Two big issues for the current listed companies:

- 1) Disclosure by most of the current listed companies are far from the international standards; and
- 2) MSE's average public float is below 10%, resulted in very low liquidity.

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## 2. MSE as an exchange SRO - Key tasks for listing management

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### Major tasks for listing management

- 1) Approve **only good companies** for listing.
  - ✓ Set appropriate **listing requirements** – only limited number of companies are eligible to list their shares.
- 2) Monitor listed companies' **eligibility**.
  - ✓ Enforce continuing listing obligations – **disclosure** and **public float** are two of the major obligations.
  - ✓ Set **delisting rules** – ineligible companies need to leave the market.

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## 2. MSE as an exchange SRO - Listing requirements

Listing requirements consist of 1) **quantitative requirements**, and 2) **qualitative requirements**. Typical quantitative and qualitative requirements are as follows:

|                           |  |
|---------------------------|--|
| Quantitative requirements | Profitable for the last <b>two</b> consecutive years |
|                           | Minimum share capital / market cap                   |
|                           | Minimum number of shareholders                       |
|                           | Minimum public float                                 |
| Qualitative requirements  | Business continuity with profitability               |
|                           | Quality management                                   |
|                           | Good corporate governance and internal control       |
|                           | Disclosure   |

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## 2. MSE as an exchange SRO - Disclosure

### Types of disclosure

- 1) Legal disclosure
  - ✓ Annual financial reports (**not only numbers**)
  - ✓ Semi-annual/quarterly financial reports (**not only numbers**)
- 2) Timely disclosure
  - ✓ **Earnings releases**
  - ✓ Material facts (earnings forecast change, dividend increase/decrease, M&A, financing, stock split, new product/service launch, change of CEO etc.)
- 3) Voluntary disclosure
  - ✓ Production volume, product/material prices, sales breakdown by product etc.

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## 2. MSE as an exchange SRO - Public float

---

### MSE's public float

- ✓ MSE's public float is **below 10%**, in our understanding
- ✓ Too low public float adversely impacts minority investors' interest
- ✓ Listed companies with too low public float should understand meaning of listing
- ✓ For instance, a listed company with 95% of shares outstanding held by certain investors, such as founders' family, cannot be called a "public company"
- ✓ Foreign investors do not invest in those with low public float, as they are afraid of **difficulty in selling their shares**
- ✓ We believe that **companies with too low public float should be delisted**

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## 3. MASD as an association SRO - Responsibilities

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### Responsibilities as an SRO

- ✓ Only half of securities associations in Asia are SROs, the rest of them are industry association without self-regulatory functions.
- ✓ Association SROs are typically responsible for **1) regulating securities sales representatives, and 2) monitoring securities companies.**
- ✓ Some association SROs are also **responsible for qualifying securities professionals.**

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### 3. MASD as an association SRO - Securities professional license

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#### Securities professional license

- ✓ MASD provides a two-week training course for sales representatives, which is mandatory for those who want to be licensed as securities professionals.
- ✓ Although a series of lectures for the training course is quite comprehensive, we think that some of the current subjects are **less relevant to securities business in Mongolia**.
- ✓ In addition, there is **no official textbook** for the securities professional license exam.
- ✓ We believe that publishing an official textbook is **top priority** for MASD's SRO activities.

**Policy Committee**  
**Project for Capacity Building of Capital Market in Mongolia**

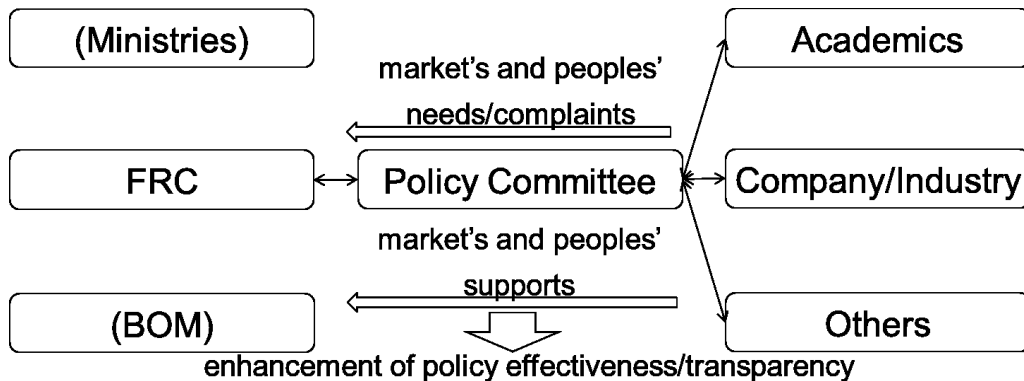
**Contents**

1. A Concept of Policy Committee (Council)
  2. Japan's Financial System Council
  3. Current FRC Policy Committee\*
- \*According to acquired information by JICA Consultant Team

**1. A Concept of Policy Committee (Council)**

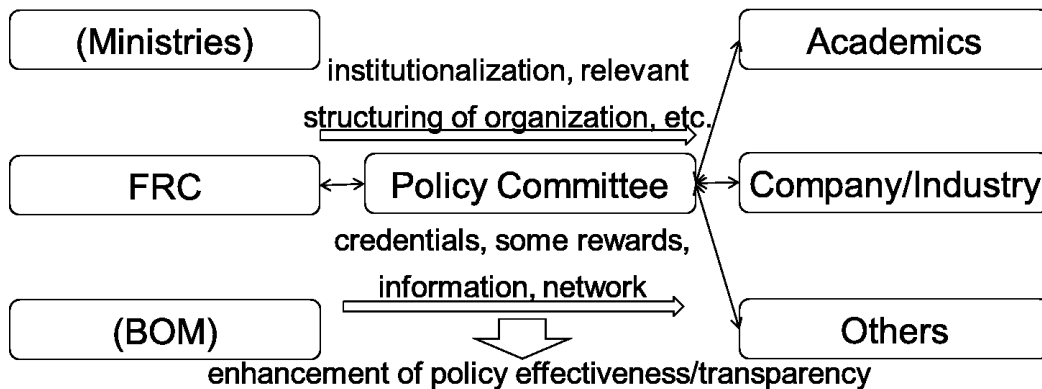
Definition and Merits for FRC

- Definition: An advisory, deliberative, or administrative body of people formally constituted and meeting regularly
- For FRC, a tool to draw up needs, complaints and supports on certain issues, thus enhance policy effectiveness and transparency



Precondition and Merits for Company/Industry, Academics

- Precondition: FRC should ensure of institutionalization, relevant structuring of organization, member, etc.
- Company and Industry, Academics can gain credentials, some rewards, alongside with information and network.





## 2. Japan's Financial System Council

### Institutionalization

- Based on Financial Services Agency (FSA) Establishment Act, 1998, with organization, member, etc. stipulated
- To have deliberation and deliver an opinion on important issues
  - ✓ related to financial system improvement, etc.
  - ✓ based on a request from the Prime Minister, the Commissioner of FSA, the Minister of Finance

### Organization

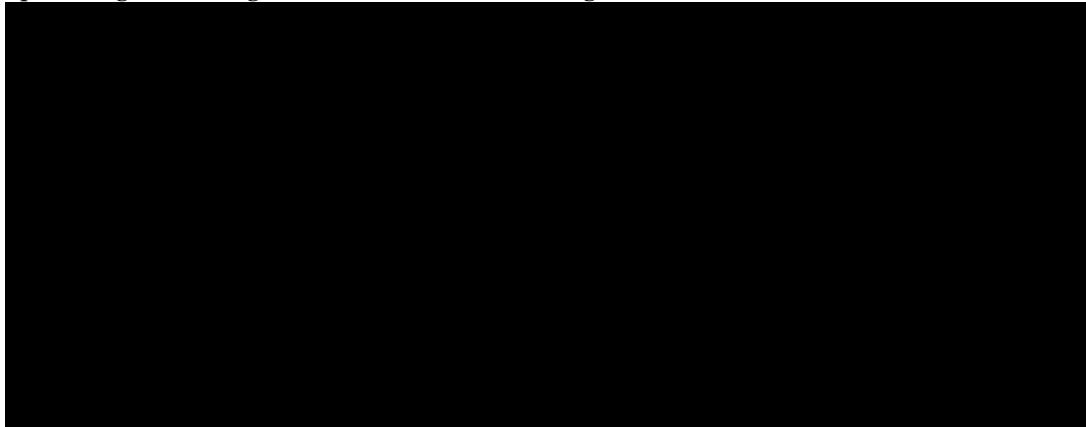
- Financial System Council is one of FSA's many advisory bodies.

|  |
|--|
| <p><b>Panel of Experts on Fin-Tech Start-ups</b></p> <p><b>Advisory Council on the Systems of Accounting and Auditing</b></p> <p><b>Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code</b></p> <p><b>Council of Experts Concerning the Corporate Governance Code</b></p> <p><b><u>Financial System Council</u></b></p> <p><b>Business Accounting Council</b></p> <p><b>Study Group on Regulation of Financial Benchmarks</b></p> <p><b>Panel for Vitalizing Financial and Capital Markets</b></p> <p><b>Council of Experts Concerning the Japanese Version of the Stewardship Code</b></p> <p><b>Public-Private Financial Roundtable</b></p> <p><b>Study Group on Financial Education Report</b></p> <p><b>Compulsory Automobile Liability Insurance Council</b></p> <p><b>Financial service dispute resolution liaison group</b></p> <p><b>Study Group on taxes related to financial markets and financial transactions</b></p> <p><b>Roundtable Committee on the Vision of the Japanese Financial System and Policies in the Future</b></p> |
|--|

<http://www.fsa.go.jp/en/measures/index.html#02> (regularly updated)

### Agenda

- Financial System Council has Working Groups for market /company needs, operating according to the definite scheduling.



[http://www.fsa.go.jp/en/refer/councils/singie\\_kinyu/reports.html](http://www.fsa.go.jp/en/refer/councils/singie_kinyu/reports.html) (regularly updated)

Member

- Totaling less than 30 with ad hoc members when needed
  - ✓ Appointed by the Prime Minister with approval from the Diet
  - ✓ Basically, Not from government ministries or political party
  - ✓ Primarily from Private company, Academics, etc.
  - ✓ Banks, securities company and their affiliates included
  - ✓ Foreign company invited (foreign nationals Not excluded)
  - ✓ Credentials bestowed with some rewards
  - ✓ Significant for information retrieval and network

<Financial System Council Member as of Oct. 2016>

- Totaling 19 members
- 11 from Academics including the chairman
- 5 from Private companies including bank and securities group  
(Boston Consulting, Nomura Research Institute, Japan Research Institute, Mitsubishi Corp., Recruit Holdings)
- 1 lawyer, 1 from labor union, 1 from consumer organization

<Working Group Member: examples>

| Name of the Working Group (WG)   | Term / # of meetings     | # of members / Head of the Group   | examples of outside lecturers  |
|--|--------------------------|--|--|
| <b>WG: Investment Management</b>   | Oct 2014 - / 6           | 17 / Mr. Kanda, prof., Univ. of Tokyo, Graduate school of law and politics | Nomura Institute of Capital Markets Research, SESC, National Consumer Affairs Center, Nippon Technology Venture Partners, The Japan Academic Society for Ventures and Entrepreneurs, Japan Federation of Bar Associations, Japan Venture Capital Assoc., etc.  |
| <b>WG: Sophistication of Payment and Settlement Operations</b>           | Oct 2014- / 10           | 23 / Mr. Iwahara, prof., Waseda Univ. Law School                           | NTT Data Group, Japan Bankers Assoc., The Japan Research Institute, Fujitsu, Bank of Japan (BoJ), Deloitte Tomatsu Consulting, JCCI, National Consumer Affairs Center, The Center for Financial Industry Information Systems, etc.   |
| <b>WG: Mid- and Long-Term Roadmap of the Financial Industry in Japan</b> | Jun 2011 - May 2012 / 14 | 21 / Mr. Yoshino, prof., Keio Univ. Economics Dept.                        | Bank of Tokyo-Mitsubishi UFJ, Tokio Marine Holdings, Daiwa Securities, Japan Center for Int'l Finance, Sumitomo Chemical, Mitsubishi Corp., HSBC, JPMorgan, Goldman Sachs, Citigroup, BoJ, Dogan Advisors, The Kagoshima Bank, Sumitomo Mitsui Asset Management, Japan Assoc. for Financial Planners, MorningStar, Carlyle Japan, A.T.Kearney, Nomura Research Institute, etc. |

[http://www.fsa.go.jp/en/refer/councils/singie\\_kinyu/20150713/01.pdf](http://www.fsa.go.jp/en/refer/councils/singie_kinyu/20150713/01.pdf)  
(WG: Investment Management, regularly updated)

#### Number of Meetings

- Financial System Council: A few times a year
- Working Groups: Frequently
  - ✓ Investment Management WG: 5 times in 3 months
  - ✓ Provision of Risk Money to Emerging and Growing Companies WG: 11 times in 6 months

#### Management

- Financial System Council & Working Groups:
  - ✓ FSA secretariats implement research on issues and prepare materials beforehand for members' use.
  - ✓ After the meeting, minutes & materials of every meeting are web-disclosed.
  - ✓ FSA reflects meeting results to policy amendment and new legislation, while continuously following up pending issues.

1

July 19th, 2016

Financial Services Agency

### **Publication of the Report by the “Working Group on Corporate Disclosure” of the Financial System Council**

The “Working Group on Corporate Disclosure” of the Financial System Council (chairman Hideki KANDA, Professor, Law School, Gakushuin University) has discussed and deliberated on corporate disclosure five times since November 2015.

Based on the results of the discussions, the Working Group has compiled and published the “Report - Promoting Constructive Dialogue”.

The “Report” (as attached hereto) is a provisional translation of the original Japanese report.

[Report - Promoting Constructive Dialogue \(PDF: 220KB\)](#)

[Summary of the Report - Promoting Constructive Dialogue \(PDF: 61KB\)](#)

Contact

Financial Services Agency

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[http://www.fsa.go.jp/en/refer/councils/singie\\_kinyu/20160719-1.html](http://www.fsa.go.jp/en/refer/councils/singie_kinyu/20160719-1.html) (regularly updated)

### 3. Current FRC Policy Committee

#### Institutionalization

- By the Order of the FRC Chairman, September 2014
- To have deliberation and to issue recommendation on important issues on the relevant policy and regulations
- FRC Law does not clarify roles/functions of Policy Committee
  - ✓ which could strengthen its position and influence in the policy process, and
  - ✓ which could ensure of credentials and some rewards for participating Company/Industry and Academics.

#### Organization, including Number of Meetings

- In September 2014 FRC decided to establish Policy Committee.
- In March 2015 FRC amended its decision into establishment of 6 Policy Councils.
- Since then, Orders of the FRC Chairman were issued for establishment of each Policy Council.
- 4 Policy Councils have been working until March 2016, followed by a current standstill, reflecting change in the political situation.

| (Council name)                   | (hosted month/year) |
|----------------------------------|---------------------|
| ✓ Capital Market                 | (6,9/2015, 3/2016)  |
| ✓ Mining Investment and Minerals | (4,6,8,10/2015)     |
| ✓ Commodity Exchange             | (4,5,9/2015)        |
| ✓ Insurance                      | (no meeting)        |
| ✓ Microfinance                   | (6,7,7/2015)        |
| ✓ Risk Management                | (no meeting)        |

#### Agenda

- Capital Market Council, at first, planned to discuss 6 areas:
  - 1) new financial products
  - 2) raising of institutional investors
  - 3) securities infrastructure
  - 4) legislation
  - 5) taxation
  - 6) investor education
- Actually, meetings were held ad-hoc, depending on the current and urgent issues which FRC thought should be addressed:
  - 1) split of function of CSD (Clearing, Settlement, Deposit)
  - 2) tax policy to promote the capital market
  - 3) privatization of SOEs listed in MSE
  - 4) private pension funds, etc.

#### Management

- Capital Market Council
  - ✓ Documents for discussion were sent to members by FRC.
  - ✓ After the meeting, summary of the meetings was disclosed on the FRC website in Mongolian but not in English.
  - ✓ Although FRC submitted recommendations of the Committee to the

Parliament and Ministries, it is not certain if they were considered seriously by them, possibly because:

- 1) Policy Committee was not regarded as officially institutionalized advisory body yet, and also,
- 2) More importantly, thorough discussions with a wide range of viewpoints were not made within a very short time-frame of the past meetings.

#### Member

- Capital Market Council (totaling 13)
  - ✓ Assigned by FRC Chairman  
Appointment by Prime Minister/Diet should be considered.
  - ✓ 3 from Government-related organizations (FRC/MOF/BOM)  
Government-related sector can be reduced.
  - ✓ 7 from Company/Industry and 1 from DBM
    - 1) Financial Market Association and Golomt Bank
    - 2) MASD, Ard Capital Group Securities Company
    - 3) Mongolian Bankers Association, Deposit Insurance
    - 4) BDSec
    - 5) Energy Resource <Lawyer>
    - 6) TDB
    - 7) MNCCIPrimarily from Company, Academics, etc.  
Affiliates of banks/securities company should be increased.  
(ex: TDB Capital, Golomt Securities, Tulgat Chandmani B)  
Foreign company and foreign expats should be utilized.
  - ✓ 3 from Academics
  - ✓ 1 from others
  - ✓ Merits: Credentials? Some rewards? Information?

# Project for Capacity Building of Capital Market in Mongolia: Consulting Approach for IPO & Dual Listing

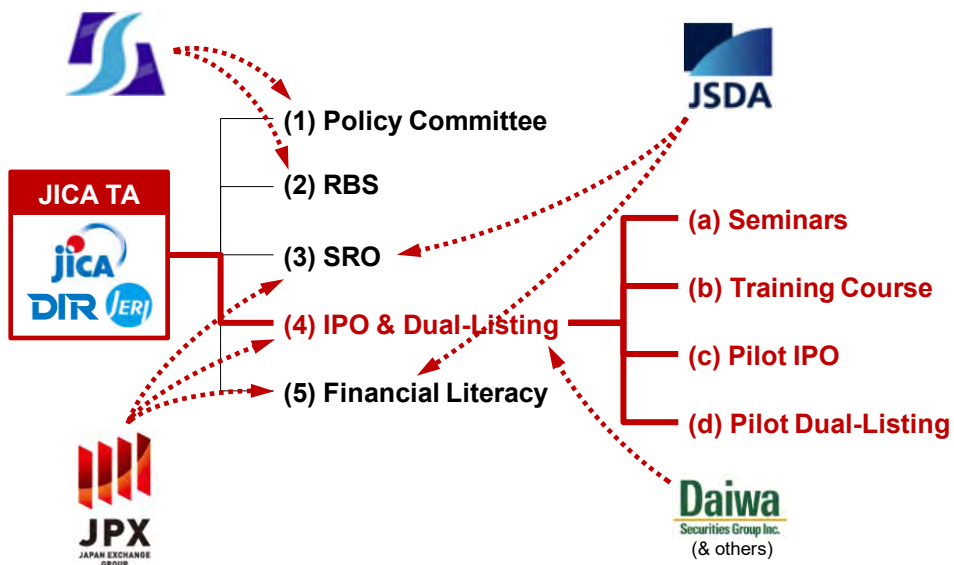
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March 31, 2015

Daiwa Institute of Research  
Japan Economic Research Institute

## Consulting Framework

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#### (4)-(a) Seminars (on IPO & Dual-Listing)

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- **Target beneficiaries:** FRC, MSE, underwriting companies, potential issuers of equity securities (SOCs, private sector companies)
- **Schedule (tentative):** Apr-Jun 2015, Jan-Mar 2016, Oct-Dec 2016 (all in UB)
- **Inputs expected from:** JPX, securities company/ies in Japan
- **Issues to be covered (tentative):**
  - Benefit of IPO / dual-listing
  - Preparation process for IPO / dual-listing
  - Pre-IPO restructuring
  - Introduction of other exchanges
  - Listing rules & other regulations
  - Investor relations (IR) activities
  - Secondary market regulations, etc.

3

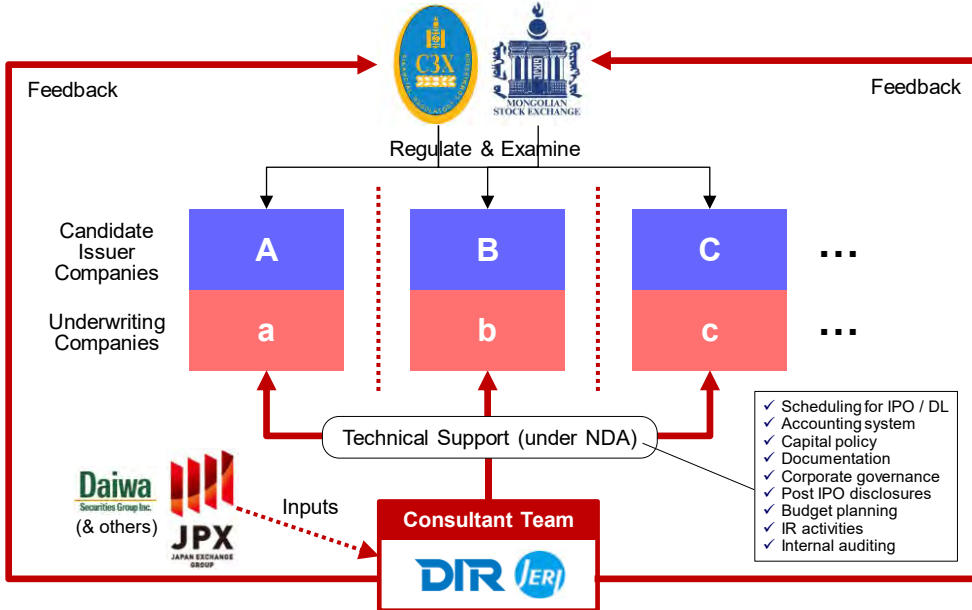
#### (4)-(b) Training Course (on IPO & Dual-Listing)

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- **Target beneficiaries:** FRC, MSE
- **Schedule (tentative):** Apr-Jun 2016 (Tokyo), Oct-Dec 2016 (UB), Jan-Mar 2017 (Tokyo)
- **Inputs expected from:** JPX, securities company/ies in Japan
- **Issues to be covered (tentative):**
  - Benefit of IPO / dual-listing (incl. other countries' practices)
  - Listing rules & regulations
  - Listing examination
  - Roles of regulatory authorities & stock exchange
  - Roles of security companies, etc.

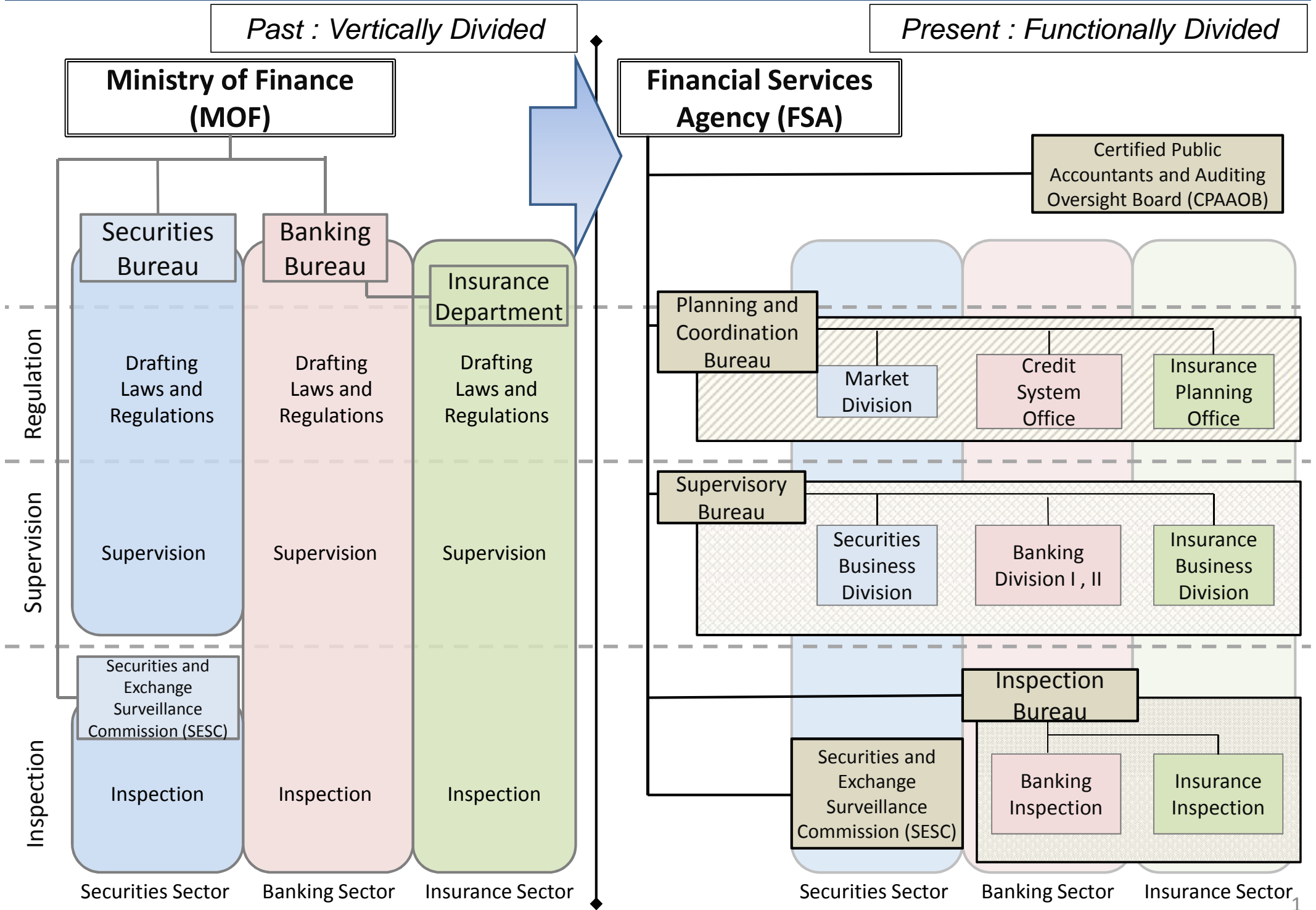
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(4)-(c),(d) Pilot IPO & Dual-Listing

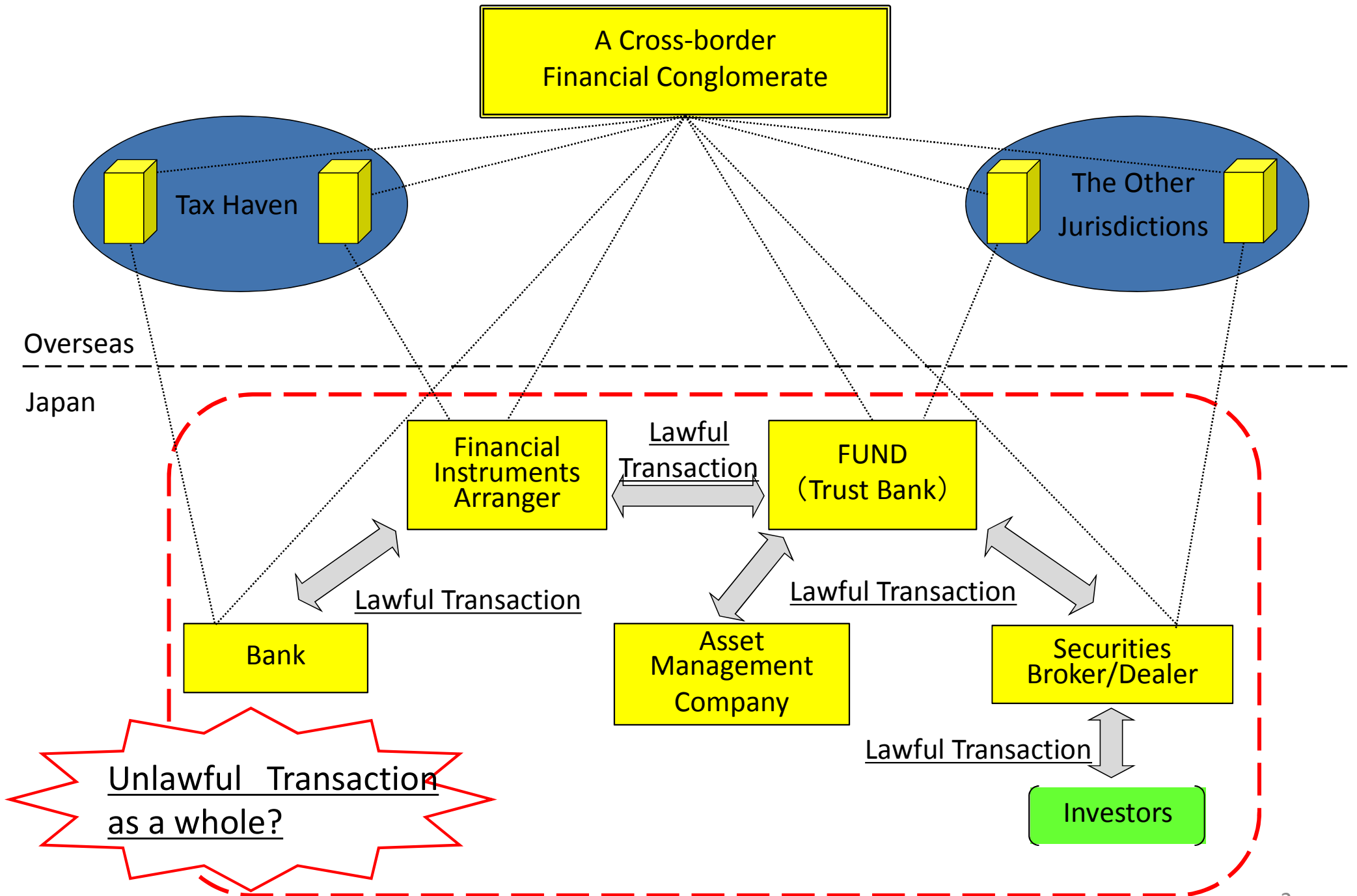




# Organization Structure for Regulating & Monitoring Financial Sector

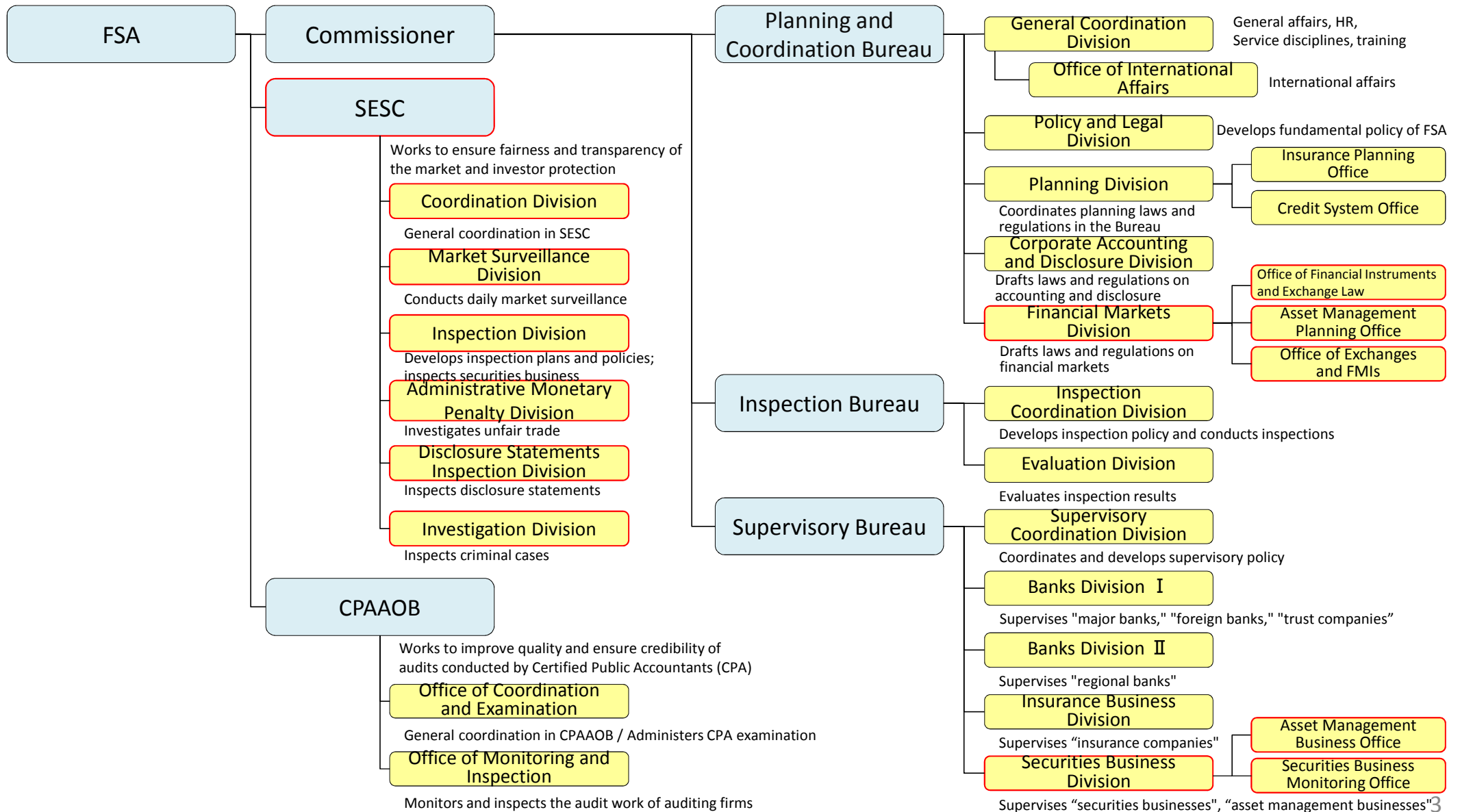


# Problem in the Vertically Divided Administrative Structure



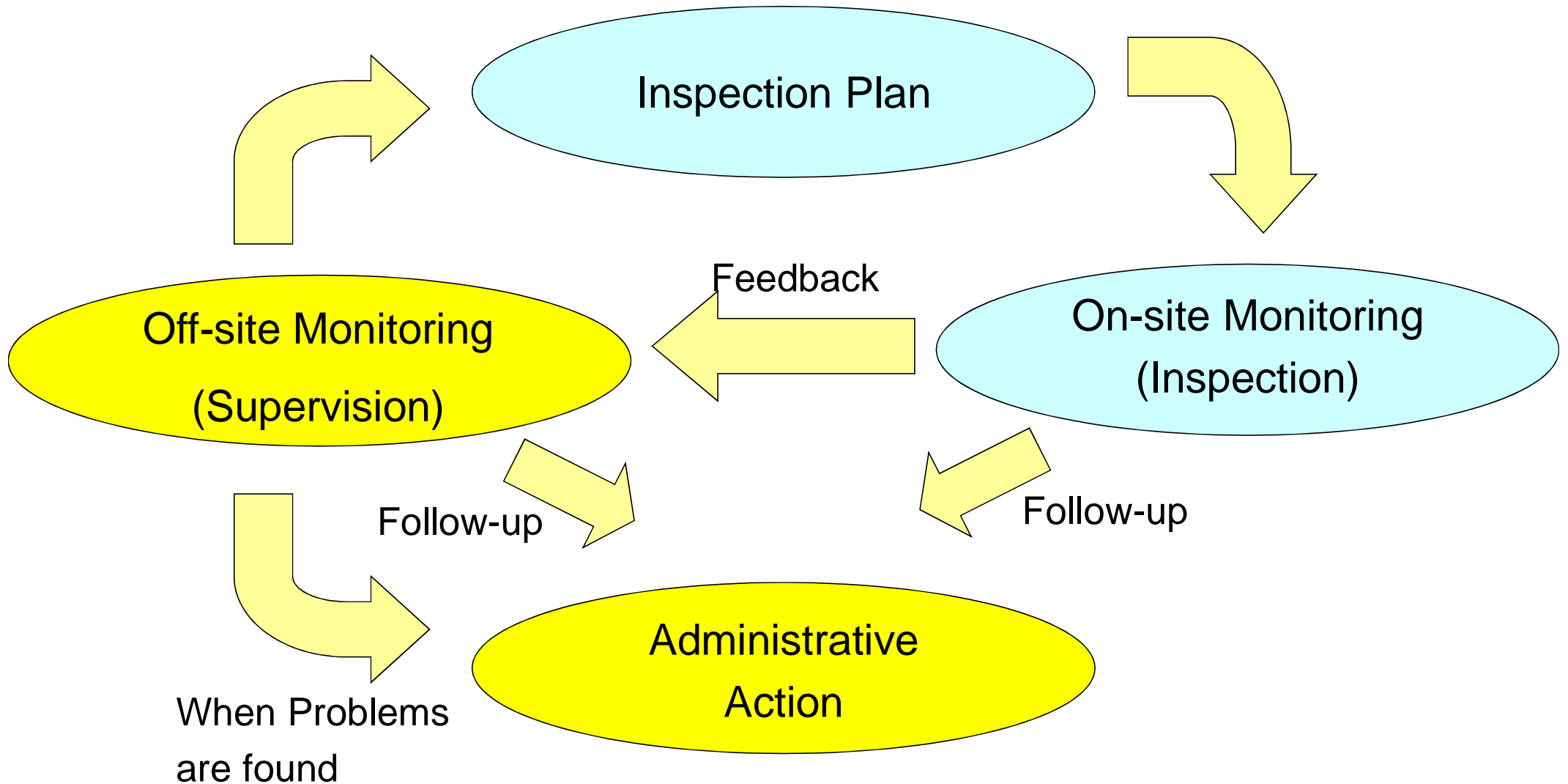
# Detailed Organization Structure

- The FSA is responsible for supervision and inspection for Banking, Securities and Insurance sectors as well as planning relevant laws and regulations and participating in international discussions.
- The number of staff in the FSA have increased to **1,600** while it was about **400** when the FSA was established.

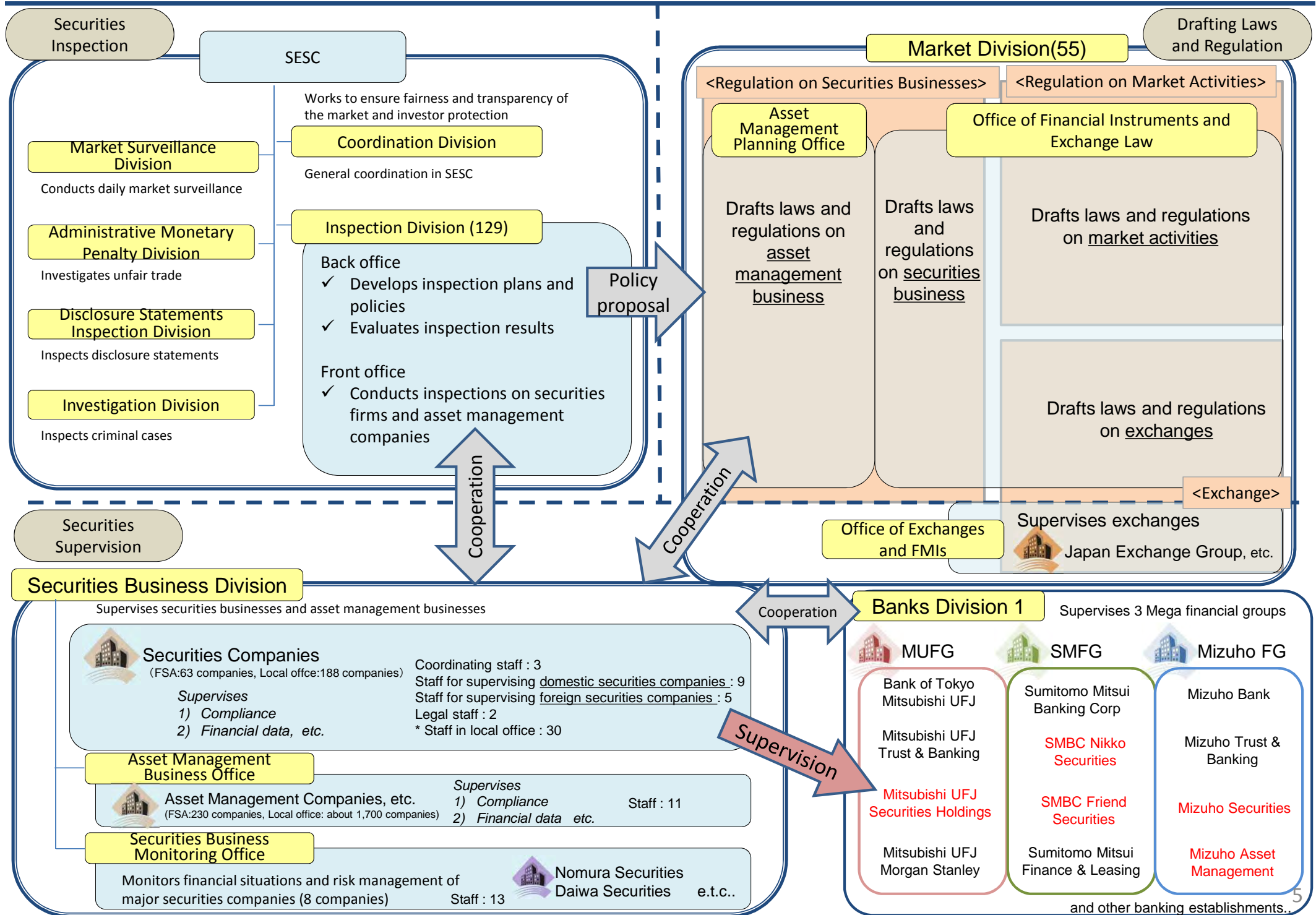


# General Framework of Supervisory Activities

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# Framework of Regulating & Monitoring Securities Sector



# Human Resources in the FSA

- The FSA is composed of a large variety of staff, including the people directly employed by the FSA (*since 1999*), assigned employees from the Ministry of Finance (MOF) and local government offices, and professionals from the private sector.

| Total Staff at the FSA : about 1,600 people                   |           |
|---|-----------|
| Employed by FSA (main career track)                           | about 130 |
| Employed by FSA (general track)                               | about 270 |
| Employees from MOF (main career track)                        | about 70  |
| Employees from MOF (general track)                            | about 40  |
| Employees from local government offices (main career track)   | about 40  |
| Employees from local government offices (general track)       | about 600 |
| Professionals from the private sector (fixed-term employment) | about 200 |
| Mid-career employees  | about 200 |
| Other (temp staff, staff members on tentative leave , etc..)  | about 50  |

## Professionals from the private sector (fixed-term employment)

|   |           |
|---|-----------|
| Attorney  | about 30  |
| Certified Public Accountant (CPA)   | about 60  |
| Actuary   | 7         |
| Real-estate appraiser   | 3         |
| Professional with practical business experience (e.g. financial institutions, IT companies) | about 100 |

(Ref.) The FSA employees who are on study programs or dispatched to other organizations

| Study abroad | Study in Japan | International organization | Japanese embassy | Other Ministries | Local office |
|--------------|----------------|----------------------------|------------------|------------------|--------------|
| about 20     | about 10       | about 10                   | about 10         | about 20         | about 40     |

# [Reference ] Recruitment/Appointment of National Government Employees

- Basic principles of a fair and equitable government employee system are stipulated under the National Public Service Act.
  - Officials are recruited based on open and equal competitive examinations conducted by the National Personnel Authority (NPA), in principle.
 

(23 types of examinations including the examination for comprehensive service, examination for general service, the examination for financial specialists and examination for national taxation specialists)
  - Officials are appointed based on their examination results, work performance and any other demonstrated abilities, in principle (merit system).
  - Officials are promoted when they are selected by an appointer based on their work performance.

[Reference] Implementation status of national government employee recruitment examinations in FY2014

|                                    | Graduate students/university graduate level |                 | High school graduate level |
|------------------------------------|---|-----------------|----------------------------|
|                                    | (Main career track)                         | (General track) | (General track)            |
| Number of applicants               | 23,047                                      | 68,712          | 136,584                    |
| Number of first-stage exam passers | 3,976                                       | 17,355          | 32,179                     |
| Number of final passers            | 2,080                                       | 10,454          | 18,626                     |

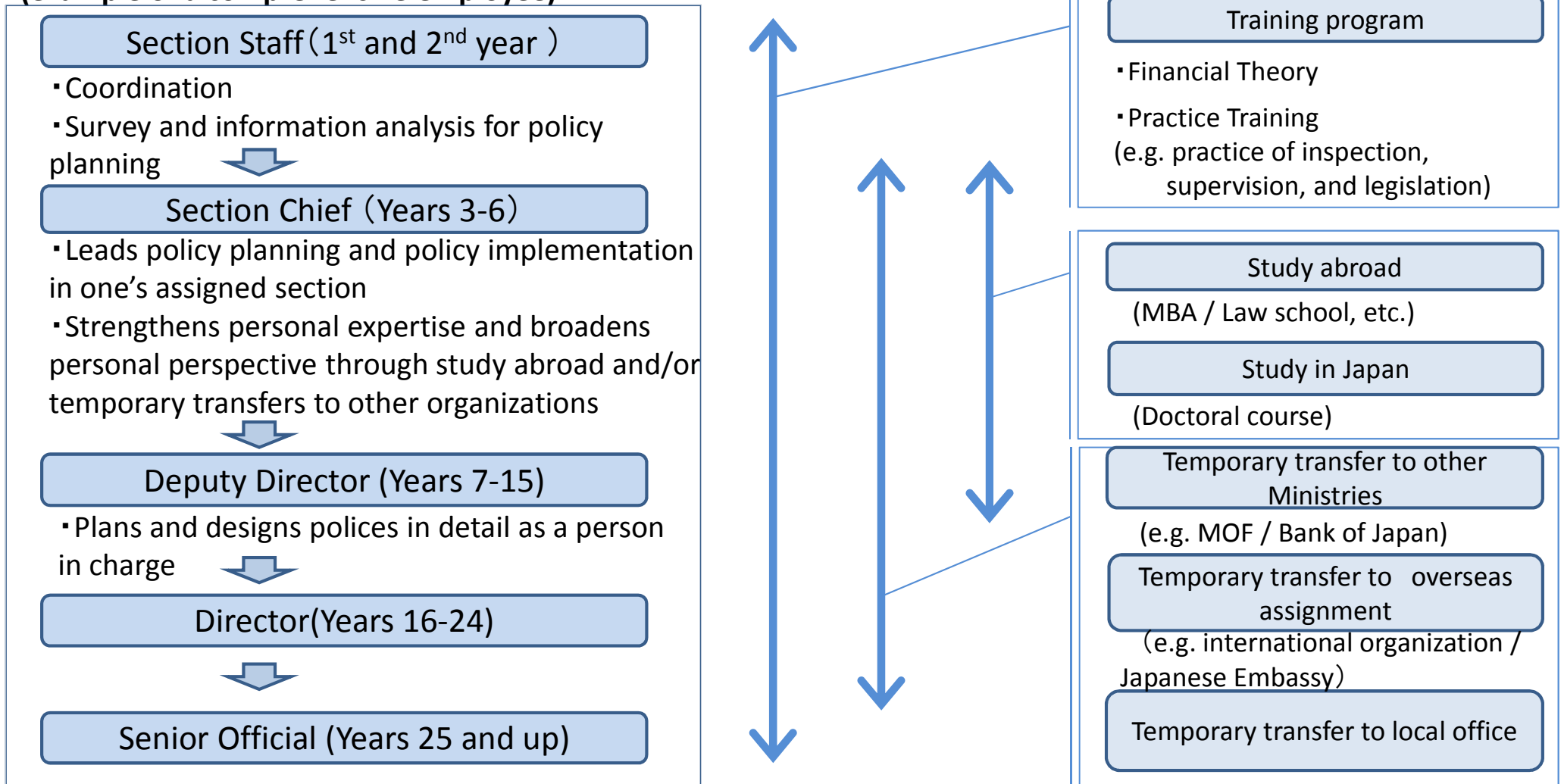
(Extract from NPA data)

# Career Path at the FSA

- FSA employees are due to gather a broad range of experience through study abroad and/or temporary transfers to other Ministries, local organizations and international organizations in their junior careers.
- FSA employees are due to be involved in all of the banking sector, the securities sector, the insurance sector, and general coordination work at the FSA. They can strengthen their expertise in certain areas based on their aptitude.

## Career track of FSA employees

### (example of a comprehensive employee)





**The AFPAC was established at the Financial Services Agency in April 2014. Since last summer, it has started to invite officials from Asian financial authorities as Visiting Fellows. It offers training programs tailored to the areas of interest for each Visiting Fellow.**

### **[Main Objectives of AFPAC]**

- To study issues related to financial and capital markets in Asia and to utilize the findings for financial sector development in Asian countries**
- To contribute to the development of business operations by Japanese firms in Asia and by Asian firms in Japan through enhancing cooperative relationships with Asian financial authorities**
- To effectively express a stronger Asian voice in the discussions for global financial regulatory reform**

## The AFPAC Visiting Fellow Program I

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- **Through the Visiting Fellow Program, Visiting Fellows will acquire knowledge, enhance their understanding of, and develop expertise in financial regulation and supervision, with a view to contributing to the development of the financial sectors of their home countries.**
- **The findings of Visiting Fellows are to be disseminated at seminars/symposiums.**
- **Through the program, AFPAC aims to build stronger cooperative relationships with other Asian financial authorities.**



*At the Opening Ceremony of AFPAC*

## The AFPAC Visiting Fellow Program II

- On 29 July 2014, AFPAC welcomed its first three Visiting Fellows – two officials from the Financial Regulatory Commission of Mongolia and one official from the State Bank of Vietnam.
- During their first month, they attended various lectures led by JFSA staff to study the basics of the Japanese financial system, financial regulation and supervisory practices at the JFSA. They also visited other organizations and institutions, including the Bank of Japan, the Tokyo Stock Exchange, self regulatory organizations, private financial institutions, and research institutes, to attend lectures and exchange views with them on various topics.
- Following those visits, each Visiting Fellow undertook a training program focused on their respective areas of interest at the JFSA and other relevant organizations and could deepen their understanding of specific topics.



*After a lecture on “Lessons from the Banking Crisis in Japan” by Mr. Ryoza Himino, Deputy Director-General of the Supervisory Bureau*



*AFPAC Visiting Fellows at the Tokyo Stock Exchange*



# “Supervision of Securities Firms in Japan”

**Kumi INOUE**

**Deputy Director, Securities Business Division**

**27 April 2015**

*\*Any views expressed in this presentation are those of the author, and are not the official views of the JFSA.*

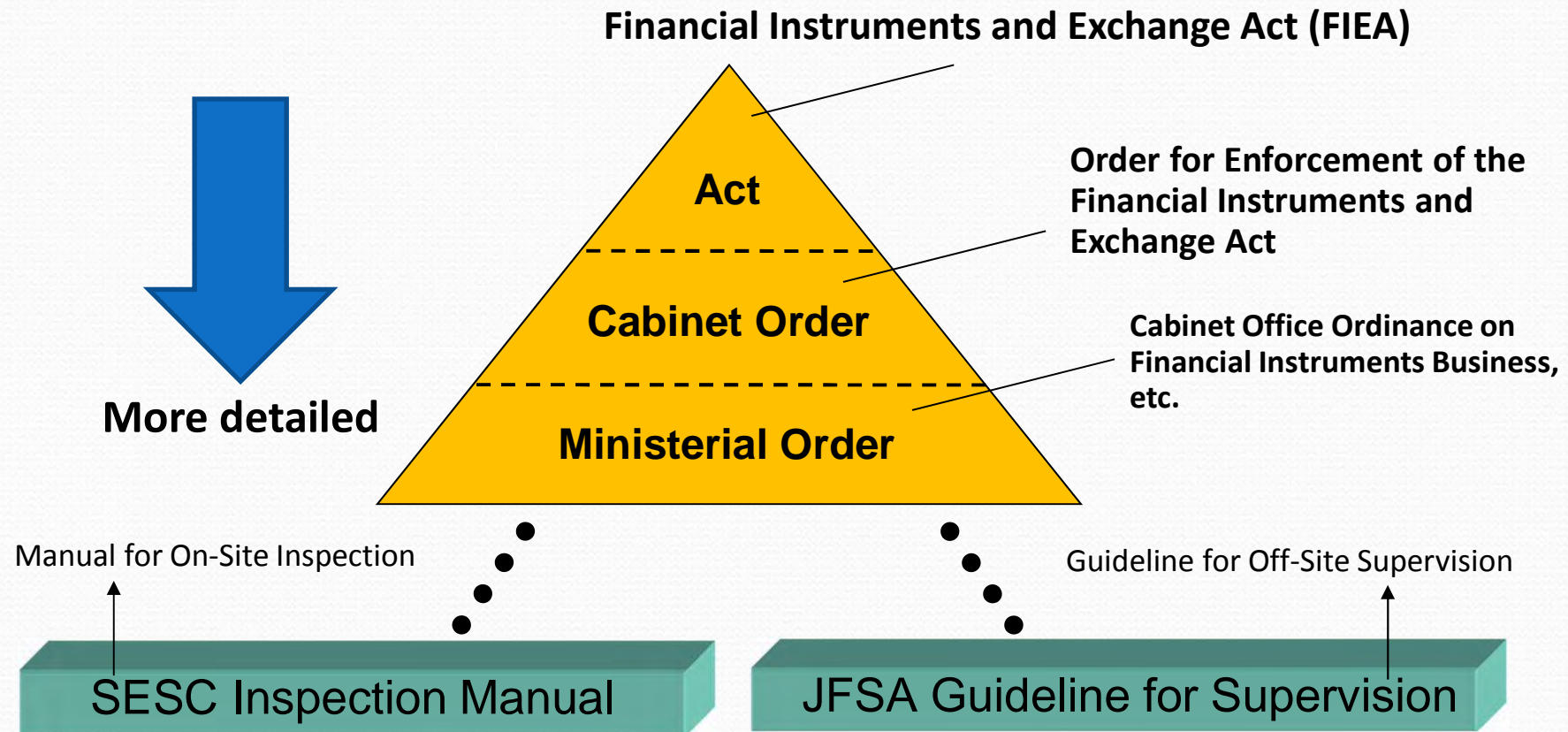


# Contents

- 1. Framework for Supervision of Securities Firms**
- 2. Legal and Supervisory Framework**
- 3. Case Example of Administrative Actions**
- 4. Off-site Monitoring**
- 5. Capital Adequacy Ratio**
- 6. Investor Protection**

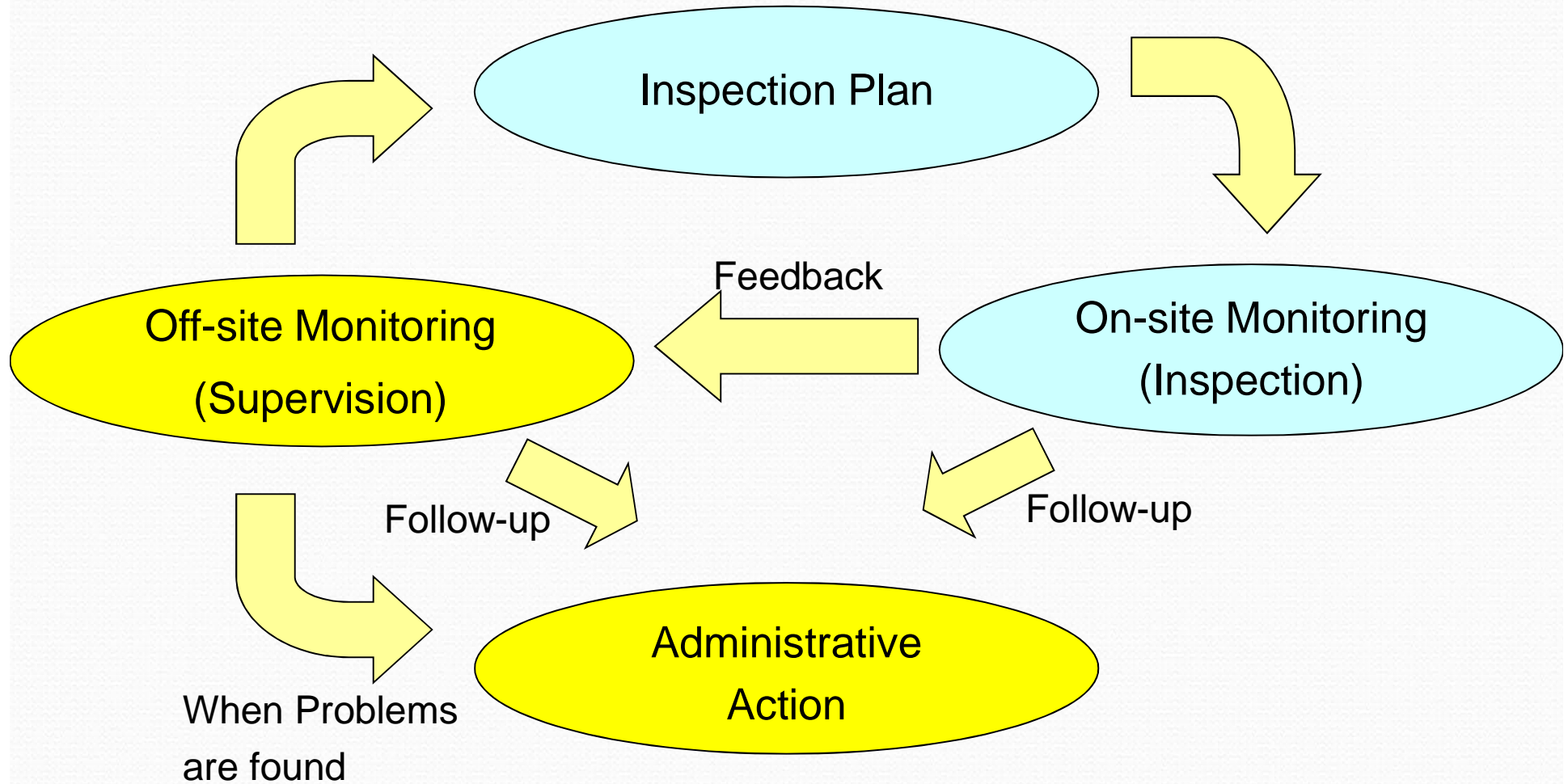
# 1. Framework for Supervision of Securities Firms

# Framework for Regulations of Securities Firms



- All of the above information is made public for transparency and also available on the JFSA's website ([http://www.fsa.go.jp/en/laws\\_regulations/index.html#02](http://www.fsa.go.jp/en/laws_regulations/index.html#02)).

# General Framework of Supervisory Activities





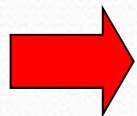
# Functions of On-site and Off-site Monitoring

## On-site Monitoring

- The Inspection Bureau conducts on-site monitoring periodically (as necessary).
  - Verify information obtained through Off-site Monitoring
  - Obtain and evaluate information that is not available through Off-site Monitoring

## Off-site Monitoring

- The Supervisory Bureau conducts off-site monitoring continuously.
  - Collect and analyze information on an ongoing basis even during intervals between one on-site inspection and another
  - Find problems in soundness and appropriateness of operations at an early stage
  - Impose administrative actions as necessary



**Close coordination and communication between the Inspection Bureau and the Supervisory Bureau makes monitoring activities more effective.**

- Risk-focused / forward-looking approach
- Transparency and predictability

# Recent Efforts in On-site and Off-site Monitoring

## Integration of on-site and off-site monitoring

- In September 2014, FSA published the financial monitoring policy for 2014-2015.
- Under the common policy, both the Supervisory Department and the Inspection Department are working together in close cooperation and mitigate the burden on financial institutions.

# 2. Legal and Supervisory Framework

# Securities Firms under the FIEA

- Under the FIEA (Article 29), those who engage in securities activities in Japan are required to register as a Financial Instrument Business Operator (FIBO). There are four main types of FIBOs as follows.

|   |   |
|---|---|
| <p><b>Type I FIBOs</b></p> <p><i>- Most of them are usually called “Securities Firms” -</i></p> | <ul style="list-style-type: none"> <li>Permitted to engage in <b>sales and solicitation of a long list of “highly liquid” securities</b> such as shares, bonds and OTC derivatives trading, clearing, underwriting of securities, public offering of securities, secondary distribution of securities and dealing in public offering securities.</li> </ul> |
| <p><b>Type II FIBOs</b></p>   | <ul style="list-style-type: none"> <li>Only permitted to engage in <b>sales and solicitation in connection with “low liquid” securities.</b></li> </ul>   |
| <p><b>Investment Management Business</b></p>  | <ul style="list-style-type: none"> <li>Permitted to <b>manage Collective Investment Schemes (CIS) and individual portfolio management.</b></li> </ul>   |
| <p><b>Investment Advisory and Agency Business</b></p>   | <ul style="list-style-type: none"> <li>Basically permitted to <b>conduct advisory businesses only</b> and cannot accept deposits or securities from a customer.</li> </ul>  |

# Ref. Number of FIBOs as of the End of Feb 2015

|   |       |
|---|-------|
| Financial Instrument Business Operators (FIBOs) | 2,846 |
| Type I FIBOs                                    | 277   |
| Type II FIBOs                                   | 1,250 |
| Investment Management Business                  | 328   |
| Investment Advisory and Agency Business         | 991   |

- A list of all FIBOs is available on the JFSA's website (<http://www.fsa.go.jp/en/regulated/licensed/index.html>).

# Ref. Number of Staff in Charge of Each Securities Firms

- There are 250 securities firms as of Feb 2015 in Japan, and Financial Services Agency (JFSA) supervises them along with Local Finance Bureaus.

| Category  | Staff Assignment   |
|---|--|
| <b>1) Major</b><br>(Daiwa, Nomura)                              | <b>3</b> staff for <b>2</b> firms  |
| <b>2) Semi-major</b><br>(Mitsubishi, Mizuho, SMBC Nikko, etc.)  | <b>3</b> staff for <b>13</b> firms   |
| <b>3) Local and small</b><br>(Ichiyoshi, etc.)                  | <b>3</b> staff (+ <b>30</b> staff in Local Finance Bureaus) for <b>180</b> firms |
| <b>4) Foreign</b><br>(Goldman Sachs, JP Morgan, Deutsche, etc.) | <b>5</b> staff for <b>32</b> firms   |
| <b>5) Internet</b><br>(Monex, Rakuten, etc.)                    | <b>3</b> staff for <b>14</b> firms   |

- Also, the JFSA has a professional team dedicated to the risk management for 4 major securities firms (Nomura Holdings, Daiwa Group, Mitsubishi UFJ Morgan Stanley Securities (MUMSS), Mizuho Securities) and 4 major foreign securities firms (Goldman Sachs, Morgan Stanley, JP Morgan, Deutsche Securities). This team is called the Securities Monitoring Office and consists of 13 staff.

# Ref. UKFCA Firm Classification

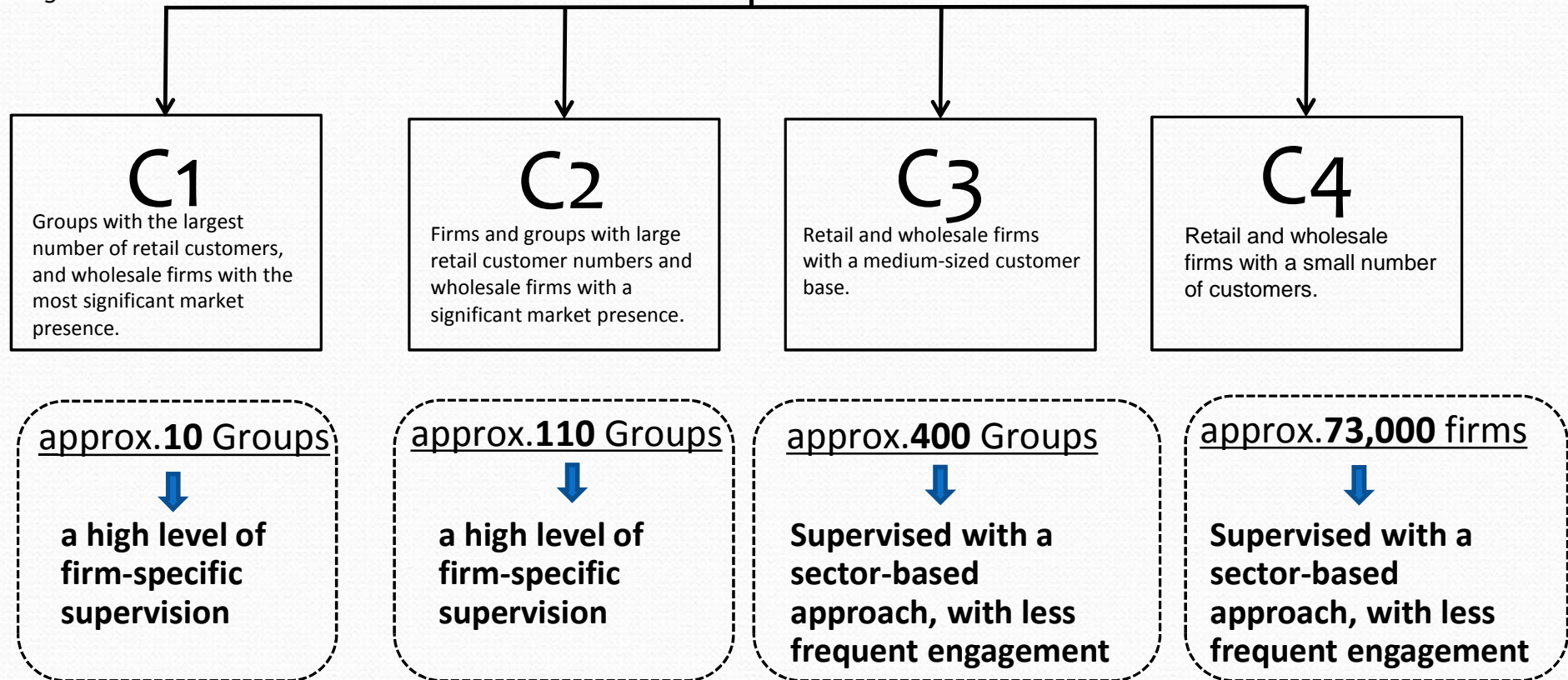
## Conduct categories

- Reflect a firm's size and retail customer numbers or wholesale presence, and the corresponding level of risk the firm potentially poses.
- Each category is subject to a different level of supervision, allowing UKFCA to use their resources as efficiently as possible and concentrate on the areas that pose the greatest risks.



## UKFCA's approach

- **Seven forward - looking areas of focus**
- **Five key priorities**



# Registration Requirements for Securities Firms

- Minimum entry requirements are established in the FIEA for each category of FIBO.
- Grounds for “refusal of registration” are also established. (FIEA Article 29-4)
- The system of registration replaced the licensing system in 1998. This change was one of the measures taken in the Financial System Reform in 1996.



# Minimum Entry Requirements for Securities Firms

- The minimum entry requirements in the FIEA for securities firms (Type I FIBOs) are mainly as follows.
  - ✓ Minimum capital requirements (Type I FIBOs are required to have no less than ¥ 50 million for capital and net assets (roughly US \$ 5 billion))
  - ✓ The applicant's directors and officers are checked to ensure they have no recent criminal record or links to organized crime
  - ✓ Submission of reports setting out business operations including risk management, internal control, details of shareholders and human resources structure
  - ✓ Adequate internal controls and risk management systems (Article 29-4 (1) of the FIEA, IV-3-1 of the Supervisory Guidelines)
  - ✓ Establishment of a compliance unit (Article 29-4 (1) of the FIEA, IV-3-1 of the Supervisory Guidelines)

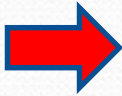
# Registration Process(1)

- Applications for registration for FIBOs are handled by the Local Finance Bureau.
- The applicant and its staff are required to show up and answer questions at the Local Finance Bureau as a part of the vetting process as needed.
- Processing the application may take several months.

## Registration Process(2)

- The application will be reviewed by focusing on whether it can contribute to the smooth circulation of securities, protecting the investors at the same time, which are the qualifications expected as market intermediaries.
- We will check whether the applicant is clearly understanding its business plan, whether the personnel, system, rules to conduct that business appropriately are prepared, whether the management has good governance such as sense of compliance and internal control, through sufficient discussion with the applicant.

## Registration Process(3)

- e.g. Review whether the applicant has adequate staffing to conduct financial instruments business appropriately.
  - ✓ Knowledge and experience of the top management
  - ✓ Knowledge and experience of the managing directors
  - ✓ Knowledge and experience regarding compliance, etc.
  - ✓ Conducting business
  - ✓ Function of the internal checking
-  ***Secure the companies' understanding of legal obligation and regulation through full communication prior to registration.***
- For your information, when a registered operator has not resumed its business within 3 months since the day of registration or has continued to suspend its business for 3 months or more without any justifiable grounds, the JFSA may rescind registration of that operator.

# Major Rules of Conduct for Securities Firms under the FIEA (1)

- **Suitability requirement**

- FIBOs must not engage in inappropriate solicitation that may result in insufficient investor protection in light of customer knowledge, experience and assets as well as the purpose of concluding a contract. (Article 40(i))
- FIBOs are required to ensure appropriate handling of customer information obtained in the course of the business. (Article 40(ii))

- **Prohibition of loss compensation (Article 39)**

- **Information to be given to clients**

- Before entering into a transaction, a FIBO is required to provide a document to customers that outlines the contract and discloses fees and consideration payable by the customer. (Article 37-3)
- After a transaction is effected, a FIBO is required to provide a confirmation which sets out the contract date and names of the parties and other relevant particulars. (Article 37-4)
- A FIBO must provide clients with a statement of “outstanding balance of transactions” at least once a year. (Article 37-4 and Cabinet Office Ordinance Article 98)

# Major Rules of Conduct for Securities Firms under the FIEA (2)

- **Duty of Best Execution (Article 40-2)**

- **Duty of Record Keeping (Article 46-2)**

- A FIBO is required to prepare and preserve the books and documents on its transactions with its clients in order to enable confirmation of inflows and outflows of accounts under article 164 and 157 of Cabinet Office Ordinance:

- a. Client account books which record inflows, outflows and net balances
- b. Safe custody securities statements which record reasons for withdrawals of deposited securities received.

- Such information must be preserved for a period of five to ten years.

- **Management of Conflicts of Interest**

- All FIBOs and their directors and employees are required to execute business in good faith and fairly to customers. (Article 36)

- Conflicts of interest must be prevented and appropriate management structures to identify and address them must be developed. (Article 36 and 44)

# Supervisory Evaluation Points

- **Governance**
- **Soundness of Financial Condition**
- **Appropriateness of Business Operations**
  - **Legal Compliance**
  - **Management of Sales Staff**
  - **Management of Customer Information**
  - **Risk Management (Liquidity, Market, Credit, Operational)**
  - **Computer System Management**
  - **Business Continuity Management**
  - **Internal Audit, etc.**

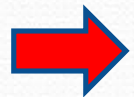
# Ref. Supervisory Viewpoints for Foreign Securities Firms(1)

- Entry of foreign securities firms has benefits such as vitalizing the domestic market and enhancing the convenience of the customers by the advanced financial products and services offered by the foreign financial groups and by the global network. On the other hand, there are special viewpoints, such as the conformity to the domestic regulation and the business customs, and the JFSA needs to cooperate with the foreign management and the foreign authorities.
- The JFSA is striving to identify the supervisory issues and to share the understanding of those issues by communicating with the headquarter in Japan and the headquarter of the group, etc. among (1) business management, (2) appropriateness of business conduct, (3) appropriateness and sufficiency of capital (4) risk management, etc. also taking the characteristics of the headquarter in Japan into consideration.
- Also, the JFSA is striving to enhance the effectiveness of supervision on the identified issues concerning the head quarter in Japan and the head quarter of the group by close cooperation and information sharing with the home supervisory authority.



# Ref. Supervisory Viewpoints for Foreign Securities Firms(2)

- Examples of issues regarding foreign securities firms
  - ✓ Local governance and internal control are not sufficient.
  - ✓ Personnel familiar with the domestic conditions and resource not enough due to the outsourcing of operational risk management, etc. to other group headquarters.
  - ✓ The system is not appropriately adjusted to the domestic regulation because it is developed and managed globally.



The JFSA sends out questionnaires to foreign securities companies annually in order to obtain more information regarding their risk profile and risk management, etc.

# The JFSA's Powers over Securities Firms (1)

- FIEA Article 56-2 provides the JFSA with broad supervisory power over FIBOs. In particular, JFSA has the power to:
  - **Request reports and information** (materials) from any FIBO, as well as from the **holding company** of the FIBO for the purpose of understanding the status of business or property of the firm.
  - **Inspect** the status of business or property of a FIBO, or its books and documents and other articles.
  - Order a **major shareholder** of a FIBO to submit reports or materials, notifications under Article 32, or have the officials inspect documents or other articles of the major shareholder.
  - Order a **parent financial institution** or a **subsidiary FI** of a FIBO to submit reports or materials and have the officials of the JFSA inspect their status of business or property, or books and records.

# The JFSA's Powers over Securities Firms (2)

- JFSA has the following enforcement powers:
  - Issue orders of improvement of business (Article 51). These orders can include
    - ▣ requiring immediate remedy of particular business conduct
    - ▣ demanding investigations of management responsibilities
    - ▣ ordering to establish preventive measures
    - ▣ amending business operations.
  - Issue suspension orders for a period not exceeding six months or rescind the registration. (Article 52).
- When those measures above are conducted, it is disclosed to the public.

# Verification for Administrative Actions(1)

| <b>(A-1) Seriousness</b>                       |  | <b>Assessment</b> | <b>Remarks</b> |
|--|--|-------------------|----------------|
| <b>Degree of Damage to Public Interests</b>    | Whether the Financial Instruments Business Operator, etc., is undermining public interests significantly by, for example, originating and providing products markedly inappropriate from the viewpoint of appropriate disclosure of financial conditions to customers, thereby damaging confidence in the financial markets. |                   |                |
| <b>Extent of Damage to Users</b>               | Whether a number of users across wide regions have suffered damage.  |                   |                |
|  | How serious the damage done to individual users is.  |                   |                |
| <b>(A-2) Maliciousness</b>                     |  |                   |                |
| <b>Maliciousness of Acts</b>                   | Whether the Financial Instruments Business Operator, etc., has acted in a malicious way, such as by continuing to sell similar products despite receiving numerous complaints from users.  |                   |                |
| <b>Duration and Repetitive Nature of Acts</b>  | Whether the act in question committed by a Financial Instruments Business Operator, etc., has been committed for a long period of time. Whether the act has been committed repeatedly and continuously or only once. Whether the Financial Instruments Business Operator, etc., committed a similar illegal act in the past. |                   |                |
| <b>Intentionality</b>                          | Whether the Financial Instruments Business Operator, etc., has committed the illegal/inappropriate act intentionally while recognizing the illegality and inappropriateness, or has done so through negligence.  |                   |                |
| <b>Institutional Involvement</b>               | Whether the act has been committed based on an individual employee's judgment or a manager has been involved. Whether the management team has been involved.   |                   |                |
| <b>Presence or Absence of Cover-Up Actions</b> | Whether an attempt to cover up the act has been made after its illegality was recognized. Whether a cover-up, if one exists, was an institutional act.   |                   |                |
| <b>Involvement of Anti-Social Forces</b>       | Whether any anti-social forces have been involved. How much involvement, if any.   |                   |                |

# Verification for Administrative Actions(2)

| <b>(B) Appropriateness of Control Environment for Governance and Business Operation</b> |   | <b>Assessment</b> | <b>Remarks</b> |
|---|---|-------------------|----------------|
| <b>Representative Director and Board of Directors</b>                                   | Whether the representative director and the board of directors are fully aware of the importance of legal compliance and make sufficient efforts to ensure compliance.                                |                   |                |
| <b>Internal Audit Section</b>   | Whether the internal audit section is adequately staffed and equipped to conduct audits and whether the division is functioning properly.   |                   |                |
| <b>Compliance and Risk Management Divisions</b>   | Whether the compliance and risk management divisions are adequately staffed and equipped to perform their tasks and whether they are functioning properly.  |                   |                |
| <b>Employees Engaging in Business</b>   | Whether employees engaging in business are fully aware of the importance of legal compliance and whether sufficient internal training is provided.  |                   |                |
| <b>(C) Attenuation Factors</b>  |   |                   |                |
| <b>Voluntary Efforts</b>  | Whether there are attenuation factors, such as the implementation of voluntary efforts by the Financial Instruments Business Operator, etc., to protect investors before the administrative response. |                   |                |
| <b>Others</b>   | Whether there are any other attenuation factors.  |                   |                |
| <b>(D) Other factors</b>  | Whether there are any other factors to be considered.   |                   |                |

- The JFSA compare some relevant cases in one chart and decide what sanction should be appropriate.

# 3. Case Example of Administrative Actions

# Case Example of Administrative Actions on Violations of Short-Selling Regulation

**Confidential**

| Securities Firms | Administrative action   | Number of disclosing violation | Number of pricing violation | Reasons  | Elements to consider in administrative action  |
|------------------|---|--------------------------------|-----------------------------|--|--|
|                  |   | (duration of violation)        |                             |  |  |
| A                | order for business improvement & business-suspension (5 business days)  | 4,613<br>(510/month)           | 293<br>(32/month)           | <ul style="list-style-type: none"> <li>flaw in the ordering system, while front staff recognize it</li> <li>insufficient engagement of compliance and IT department</li> </ul> | <ul style="list-style-type: none"> <li>voluntary surrender</li> <li>marked shortage of the knowledge about legal matters</li> </ul>  |
|                  |   | 9 months                       |                             |  |  |
| B                | order for business improvement & business-suspension (10 business days) | 1,200,000<br>(60,000/month)    | 128<br>(7 /month)           | <ul style="list-style-type: none"> <li>flaw in the ordering system</li> <li>insufficient prior confirmation and periodic checkup</li> </ul>                                    | <ul style="list-style-type: none"> <li>voluntary surrender</li> <li>prior record of violating the same regulation</li> <li>extremely insufficient system management structure</li> </ul> |
|                  |   | 18 months                      |                             |  |  |
| C                | Order to submit reports   | 1,106<br>(23/month)            | —                           | <ul style="list-style-type: none"> <li>solely relied on pre-approval of its regional compliance department</li> <li>insufficient ex-post monitoring</li> </ul>                 | <ul style="list-style-type: none"> <li>Voluntary surrender</li> <li>Voluntarily work out measures for preventing a recurrence of this legal violation</li> </ul>                         |
|                  |   | 4 years                        |                             |  |  |
| D                | Order to submit reports   | 8,517<br>(2,100/month)         | —                           | <ul style="list-style-type: none"> <li>a flaw in the system concerning cross-border transaction</li> <li>insufficient ex-post monitoring</li> </ul>                            | <ul style="list-style-type: none"> <li>Voluntary surrender</li> <li>Voluntarily work out measures for preventing a recurrence of this legal violation</li> </ul>                         |
|                  |   | 4 months                       |                             |  |  |
| E                | Order to submit reports   | 33,087<br>(7,000/month)        | 196<br>(23/month)           | <ul style="list-style-type: none"> <li>change the ordering system without pre-approval, wrongly</li> <li>insufficient ex-post monitoring</li> </ul>                            | <ul style="list-style-type: none"> <li>Voluntary surrender</li> <li>Voluntarily work out measures for preventing a recurrence of this legal violation</li> </ul>                         |
|                  |   | 5 months                       |                             |  |  |

# Business Improvement Order against Barclays Securities Japan Limited

- On September 30, 2011, the JFSA took an administrative action against Barclays Securities Japan Limited due to “Short-Selling in breach of the FIEA” and “Inadequate management of the electronic data processing systems for the financial instruments business”.
- In addition to the business suspension order, the following business improvement orders were issued.
  - a. Clarifying the responsibility of the management and staff regarding the above-mentioned violations.
  - b. Securing strict compliance by all the directors and staff and taking preventive measures against recurrence of the above- mentioned violations.
  - c. Strengthening the internal control system, including the management of the electronic data processing systems.
  - d. Submitting a written report to the JFSA on the implementation of the above measures (a - c) by October 21, 2011, and b and c by January 4, 2012, every 3 months thereafter, and at any times as needed in consideration of the implementation status.



# 4. Off-site Monitoring

# Information and Data Collected from Securities Firms(1)

- Under the law, the securities firms are obliged to submit the Business Report (annually, article 46-3 (1)), the Report on relevant companies and the Report on International Business (annually, article 46-3 (2) and article 173 of the cabinet ordinance), the capital adequacy ratio (monthly, article 46-6).
- Additionally, though not stipulated in law, the JFSA has ordered all the securities firms to report major accounts (financial data), status of asset segregation, status of capital and risk, and financial status, etc. monthly or semi-annually. *(see the next page for details)*

# Information and Data Collected from Securities Firms(2)

| Data  | submission                      | reference date   |
|---|---------------------------------|--|
| ★ Capital Adequacy Ratio                                | monthly                         | End of each month  |
| Major Account Balance                                   | monthly                         | End of each month  |
| State of Business                                       | monthly                         | End of each month  |
| State of Operating Proprietary Trading System           | monthly                         | End of each month  |
| State of Operating Foreign Exchange Margin Transactions | monthly                         | End of each month  |
| ★ State of Segregation of Client Funds                  | monthly                         | Every Friday<br>(every business day)   |
| ★ State of Segregation of Client Securities             | quarterly                       | End of each quarter  |
| State of claims subject to compensation                 | annually                        | End of each year   |
| State of Segregation of Funds for Clearing Margins      | monthly<br>quarterly<br>monthly | End of each month<br>End of each quarter<br>Every Friday<br>(every business day) |
| Market Risk   | monthly                         | every business day   |
| List of Top Large Positions                             | monthly                         | End of each month  |
| Balance on Securities                                   | semi-annually                   | End of each half year  |
| Profit and Loss on Securities                           | semi-annually                   | End of each half year  |
| Market Fluctuation Effect                               | monthly                         | End of each month  |
| Counterparty Risk                                       | monthly                         | End of each month  |
| Data on Loss by Operational Risk                        | quarterly                       | End of each quarter  |
| Data on Sources and Uses of Cash                        | monthly                         | every business day   |
| Data on Sufficient Liquidity                            | monthly                         | End of each month  |
| State of Financing Method                               | monthly                         | End of each month  |

# Utilizing Collected Information and Data in Supervision

- Information reported by securities firms is utilized in daily supervision for checking their business and conditions. It is also utilized as basic information for inspection and as reference materials for amending regulations by sharing with the inspection section and rule-planning section.
- Especially, for data reported monthly, one staff member exclusively conducts analysis and verification utilizing interviews if necessary, and the analysis is provided to relative staff in the supervisory section and the inspection section and used for daily supervision and inspection.

# 5. Capital Adequacy Ratio

# Overview of Capital Adequacy Framework for Securities Firms

## (1) Background / Objectives

- First introduced in the 1990's in view of maintaining financial soundness of securities firms and ensuring investor protection.
- Through efforts to maintain an adequate level of capital adequacy ratio, FIBOs must identify and manage risks involved in their businesses in a comprehensive manner and keep liquid assets (non-fixed capital) in sufficient quantity and quality, to enable them to withstand losses that may be caused by the materialization of various risks.

## (2) Supervisory framework based on Capital Adequacy Ratio

| Capital Adequacy Ratio   | Early Remedial Measures                                       |
|--|---|
| $\frac{\text{Non-fixed Capital}}{(a) \text{ Market Risk} + (b) \text{ Counterparty Risk} + (c) \text{ Basic Risk}}$  | <p>&lt; 140%<br/>Required to notify JFSA</p>                  |
| <p>[Note1]</p> <p>(a) The risk of a FIBO incurring losses due to fluctuations in prices of its asset holdings (including positions related to off-balance transactions) caused by changes in various market-related risk factors, such as prices of securities and other financial instruments, interest rates and exchange rates, as well as credit and other risks associated therewith</p> <p>(b) The risk of a FIBO incurring losses due to a failure by the counterparties to its transactions to fulfill their contractual obligations</p> <p>(c) The risk of a FIBO regarding operating expenses and operational error which should be noted in the business as usual</p> | <p>&lt; 120%<br/>Ordered to improve business</p>              |
| <p>[Note2] Actual figures of Capital Adequacy Ratio (as of Feb 2015)<br/>Nomura: 283.7% / Daiwa: 317.8% / Mitsubishi UFJ Morgan Stanley: 293.6% / Mizuho: 333.4%</p>   | <p>&lt; 100%<br/>Ordered to suspend business for a period</p> |

# An Image of Non-fixed Capital

| Assets  | Liabilities         |
|---|---------------------|
| Current Assets  | Liabilities         |
| <div style="border: 1px dashed black; border-radius: 15px; padding: 10px; background-color: #ADD8E6;">Non-fixed Capital<br/>= Current Assets – Liabilities<br/>= Capital – Fixed Assets</div> | Capital<br>(Equity) |
| Fixed Assets  |                     |

# Early Remedial Measures Based on Capital Adequacy

| Capital Adequacy Ratio   | Early Remedial Measures   |
|--|---|
| $\frac{\text{Non-fixed Primary Capital}}{\text{The amount of various risks}} \times 100$ | <p>&lt; 140(%)...Required to notify JFSA</p> <p>&lt; 120(%)...Ordered to improve businesses</p> <p>&lt; 100(%)...Ordered to suspend businesses for a period</p> |

- The ratio is derived from a formula where the numerator is calculated by deducting the amount of illiquid assets such as unlisted securities, loans and real estate from capital and where the denominator is the equivalent of credit risk, market risk and operational risk.
- The JFSA will take “Early Remedial Measures” against Type I FIBOs based on their Capital Adequacy Ratios.
- If the ratio of a Type I FIBO goes below pre-set thresholds, a corrective order will be issued (e.g. Business Improvement Order, Business Suspension Order).
- On an ongoing basis, Type I FIBOs must maintain a capital ratio formula with monthly/quarterly/annual reporting to the JFSA.



# Early Warning System

- Even if a securities firm does not fail to keep the capital adequacy ratio more than 140 percent, it may still need to improve its soundness and management continuously. Thus, the JFSA has the early warning system, in which the JFSA analyzes information and data, categorize the companies, focus on some relatively fragile ones, and conduct a dialog with them or order them to improve their soundness and management.

(as of Feb 2015)

|              | Promote Improvement        |   |   |                                      | Focus on Improvement       |   |                                      | Total     |
|--------------|----------------------------|---|---|--------------------------------------|----------------------------|---|--------------------------------------|-----------|
|              | Decrease by more than 100% | Decrease for 2 consecutive months<br>+<br>Not exceed 200% | Impact of Change in Prices of Securities and Interest Rates | Impact of Change in Foreign Exchange | Decrease by more than 200% | Decrease for 3 consecutive months<br>+<br>Not exceed 200% | Impact of Change in Foreign Exchange |           |
| A            | 8                          | 0   | 0   | 1                                    | 1                          | 0   | 1                                    | 11        |
| B            | 1                          | 0   | 0   | 0                                    | 0                          | 0   | 0                                    | 1         |
| C            | 0                          | 0   | 0   | 0                                    | 0                          | 4   | 1                                    | 5         |
| D            | 0                          | 0   | 0   | 0                                    | 0                          | 0   | 0                                    | 0         |
| <b>Total</b> | <b>9</b>                   | <b>0</b>  | <b>0</b>  | <b>1</b>                             | <b>1</b>                   | <b>4</b>  | <b>2</b>                             | <b>17</b> |

- ◇ A: Temporary factors or CAR remains at a high level.
- ◇ B: Remedial measures such as capital increase are planned.
- ◇ C: Remedial measures are not planned. Continued attention is necessary.
- ◇ D: During a follow-up by an order for submission of reports

# Ref. Stress Scenarios and Recovery Actions

## ● Examples of stress scenarios

- ✓ Severe Losses through a Rogue Trader
- ✓ Rating Downgrades
- ✓ Collapse of Global Financial Markets
- ✓ Fraud, etc.

\* Refer to “Guidance on Recovery Triggers and Stress Scenarios” published by FSB on 16 July 2013 for details.

## ● Recovery Options

- ✓ Liquidity (Raise Immediate Short Term Funding, Debt Financing, Unwind of Liquidity Portfolio, etc.)
- ✓ Capital/RWA (Capital Planning, Cost Reduction, Asset Disposal, Business Disposal, etc.)

# 6. Investor Protection

- Segregation Requirement
- Investor Protection Fund

# Segregation of Client Assets(1)

- FIBOs are required to segregate clients assets from their own properties. (Article 43-2)
- Clients money or securities must be deposited with a trust company licensed in Japan. (Article 43-2)
- Type I FIBOs are required to have an audit on clients assets by a CPA or audit firm at least once a year. (Article 43-2, Cabinet Office Ordinance Article 142)
- Written consent from a client is required for a securities firm to use the securities posted by the client. (Article 43-4)

## Segregation of Client Assets(2)

- In Japan, the way of asset segregation is different between securities and cash.
- For listed stocks, most are managed by JASDEC (Japan Securities Depository Center, inc.), which is a securities depository.
- Regarding cash, some are cash for purchasing stock, etc. There are also sales proceeds and redemption that are deposited temporarily. Cash that should be returned to the clients are entrusted to trust banks as “Customer discretionary trust”.
- Such status of asset segregation is inspected by the JFSA and JSDA (Japan Securities Dealers Association).

# Investor Protection Fund

- Type I FIBOs are required to join an investor protection fund established in 1998 (Article 79-20) and to contribute to it.
- In the event of the insolvency of a FIBO, segregated clients assets are expected to be returned to the clients promptly or transferred to another FIBO. Based on Article 51 of FIEA, the JFSA can issue an administrative order for those purposes.
- The maximum reimbursement amount by the fund in the event of bankruptcy of a firm is not more than ¥10 million per investor.
- The fund does not compensate for loss to clients owing to a decline of the securities holding prices.



**Thank you**



*"for investors, with investors"*

# An overview of Securities Inspection

28 April, 2015

Kaoru Murakami  
Deputy Director for Inspection Division  
Securities and Exchange Surveillance Commission



# Contents

1. SESC's Mission
2. SESC's Organization
3. Outline of Activities
4. Legal Framework
5. Securities Inspection
6. Collection and Analysis of Information
7. Recent Cases

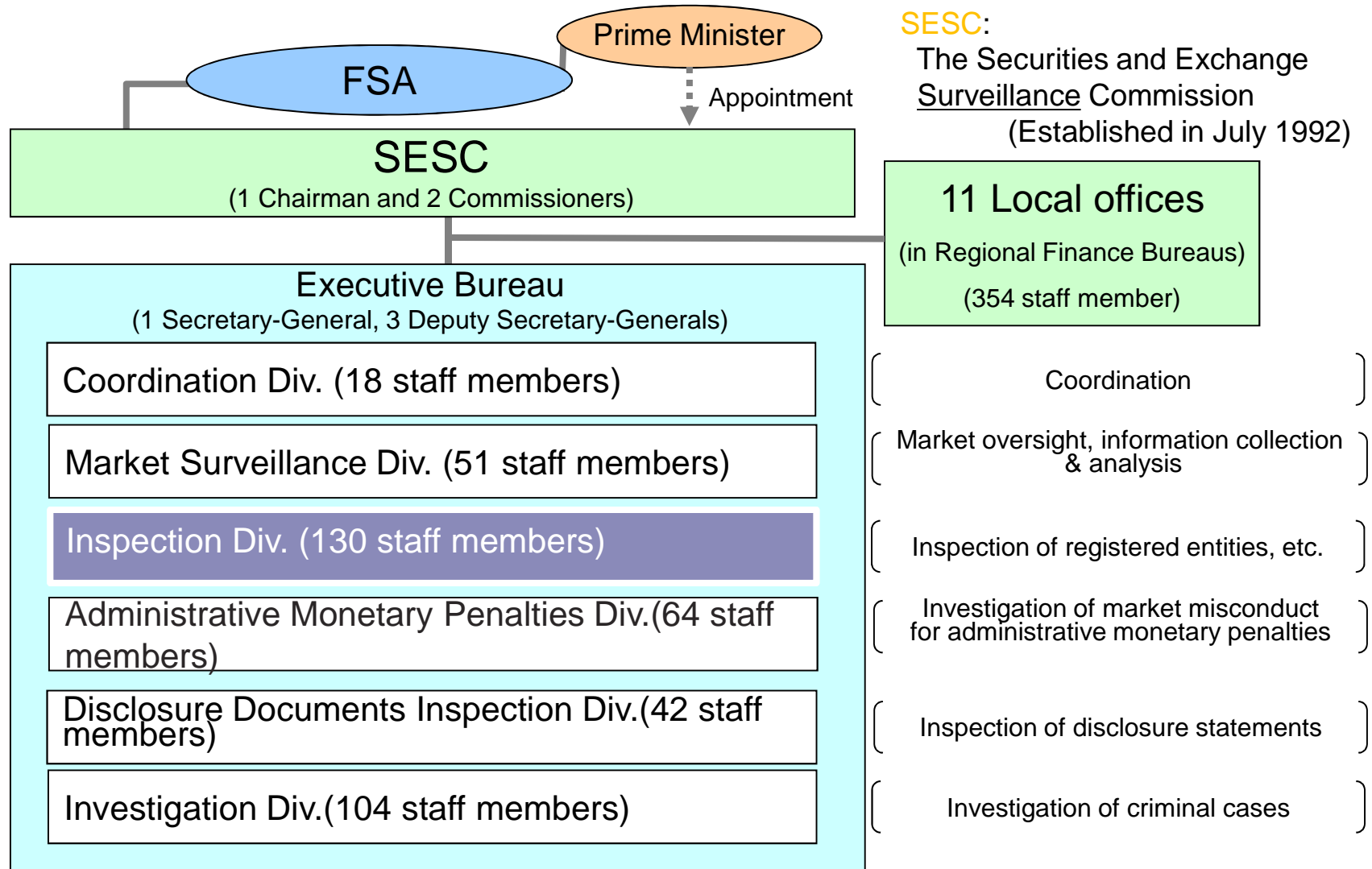
## 1. SESC's Mission

- To ensure the integrity of the Japanese capital market
- To protect investors

*"To be feared by wrongdoers and trusted by ordinary investors"*



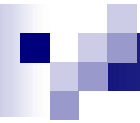
## 2. SESC's Organization(1)



Note : Staff members of Executive Bureau are quota as at the end of FY2014.

## 2. SESC's Organization(2)

- The SESC (chairman and commissioners) executes its official authority independently, though it is within the Financial Services Agency (FSA).  
(Chairman and commissioners will not be dismissed against their will.)
- The SESC doesn't have the power to make rules or to take administrative actions. Instead, it can submit policy proposals or make recommendations to take administrative actions.

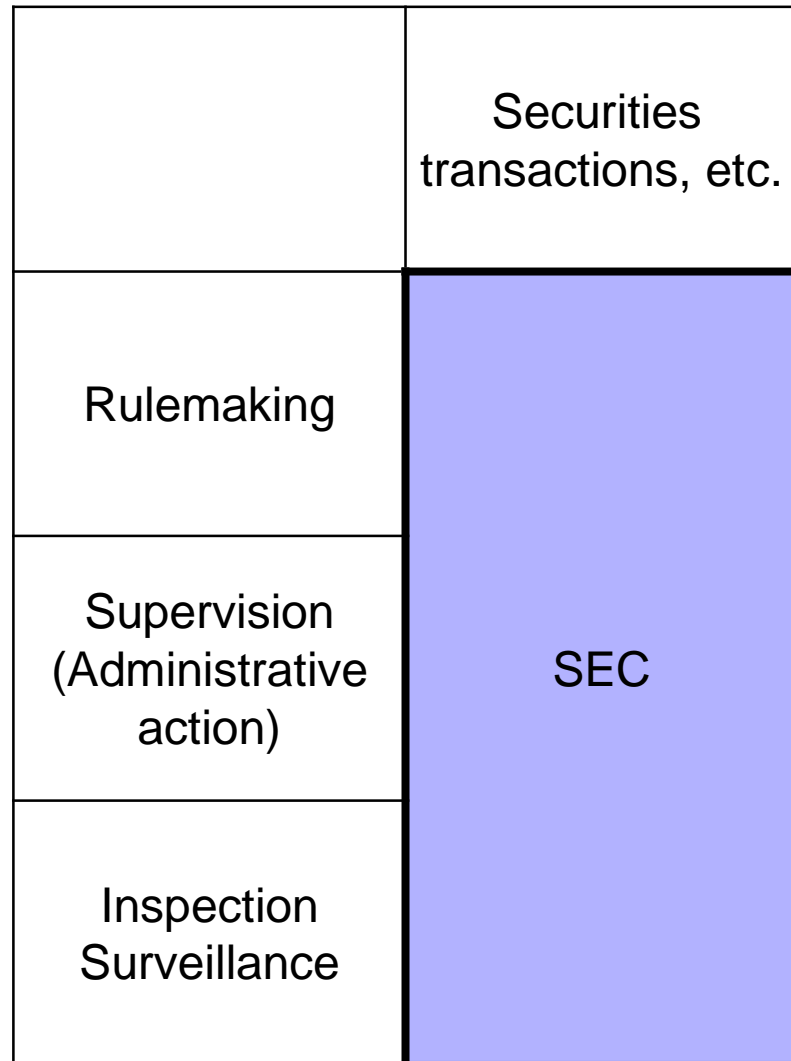


## 2. SESC's Organization(3)

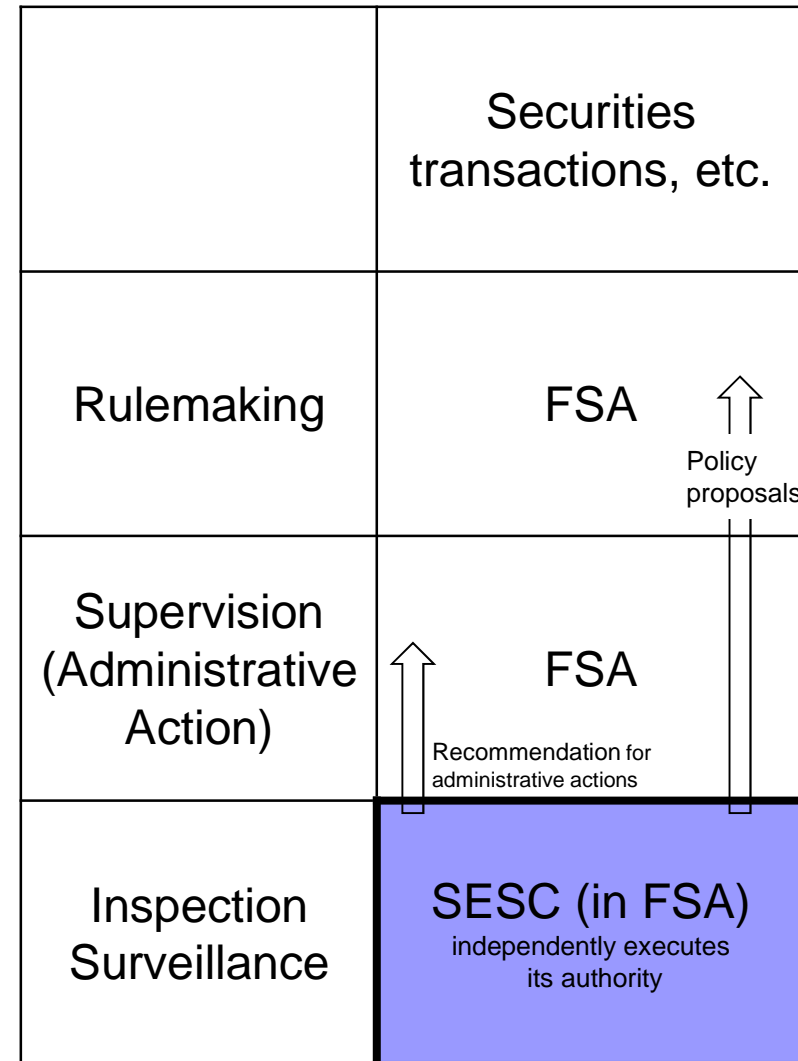


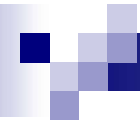
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USA



Japan



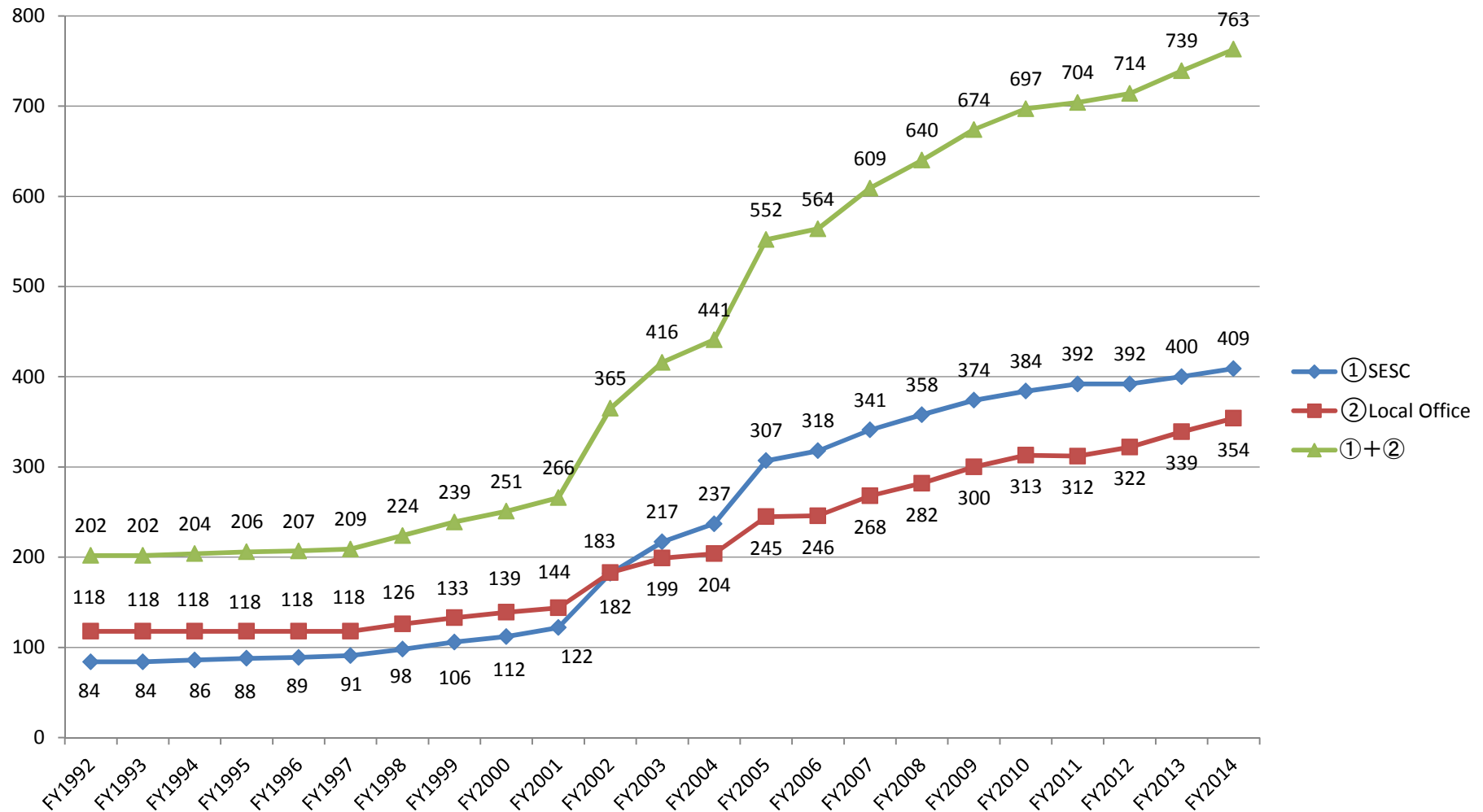


## 2. SESC's Organization(4)

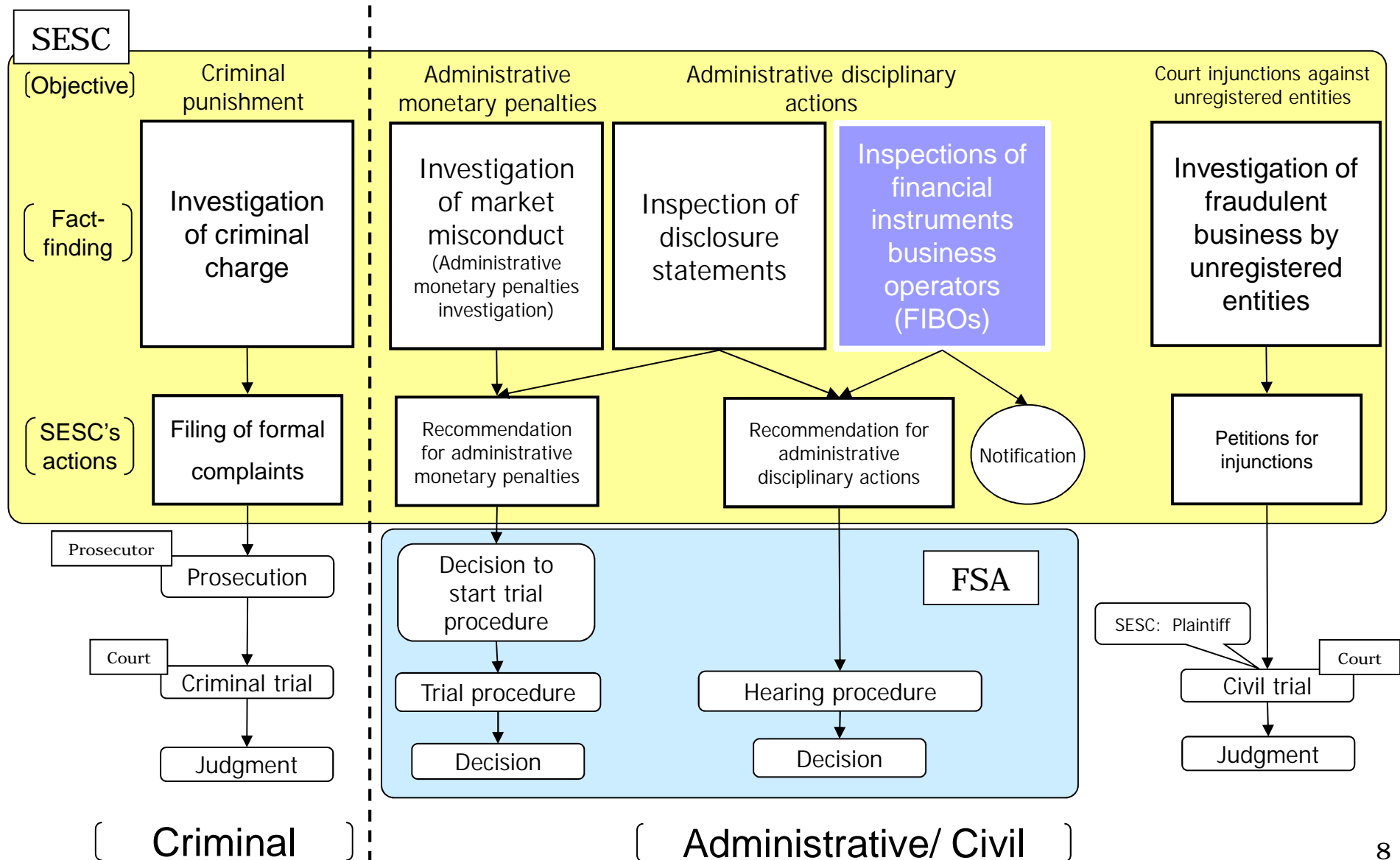


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### Changes in Number of SESC Staff Members

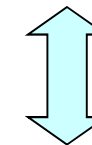


# 3. Outline of Activities (1)



### 3. Outline of Activities (2)

| Activity type  | Typical “target”  | Possible result  | Purpose  | Characteristics  |
|--|---|--|--|--|
| Inspection for <u>administrative disciplinary actions</u>  | Registered entities (e.g. FIBOs)                            | <ul style="list-style-type: none"> <li>• Revocation of Registration</li> <li>• Business suspension order</li> <li>• Improvement order</li> </ul> | <u>Improvement</u> of business operations  | <ul style="list-style-type: none"> <li>• Based on <u>dialogue</u> (but not always)</li> <li>• No coercive measure</li> </ul>   |
| Investigation for <u>administrative monetary penalties</u> | Listed companies that made false statements                 | Monetary penalties   | <u>Deterrence</u> of market misconducts to ensure the effectiveness of regulations | <ul style="list-style-type: none"> <li>• Less severe penalty</li> <li>• No coercive measure</li> <li>• Lighter burden of proof</li> </ul>                                  |
|  | Insider traders, market manipulators                        |  |  |  |
| Investigation for <u>criminal charge</u>                   | Offenders of certain statutory provisions (including above) | Imprisonment and/or fine   | <u>Imposition</u> of <u>criminal sanctions</u>                                     | <ul style="list-style-type: none"> <li>• More severe penalty</li> <li>• Coercive measure (search &amp; seizure with warrant)</li> <li>• Heavier burden of proof</li> </ul> |





### 3. Outline of Activities (3)

## Supervisory powers over Securities Companies

#### 1. **Submission of Reports and On-site inspection**

- ✓ ordering any securities company to submit reports and information from
- ✓ inspecting the status of business or property of a securities company or its books and documents and other articles

#### 2. **Business Improvement Order**

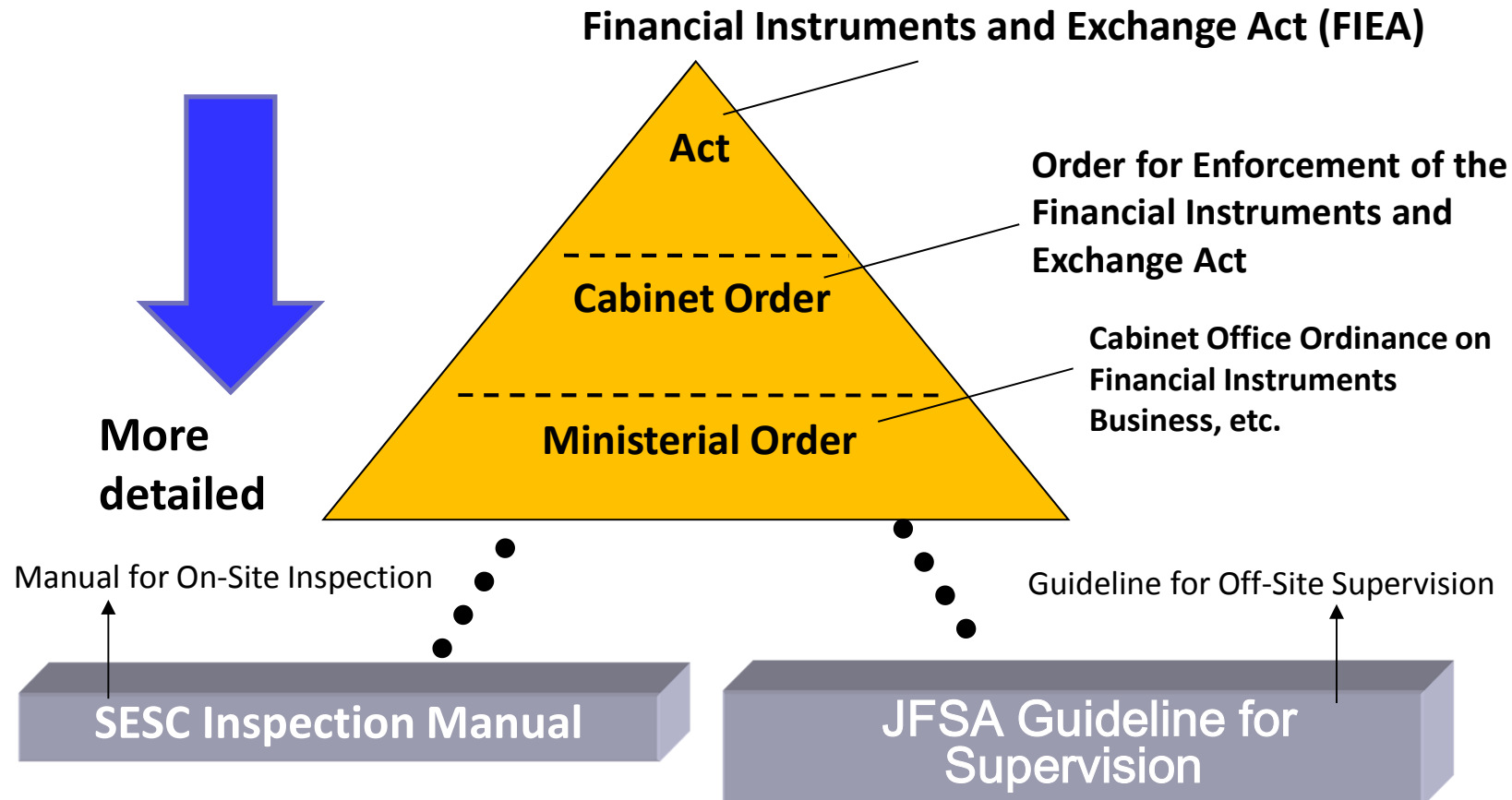
- ✓ requiring immediate remedy of a particular business conduct
- ✓ demanding investigations of management responsibilities
- ✓ ordering the establishment of preventive measures
- ✓ amending business operations.

#### 3. **Business Suspension Order**

- ✓ period not exceeding six months

#### 4. **Registration Revocation Order**

## 4. Legal Framework(1)



All of the above information is made public for transparency and also available on the JFSA's website

[http://www.fsa.go.jp/en/laws\\_regulations/index.html#02](http://www.fsa.go.jp/en/laws_regulations/index.html#02)

<http://www.fsa.go.jp/sesc/english/guideline/index.htm>

## 4. Legal Framework(2)



### Inspection Manual

(a tool to enable an inspector to make verification)

- Inspection Manual is not “regulations” or “instructions”.
- Inspection items are Examples of items considered effective for comprehending the actual conditions of business operators.
- It is necessary to take care so as not to merely verify each item of the Inspection Manual automatically and uniformly.

## 5. Securities Inspection (1)

### -Objectives

- To encourage the improvement of internal control systems in the Financial Instruments Business Operators (FIBOs)
- To ensure the appropriateness of risk management systems including financial soundness in the FIBOs
- To enhance awareness of the FIBOs as gatekeepers

## 5. Securities Inspection (2)

### -Changes in Circumstances

#### Diversification and increase in the number of FIBOs

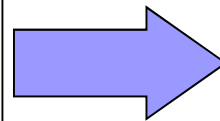
- Around 8,000 operators engage in business
- Actions have to be taken against unregistered business operators
- Financial instruments and transactions have become more diverse and complex

## 5. Securities Inspection (3)

### -Number of entities to be inspected

#### SESC's establishment

- Domestic Securities Companies  
216 (Dec.1992)
- Foreign Securities Companies  
49 (Jun. 1992)
- Financial Futures Dealers  
216 (May. 1993)
- Registered Financial Institutions  
619 (Jul. 1993)



#### Feb 2015

- |   |       |
|---|-------|
| 1. Type I FIBOs   | 277   |
| 2. Type II FIBOs  | 1,250 |
| 3. Investment Advisories/Agencies   | 991   |
| 4. Asset Management Firms   | 328   |
| 5. Registered Financial Institutions  | 1,097 |
| 6. Specially Permitted Business Notifying Firms for Qualified Institutional Investors | 2,884 |
| 7. Financial Instruments Intermediaries   | 818   |
| 8. Self-Regulatory Organization   | 13    |
| 9. Investment Corporation   | 68    |
| 10. Credit Ratings Agencies   | 7     |
| (+ Unregistered Business Operators)   |       |

## 5. Securities Inspection (4)

### Type of Financial Instruments businesses

| Type I financial instruments business  | Type II financial instruments business  | Investment advisory and agency business   | Asset management business   |
|--|---|---|---|
| <ul style="list-style-type: none"> <li>• Sales and solicitation of securities with high liquidity</li> <li>• Market derivatives transactions of highly liquid securities</li> <li>• Underwriting</li> <li>• Over-the-counter derivatives transactions</li> <li>• Asset management</li> </ul> | <ul style="list-style-type: none"> <li>• Sales and solicitation of securities with lower liquidity</li> <li>• Market derivatives transactions of securities with lower liquidity</li> <li>• Market derivatives transactions of those other than securities</li> <li>• Self placement</li> </ul> | <ul style="list-style-type: none"> <li>• Investment advice</li> <li>• Acting as agent or intermediary in concluding investment advisory contracts and discretionary investment contracts</li> </ul> | <ul style="list-style-type: none"> <li>• Investment management</li> </ul> |

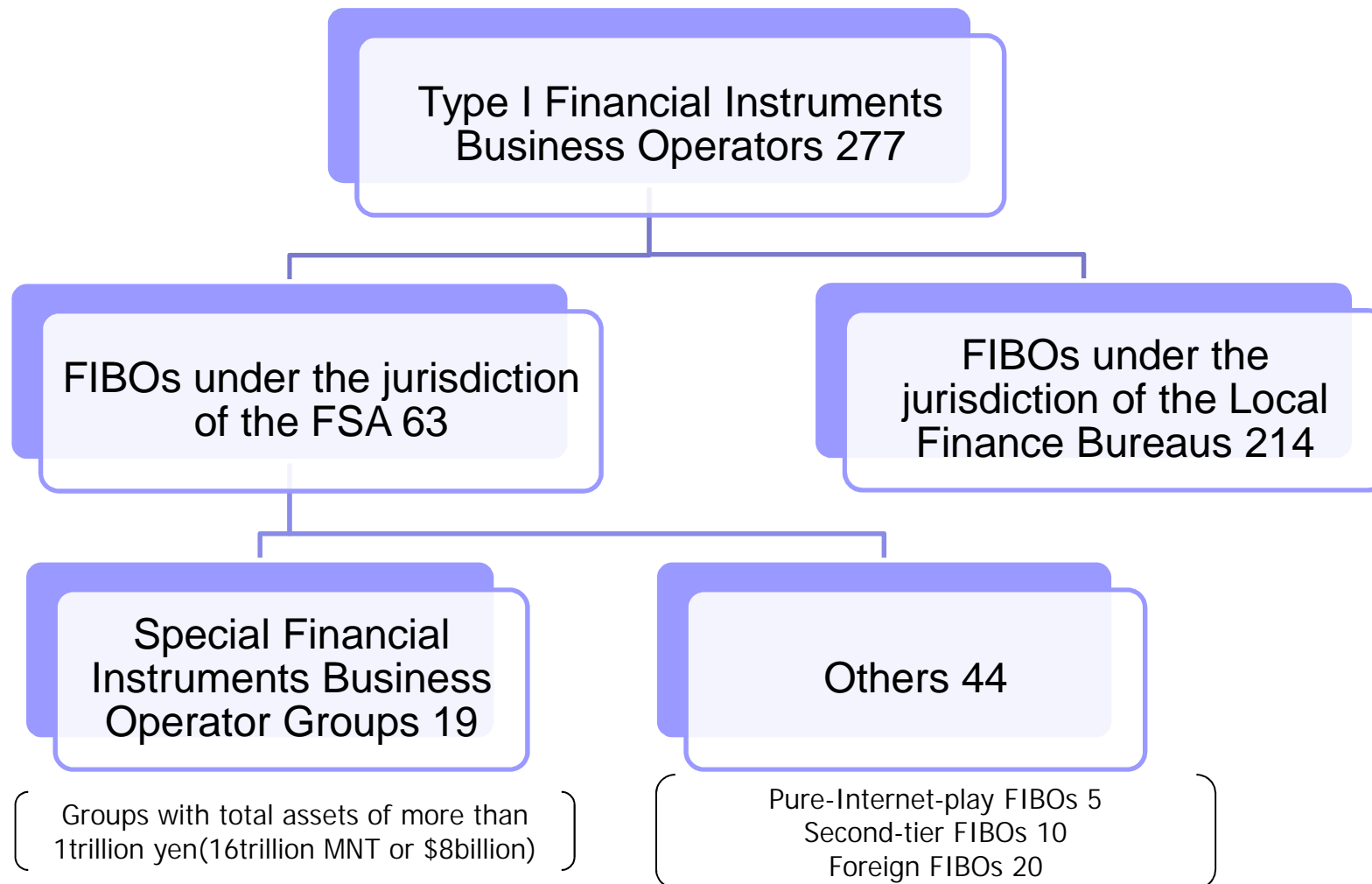
## 5. Securities Inspection (5)

- Risk-based prioritization of the inspection reflecting business type
  - FIBOs to inspect on a regular basis
    - ✓ Type I FIBOs
    - ✓ Type II FIBOs particularly on those which sell finds many individual investors
    - ✓ Asset Management Firms
  - FIBOs to inspect as needed
    - ✓ Investment Advisories/Agencies
    - ✓ Financial instrument intermediaries, etc.



## 5. Securities Inspection (6)

### -Number of the Type I FIBOs





## 5. Securities Inspection (7)

### -Inspection Policy and Program for 2014-15

#### Inspection Implementation Policy

- Constantly monitoring large-scale securities company groups' financial soundness as a whole

#### Efficient, effective and viable securities inspections

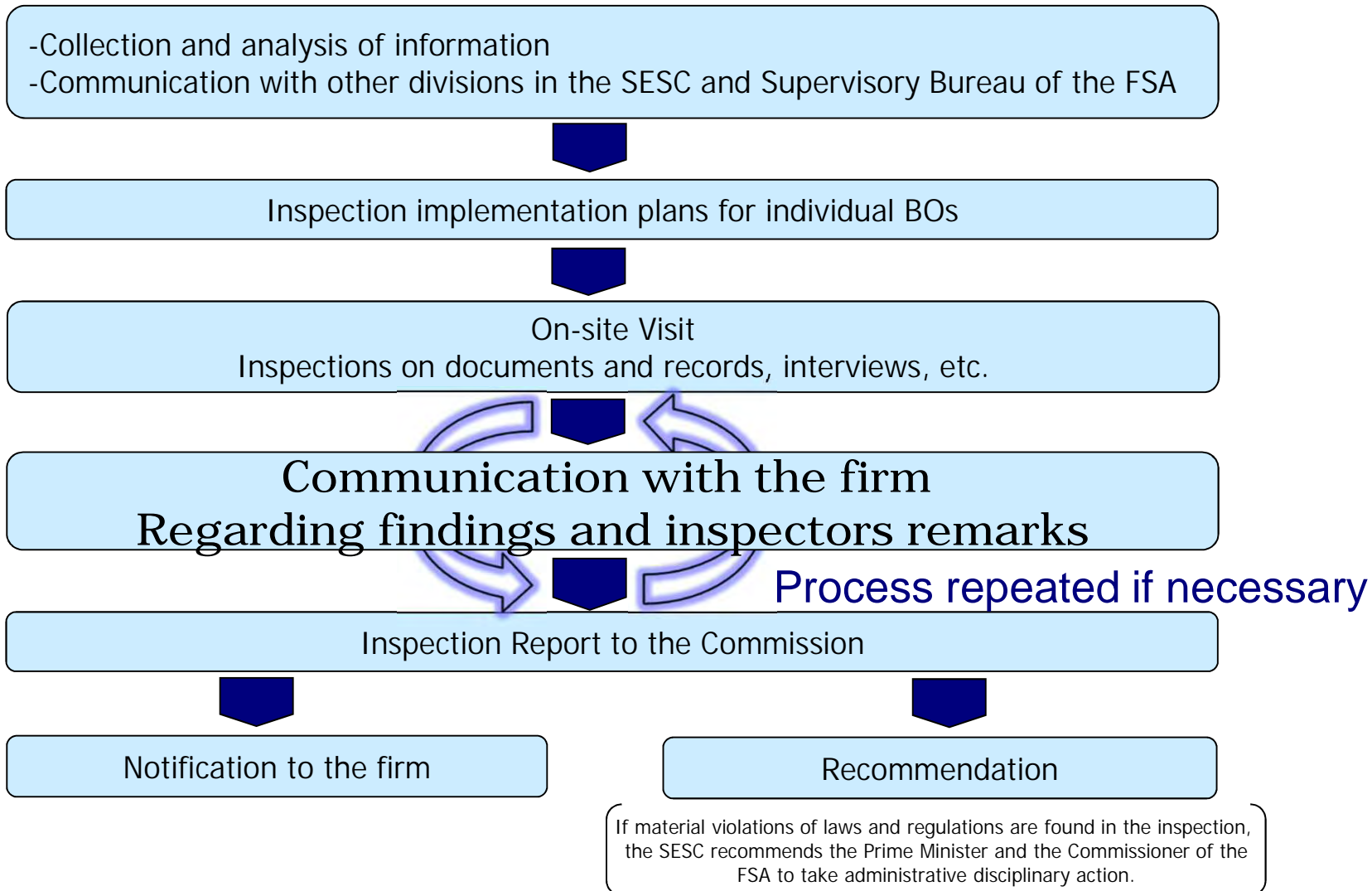
- When determining inspection priorities for individual BOs, the SESC will collect and analyze a variety of information,
- Corresponding to their business types, sizes, other characteristics and the market conditions at the time,
- Then utilize a risk-based approach to decide which BOs to inspect, considering their market positions and inherent problems in a comprehensive manner.



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## 5. Securities Inspection (8)

### -Inspection Process



## 5. Securities Inspection (9)

### -Inspection Areas

|  |                  |             |  |
|--|------------------|-------------|--|
| 1. Business Management                                     |                  |             |  |
| 2. Internal Control, Legal Compliance                      |                  |             |  |
| 3. Risk Management<br>(including Financial Soundness)      |                  |             |  |
| Risks concerning<br>Regulations<br>on Capital Requirements | Operational Risk | System Risk | Other Risks<br>(e.g. Investment Risk,<br>Funding Risk) |
| 4. Internal/External Audit Function                        |                  |             |  |
| 5. Crisis Management (BCP)                                 |                  |             |  |

\*For more details visit [http://www.fsa.go.jp/sesc/kensa/manual/kinyusyouhin\\_en.pdf](http://www.fsa.go.jp/sesc/kensa/manual/kinyusyouhin_en.pdf)

# 6. Collection and Analysis of Information(1)

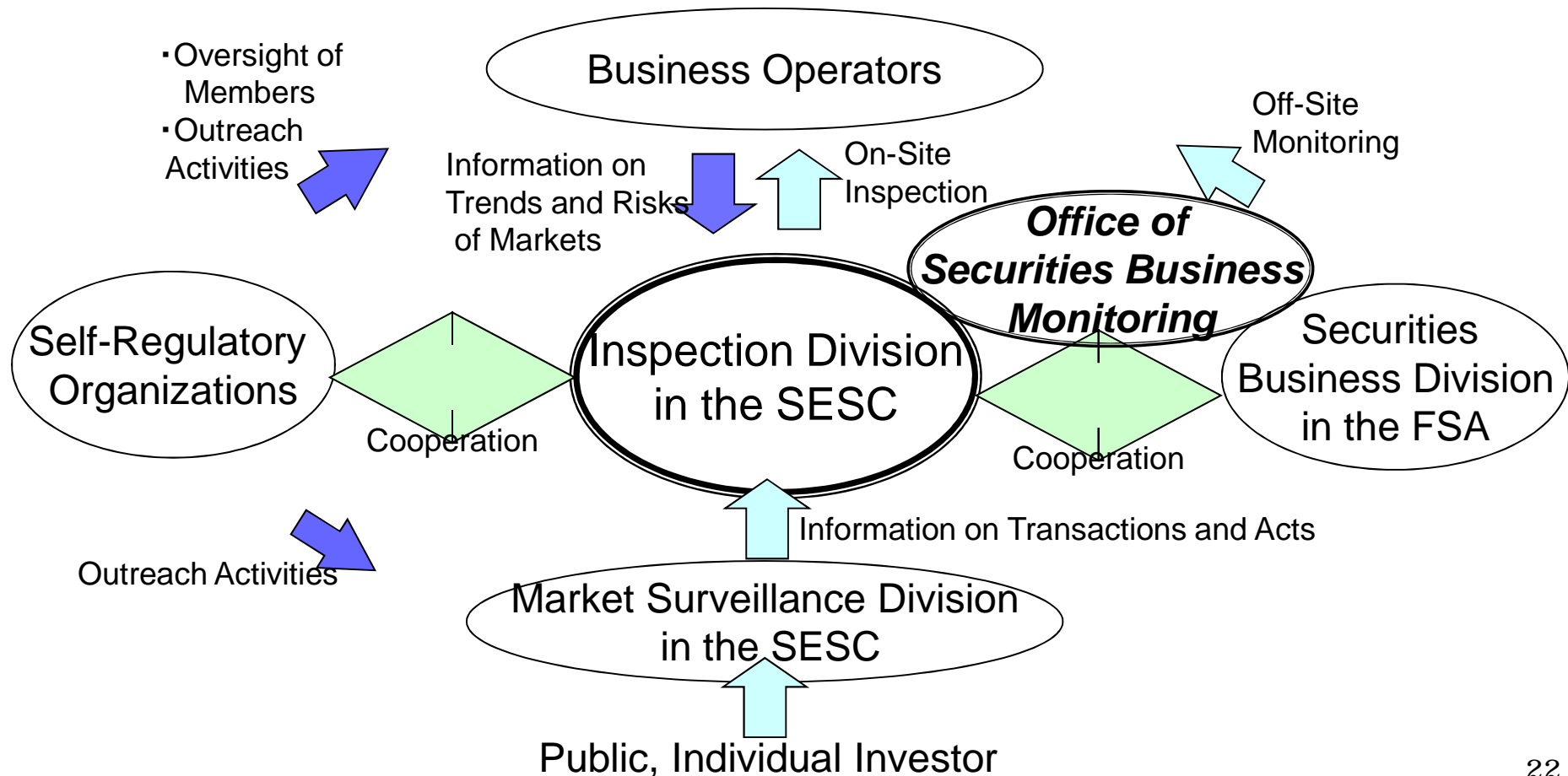
Process and Practice of Securities Inspection



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## Enhanced Communication and Cooperation with Other Institutions

- Importance of Information gathering
- Importance of Cooperation with SROs



## 6. Collection and Analysis of Information(2)



### Types of inspection

#### 1) General inspections

- General inspections are conducted focusing on general operational issues of the business operators, taking into comprehensive account various information, the results of the previous inspection and the inspection cycle.

#### 2) Special inspections

- Special inspections are conducted expeditiously on a part of a business operator's business operations based on information acquired.

## 6. Collection and Analysis of Information(2)



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### Information Reception

| Fiscal Year  | 2009  | 2010  | 2011  | 2012  | 2013  |
|--|-------|-------|-------|-------|-------|
| 1.Amount of information received                                   | 7,118 | 6,927 | 6,179 | 6,362 | 6,401 |
| Internet   | 4,293 | 4,040 | 3,543 | 3,881 | 4,316 |
| Telephone calls  | 1,917 | 2,219 | 2,033 | 1,883 | 1,518 |
| Letters  | 380   | 393   | 385   | 346   | 395   |
| Visitation   | 60    | 45    | 54    | 57    | 56    |
| Information forwarded from the FSA<br>and Local Finance Bureaus    | 468   | 230   | 164   | 195   | 116   |
| 2.Content of the information                                       |       |       |       |       |       |
| Individual stock   | 3,889 | 3,640 | 3,227 | 3,751 | 4,040 |
| Issuer   | 835   | 597   | 440   | 436   | 402   |
| Sales approach of financial instruments<br>business operator, etc. | 1,349 | 1,142 | 878   | 790   | 907   |
| Other(opinion, inquiry, etc.)                                      | 1,045 | 1,548 | 1,634 | 1,385 | 1,052 |

## 6. Collection and Analysis of Information(3)



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### Analysis of data(1/2)

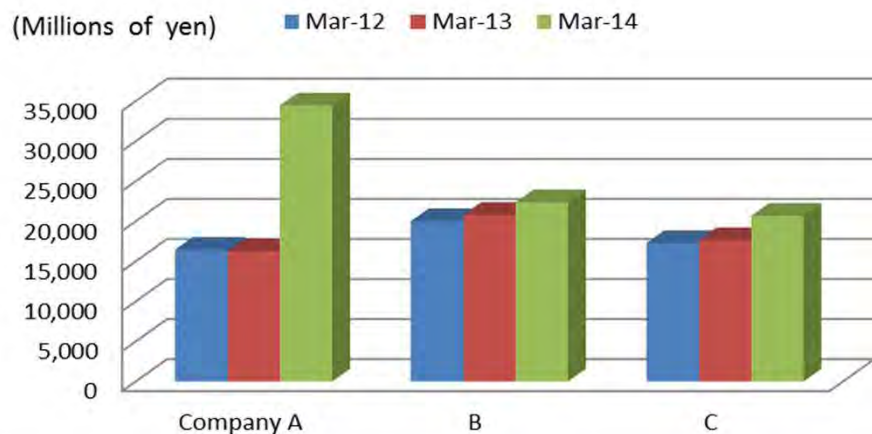
| FY2013   | Company A    | B             | C             | FY2013                                       | Company A | B   | C   |
|--|--------------|---------------|---------------|--|-----------|-----|-----|
| <b>Balance sheet(Billions of yen)</b>                  |              |               |               | <b>Statement of income(Billions of yen)</b>  |           |     |     |
| Current assets   | 6,937        | 10,919        | 16,145        | Operating revenue                            | 333       | 279 | 322 |
| Trading products                                       | 3,054        | 5,263         | 10,076        | Commission received                          | 184       | 148 | 165 |
| Loan secured by securities                             | 2,865        | 4,926         | 4,340         | Brokerage commissions                        | 44        | 43  | 43  |
| Other current assets                                   | 1,019        | 730           | 1,729         | Underwriting and distribution commissions    | 35        | 24  | 21  |
| Noncurrent assets                                      | 189          | 356           | 116           | Flotation and distribution fees              | 65        | 37  | 51  |
| Property and equipment                                 | 7            | 17            | 17            | Other fees received                          | 41        | 43  | 51  |
| Intangible assets                                      | 32           | 30            | 23            | Net trading income                           | 127       | 96  | 137 |
| Investments and other assets                           | 149          | 308           | 76            | <Equities>                                   | 11        | 26  | 48  |
| Investment securities                                  | 60           | 231           | 60            | <Bonds>                                      | 108       | 70  | 96  |
| <b>Total assets</b>                                    | <b>7,126</b> | <b>11,274</b> | <b>16,260</b> | <Other>                                      | 7         | -1  | -7  |
| Current liabilities                                    | 6,069        | 9,583         | 15,521        | Financial revenue                            | 23        | 33  | 19  |
| Trading products                                       | 1,871        | 4,210         | 7,232         | Financial expenses                           | 15        | 26  | 9   |
| Loans payable secured by securities                    | 2,526        | 4,252         | 5,855         | Net operating revenue                        | 319       | 253 | 313 |
| Short-term loans payable                               | 1,033        | 510           | 1,997         | Selling, general and administrative expenses | 222       | 203 | 197 |
| Other current liabilities                              | 638          | 612           | 438           | Operating income/loss                        | 97        | 50  | 116 |
| Noncurrent liabilities/Reserves under the special laws | 482          | 1,093         | 359           | Ordinary income/loss                         | 97        | 54  | 118 |
| Long-term loans payable                                | 198          | 405           | 345           | Extraordinary income/loss                    | -1        | -0  | 5   |
| Bonds payable  | 274          | 456           | 0             | Net income before income/loss                | 97        | 54  | 123 |
| <b>Total liabilities</b>                               | <b>6,551</b> | <b>10,677</b> | <b>15,881</b> | Income taxes-current                         | 18        | 2   | 9   |
| <b>Total net assets</b>                                | <b>575</b>   | <b>597</b>    | <b>379</b>    | Income taxes-deferred                        | 17        | -8  | -7  |
| <b>Total liabilities and net assets</b>                | <b>7,126</b> | <b>11,274</b> | <b>16,260</b> | Net income/loss                              | 61        | 60  | 121 |



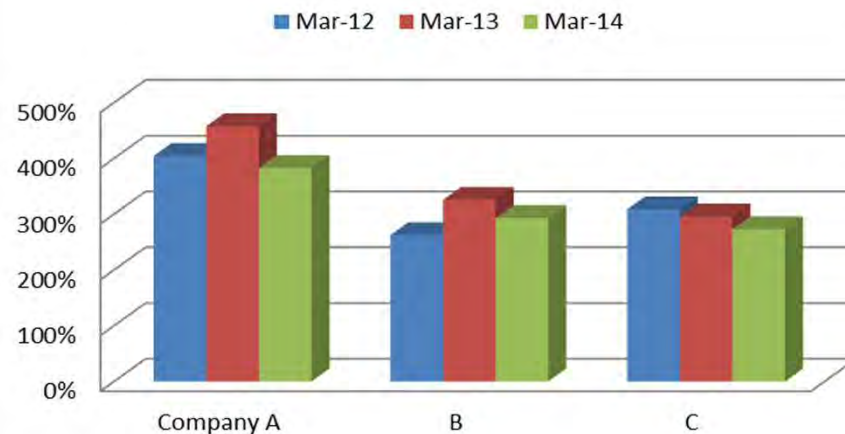
# 6. Collection and Analysis of Information(4) Analysis of data(2/2)



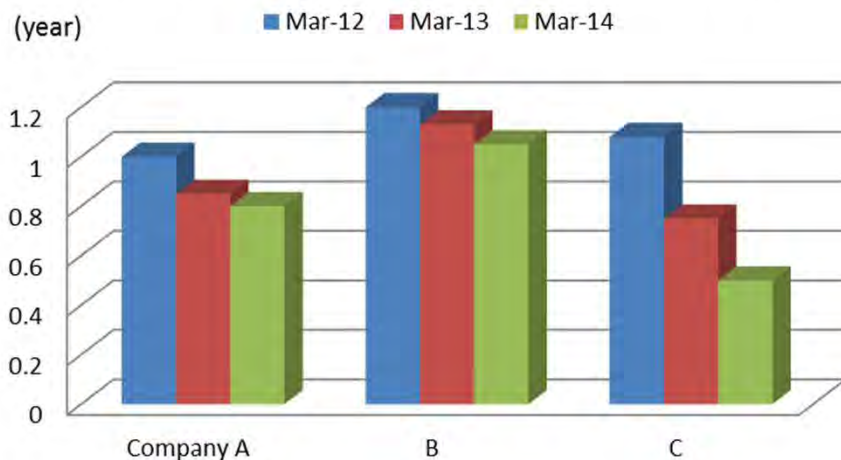
**Underwriting Fee**



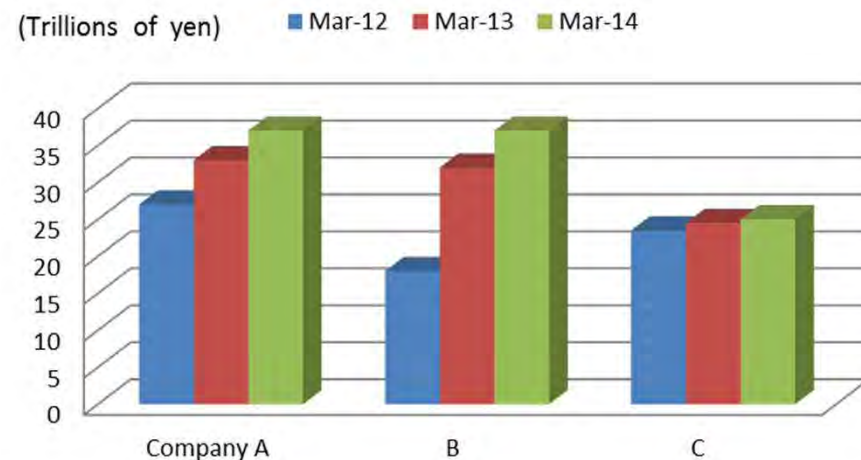
**Capital-to-risk ratio**



**Average holding period of Investment Trust**



**Client Assets**



## 7. Recent Cases(1)

~ Lack of adequate staffing, failure to maintain the statutory levels of net assets, and violation of business improvement order ~

### ■ Findings

- The on-site inspection revealed that:
  - Securities Company M did not have adequate staffing to conduct securities business appropriately.
  - Though the FSA had issued an improvement order to Securities Company M to increase its net assets, it didn't take any remedial measures, so their net assets were still below the statutory level.(50million yen or 800million MNT)
  - Securities Company M had not submitted a business improvement report even though the due date of submission had already passed.

## 7. Recent Cases(2)

### ■ Enforcement action (Aug. 12, 2011)

A) Registration Revocation Order

B) Business Improvement Order:

- i. Comprehend the situation of customers and the management of customers' assets promptly, developing a plan for returning these assets to customers, and implement the plan properly.
- ii. Adequately explain to the customers the plan regarding i. above and the enforcement actions.
- iii. Do not misappropriate Securities Company B's assets.
- iv. Submit a written report by Aug. 26, 2011, describing the actions taken and the implementation status regarding i. to iii. above.

## 7. Recent Cases(3)



- **TIBOR/LIBOR cases** (Recommended on December 9, 2011)
  - Against UBS Securities Japan Ltd. & Citigroup Global Markets Japan Inc.
  - Recommendations made concerning inappropriate actions related to TIBOR, etc.
  - FSA suspended their related derivative transactions.
  
- **Nomura case** (Recommended on July 31, 2012)
  - Against Nomura Securities Co., Ltd.
  - Recommendation made concerning its insufficient systems to prevent misuse of confidential corporate information related to public offering of new shares
  - FSA issued a business improvement order.

## 7. Recent Cases(4)



- **Deutsche Securities cases** (Recommended on December 5, 2013)
  - Against Deutsche Securities Inc.
  - Recommendations made concerning special benefits to officers of three employees' pension funds.
  - FSA issued a business improvement order.



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# Reference Material

# Main points of Inspection Policy for 2014-15



## 《Basic Direction》

| <b>Role of inspections</b>  | <b>Change in Circumstances</b>  | <b>Current Challenges</b>   |
|---|---|---|
| <ul style="list-style-type: none"><li>○ To take rigorous actions against illegal activities and play a role in sending alerts to the markets</li><li>○ To ensure investor confidence in the markets by enhancing self-discipline of BOs</li></ul> | <ul style="list-style-type: none"><li>○ Diversification and increase in the number of BOs (Around 8,000 operators engage in business)</li><li>○ Financial instruments and transactions have become more diverse and complex</li></ul> | <ul style="list-style-type: none"><li>○ Revelation of serious cases</li><li>○ To restore investors' confidence by not only verifying the compliance but also urging BOs to improve compliance posture and professional ethics</li></ul> |

### < Efforts toward efficient, effective and viable securities inspection corresponding to the diverse characteristics of the BOs >

- Strengthening the capabilities to collect and analyze information by enhancing the capacity of the SESC to identify potential problems with consideration given to the characteristics of business types, customers types, and types of financial instruments and transactions.
- Utilizing a risk-based approach to decide which BOs to inspect by considering their business types, sizes, other characteristics and other information in a comprehensive manner.

## 《Inspection Implementation Policy》

- ◆ Conducting on-site inspections and off-site monitoring on large-scale securities groups
- ◆ Enhancement of cooperation with FSA for inspections of Type I FIBOs
- ◆ Conducting regular inspections on Type II FIBOs, particularly on those which sell funds to a large number of individual investors
- ◆ Conducting regular inspections on investment management business operators
- ◆ Conducting concise inspection of registered information on Type II FIBOs and investment advisors/agencies
- ◆ Rigorous actions against fund related business operators engaging in illegal activities and unregistered business operators

### < Implementation Plan and Focus in Verification >

- Establishment of systems for properly soliciting and explaining to aged customers or customers utilizing the NISA
- Management of material non-public information
- Organizational actions to block relations with anti-social groups
- Financial soundness of BOs
- Due diligence, monitoring and customer solicitation activities by fund related business operators selling overseas instruments

# Number of Inspected Entities

| Business categories                                 | Apr.-10 | Apr.-11 | Apr.-12 | Apr.-13 | Apr.-14 |
|---|---------|---------|---------|---------|---------|
|   | Mar.-11 | Mar.-12 | Mar.-13 | Mar.-14 | Mar.-15 |
| Financial Instruments Firms                         | 148     | 148     | 153     | 222     | 206     |
| Type I Financial Instruments Business               | 91      | 85      | 57      | 69      | 77      |
| Type II Financial Instruments Business              | 6       | 14      | 20      | 108     | 72      |
| Asset Management Firms                              | 15      | 9       | 36      | 16      | 15      |
| Investment Advisories/Agencies                      | 36      | 40      | 40      | 29      | 42      |
| Registered Financial Institution                    | 28      | 32      | 28      | 9       | 1       |
| Financial Instrument Intermediary Service Providers | 1       | 9       | 9       | 8       | 18      |
| Investment Companies                                | 6       | 2       | 0       | 3       | 2       |
| Self Regulatory Organizaitions                      | 1       | 0       | 0       | 3       | 3       |
| Others  | 2       | 11      | 24      | 26      | 36      |

(Note ) The number above is that of inspections undertaken.



# Findings from Inspections

| Category                     | Apr.-12 | Apr.-13 | Apr.-14 |
|------------------------------|---------|---------|---------|
|                              | Mar.-13 | Mar.-14 | Mar.-15 |
| Recommendation               | 18      | 18      | 16      |
| Firms with problems found    | 102     | 118     | 105     |
| Unfair transactions          | 6       | 5       | 7       |
| Lack of investor protection  | 52      | 65      | 71      |
| Improper financial soundness | 11      | 9       | 19      |
| Others                       | 71      | 69      | 52      |

Note) “firms with problems found” shows the number of the firms for which we pointed out some problems in the inspection.



# List of the item we ask for

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## 検査会場においてご準備いただきたい資料等 (Material to submit)

検査基準日：平成27年3月8日 (AS of 3/8/2015)

証券取引等監視委員会 (SESC)

| 番号 (No.)   | 項目 (Items)   | 期間 (Term)      | 提出形態等 (Submission method)    | 提出期限 (Due Date) | 備考 (Remarks)  |
|--|--|----------------|------------------------------|-----------------|---|
| <b>1. 全般資料 (General)</b>                                 |  |                |                              |                 |   |
| 1-1  | 組織図 (Organizational chart)                         | 2012/4～2015/3  | イントラ (Intranet)              | 2015/3/19       | 改正の経緯がわかるもの、検査基準日現在では部署毎に常勤職員数記入のこと (include the number of the employees)                     |
| 1-2  | グループ図 (Correlation chart)                          | 2012/4～2015/3  | イントラ (Intranet)              | 2015/3/19       | 改正の経緯がわかるもの (include transition)  |
| 1-3  | 各種社内規程集 (Internal rule)                            | 直近のもの (Latest) | イントラ或いは紙 (Intranet or paper) | 2015/3/19       | 各業務マニュアル等も含む (include various operating manual)   |
| 1-4  | 役員 の 履 歴 (List of the executive)                   | 直近のもの (Latest) | イントラ或いは紙 (Intranet or paper) | 2015/3/19       | 検査対象期間中に退任した役員分も含む、役員については兼職状況も併せて記載 (Include ex-executives)                                  |
| 1-5  | 業務概況メモ (Operation overview)                        | 直近のもの (Latest) | イントラ或いは紙 (Intranet or paper) | 2015/3/19       | 対象は営業部門のみ。各営業部門の提出資料と重複しないように要相談。 (only for sales division)                                   |
| <b>2. 会議録資料 (Minutes)</b>                                |  |                |                              |                 |   |
| 2-1  | 主要会議・委員会等の記録 (Board Minutes, etc.)                 | 2012/4～2015/3  | イントラ或いは紙 (Intranet or paper) | 2015/3/19       | 議事録等の一覧を提出、個別記録は別途相談 (submit the list of the minutes at first)                                |
| <b>3. 法定帳簿等 (Statutory Books)</b>                        |  |                |                              |                 |   |
| 3-1  | 注文伝票 (Order invoice)                               | 2012/4～2015/3  | イントラ或いは紙 (Intranet or paper) | 2015/3/19       |   |
| 3-2  | 取引日記帳 (Trading diary)                              | 2012/4～2015/3  | イントラ或いは紙 (Intranet or paper) | 2015/3/19       |   |
| 3-3  | 顧客勘定元帳 (Customer accounts ledger)                  | 2012/4～2015/3  | イントラ或いは紙 (Intranet or paper) | 2015/3/19       |   |
| 3-4  | トレーディング商品勘定元帳 (traded instruments accounts ledger) | 2012/4～2015/3  | イントラ或いは紙 (Intranet or paper) | 2015/3/19       |   |
| 3-5  | 法定帳簿のコード索引表等 (Code table of the books)             |                | イントラ或いは紙 (Intranet or paper) | 2015/3/19       | 電子データで保存の場合、その使用手引き等を含む (include manual that explains how to use)                             |
| <b>4. 内部管理 (Internal Control Systems)</b>                |  |                |                              |                 |   |
| 4-1  | 内部統制・法令遵守・内部管理体制について (Management system)           |                | イントラ或いは紙 (Intranet or paper) | 2015/3/19       | ①当社の内部統制・法令遵守・内部管理体制全般について記載<br>②①については当社営業部門に対する牽制、チェック体制について記載 (describe management system) |
| 4-2  | メール記録等 (E-mail data)                               | 直近のもの (Latest) | イントラ (Intranet)              |                 | 検査予告後削除禁止 (don't delete until a further instruction)  |
| 4-3  | 証券事故関係 (Reporting of problematic conduct)          | 2012/4～2015/3  | イントラ或いは紙 (Intranet or paper) | 2015/3/26       |   |
| 4-4  | 苦情処理・訴訟関連 (The list of complaints)                 | 2012/4～2015/3  | イントラ或いは紙 (Intranet or paper) | 2015/3/26       |   |
| <b>5. Stock Sales</b>                                    |  |                |                              |                 |   |
| <b>6. Debenture Business</b>                             |  |                |                              |                 |   |
| <b>7. Investment Banking Business</b>                    |  |                |                              |                 |   |
| <b>8. Property and Accounting</b>                        |  |                |                              |                 |   |
| <b>9. Separate Management</b>                            |  |                |                              |                 |   |
| <b>10. Internal Audit System</b>                         |  |                |                              |                 |   |
| <b>11. Risk Management System</b>                        |  |                |                              |                 |   |
| <b>12. Liquidity Risk Management System</b>              |  |                |                              |                 |   |
| <b>13. Market Risk Management System</b>                 |  |                |                              |                 |   |
| <b>14. Credit Risk Management System</b>                 |  |                |                              |                 |   |
| <b>15. Operational Risk Management System</b>            |  |                |                              |                 |   |
| <b>16. Information Technology Risk Management System</b> |  |                |                              |                 |   |



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# Thank you

SESC's pamphlet: <http://www.fsa.go.jp/sesc/english/aboutsesc/all.pdf>

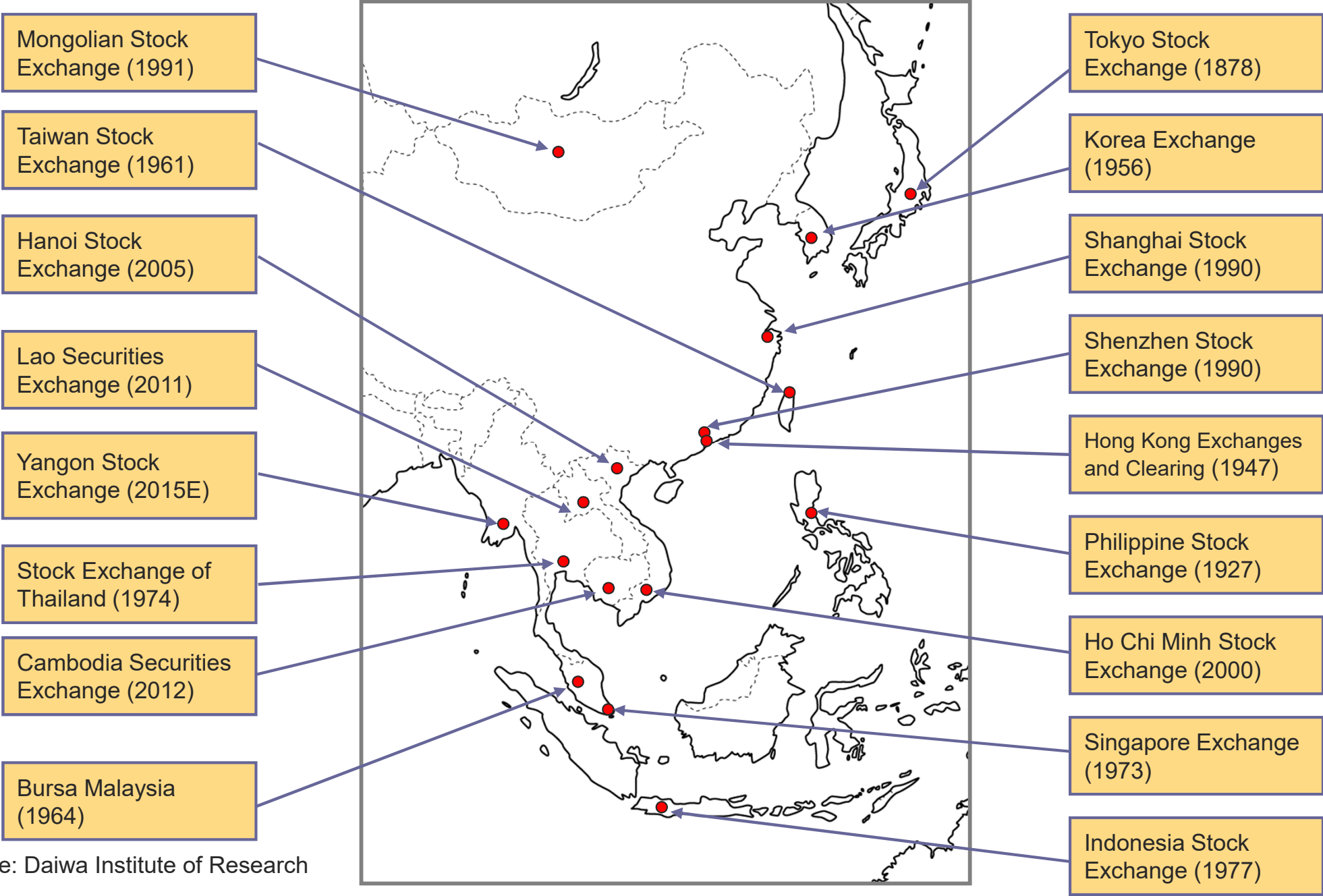
# **Project for Capacity Building of Capital Market in Mongolia: Stock Markets in Asia**

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29 April 2015

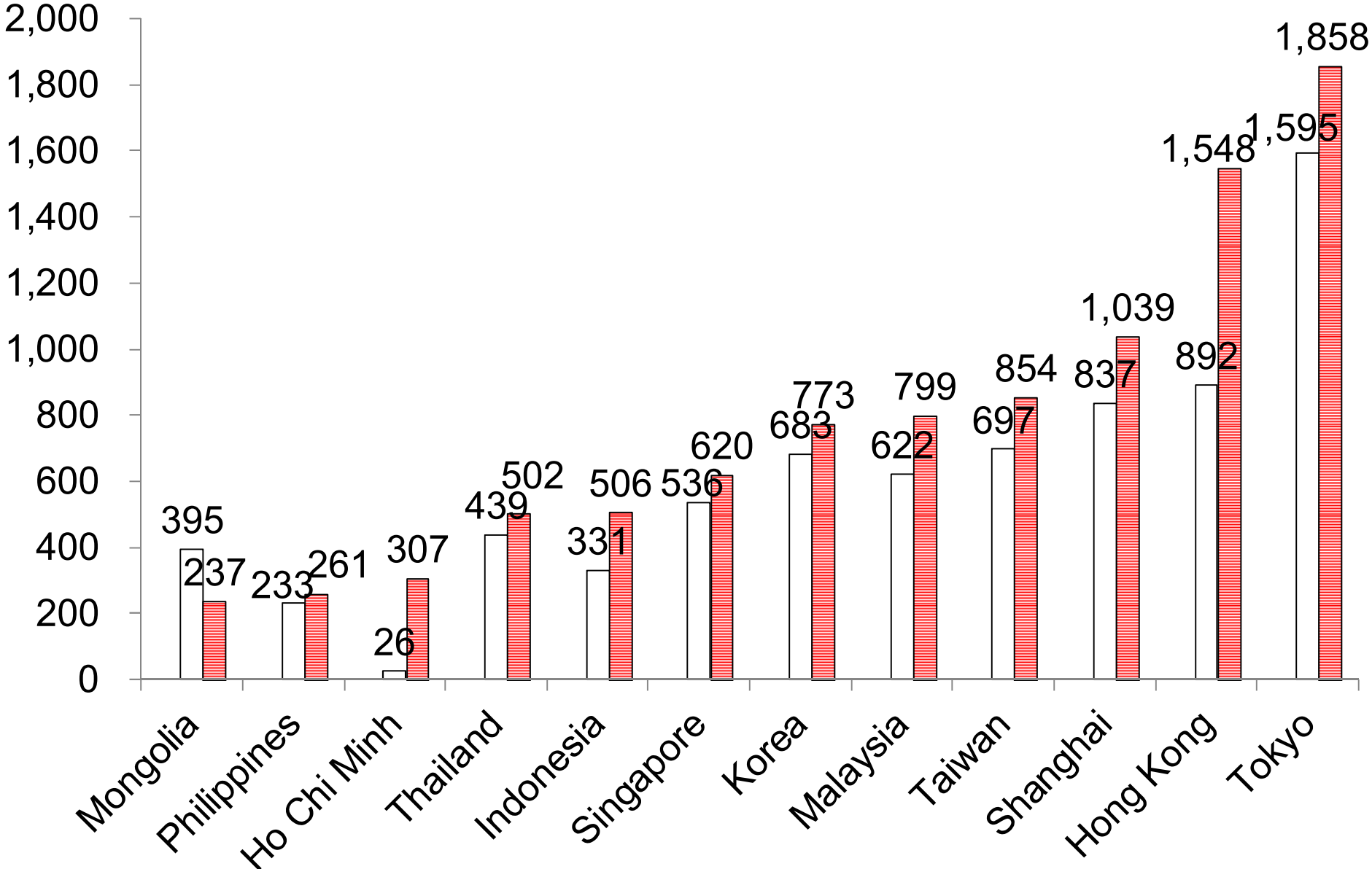
Daiwa Institute of Research  
Japan Economic Research Institute

# 1-a. Stock exchanges in Asia



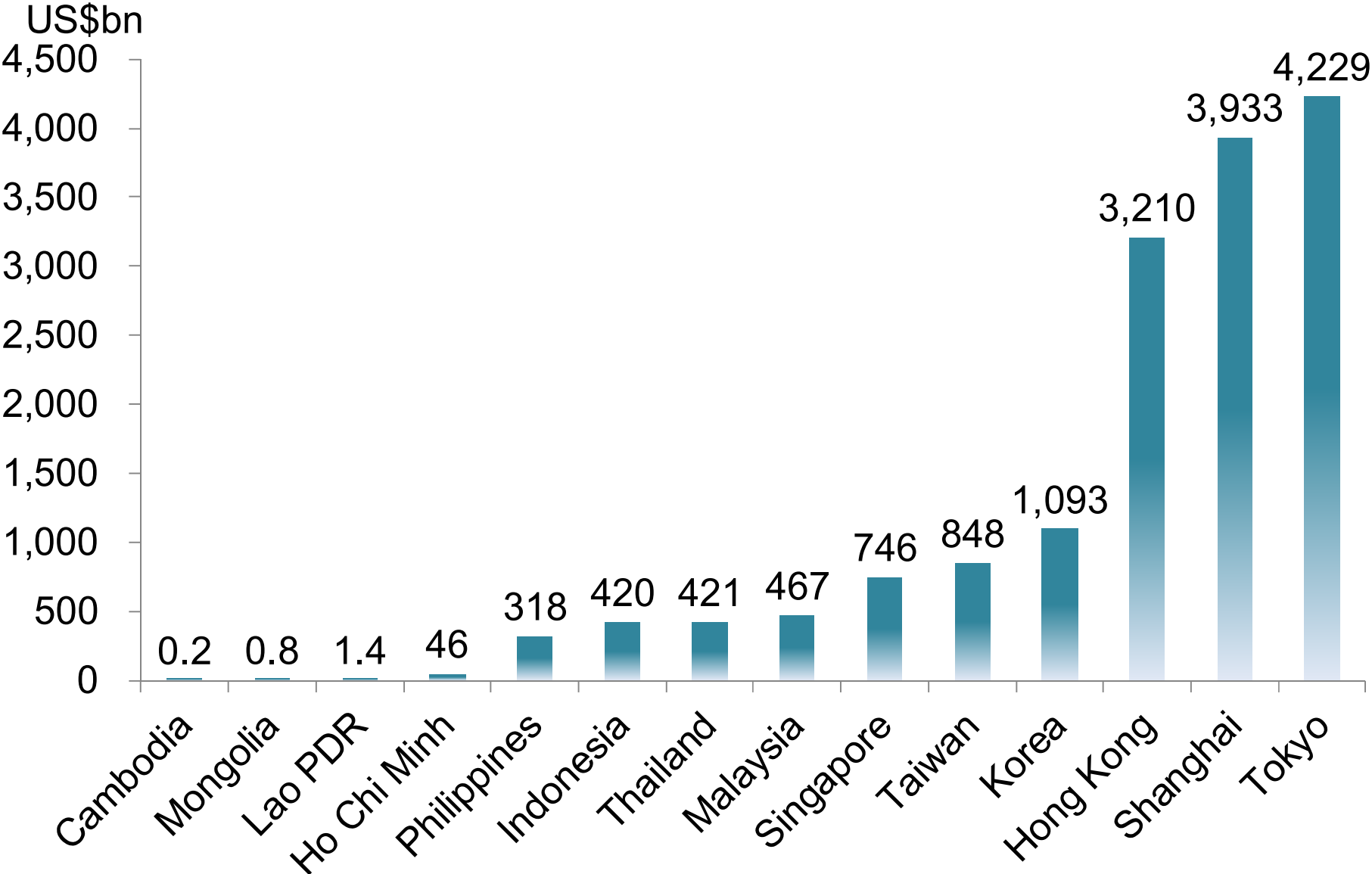
Source: Daiwa Institute of Research

# 1-b. Number of listed companies, end-Dec04 and end-Dec14



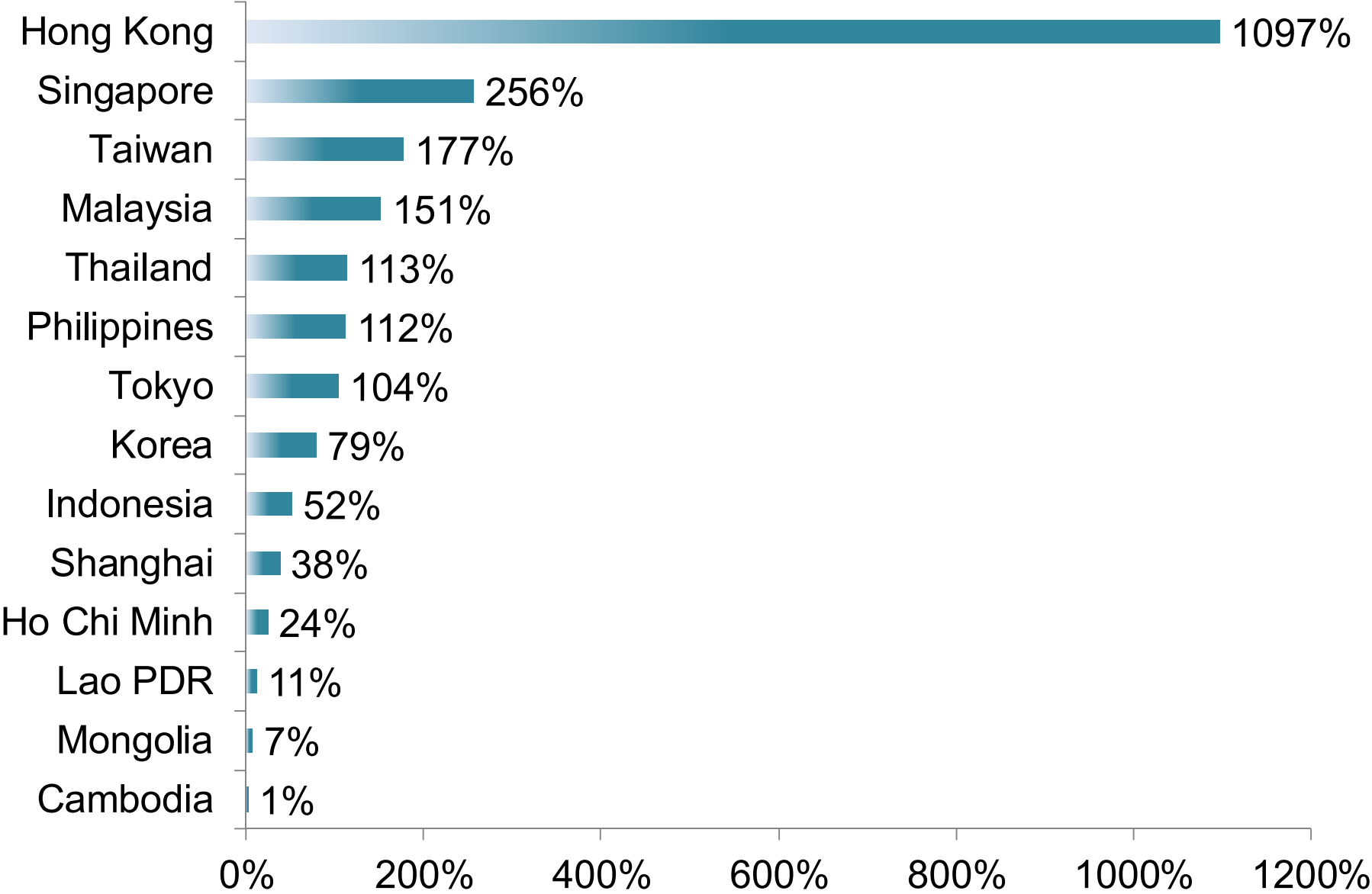
Source: various stock exchanges

# 1-c. Market capitalization, end-Dec14



Source: various stock Exchanges

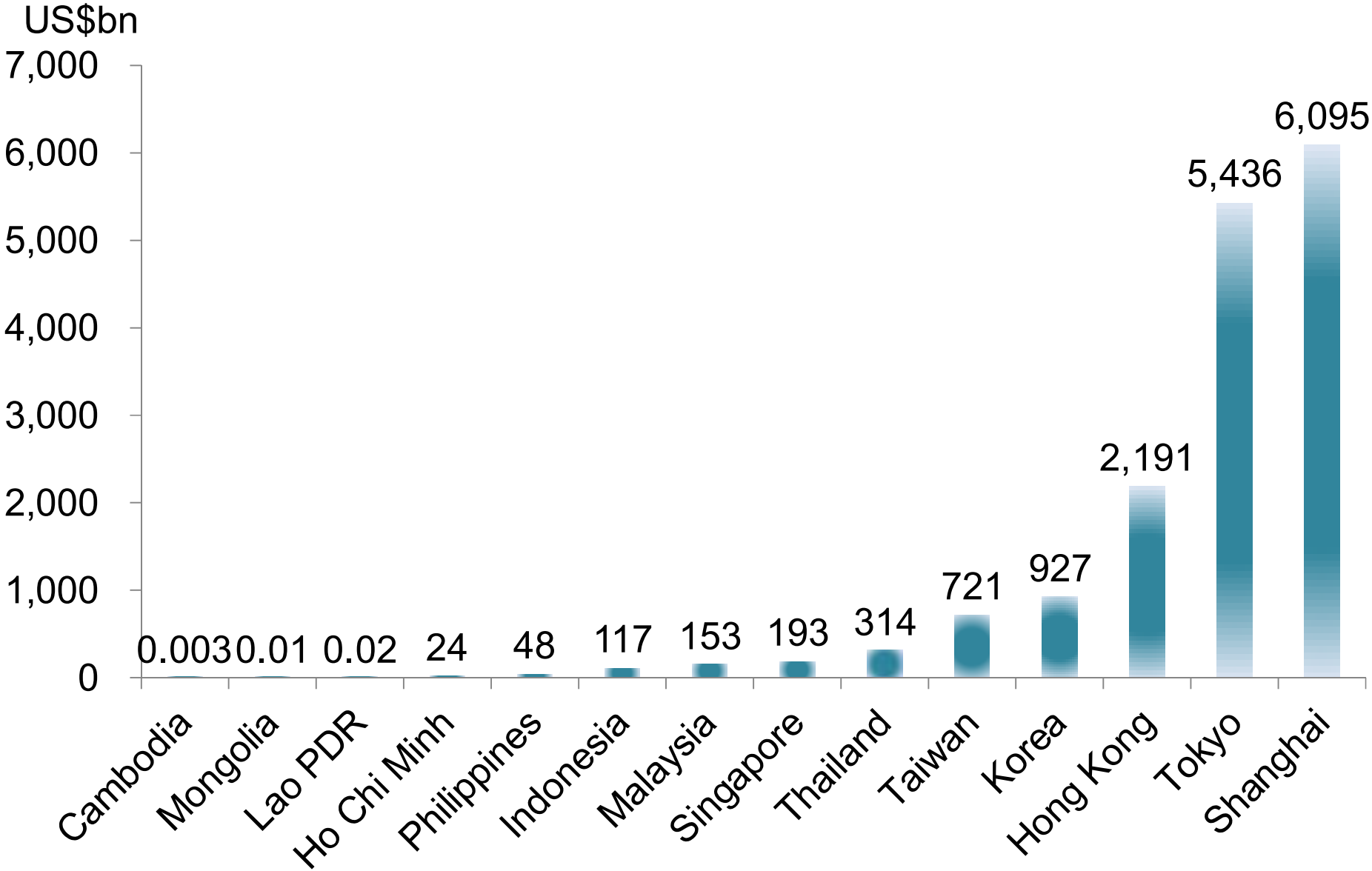
# 1-d. Market capitalization to GDP, 2014



Source: various stock exchanges

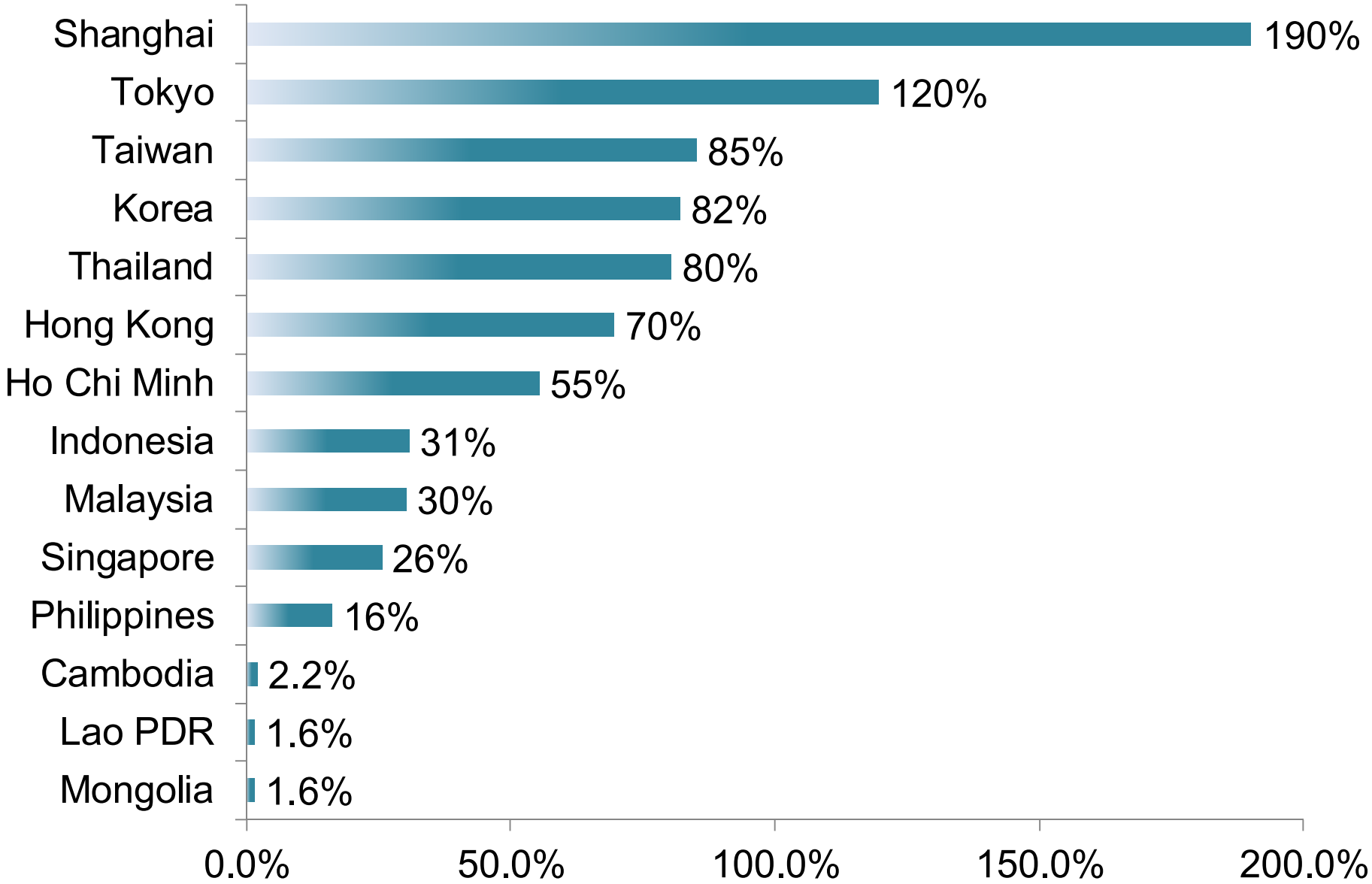


# 1-e. Annual trading value, 2014



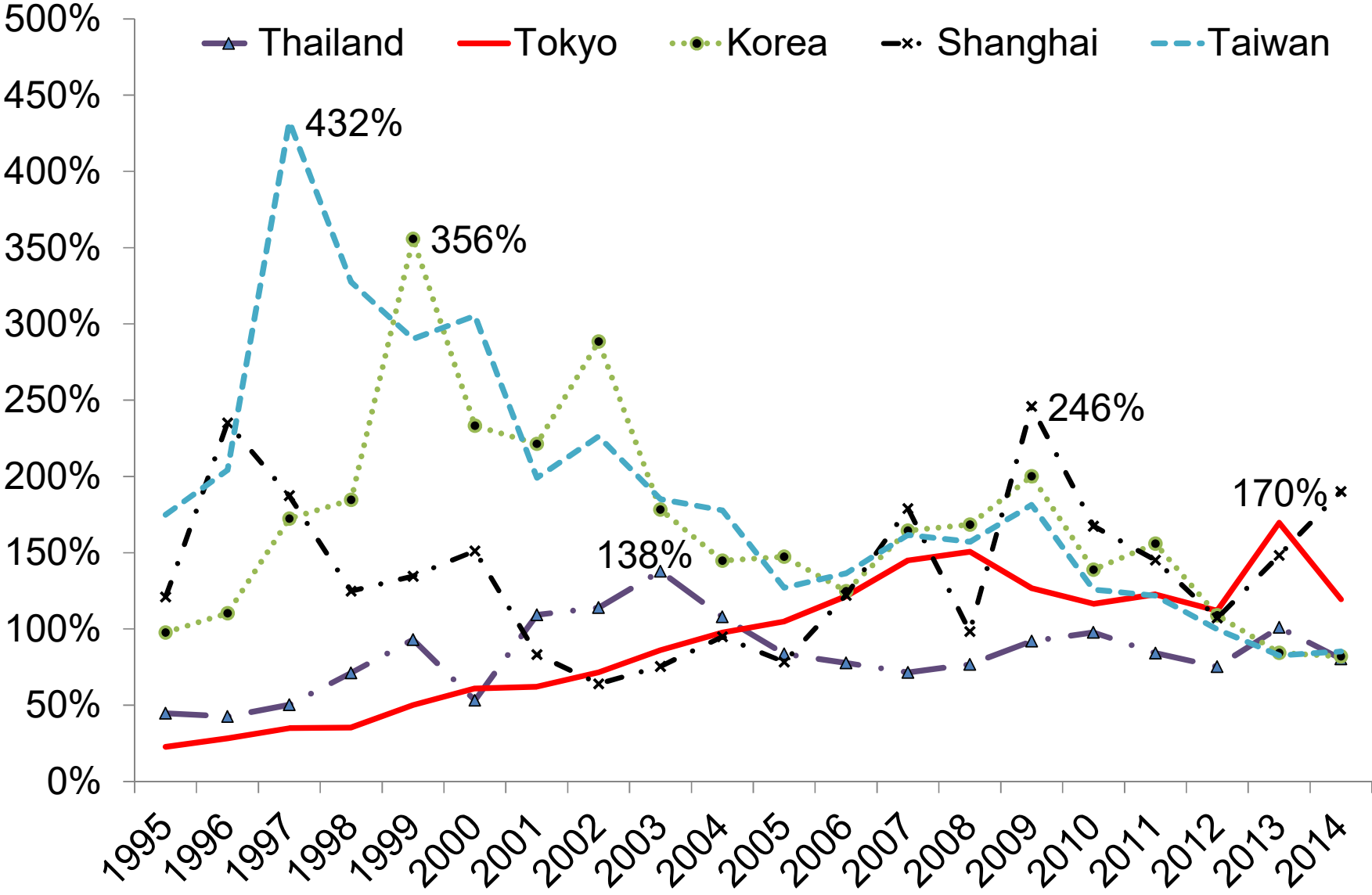
Source: various stock exchanges

# 1-f. Turnover ratios (trading value / market capitalization), 2014



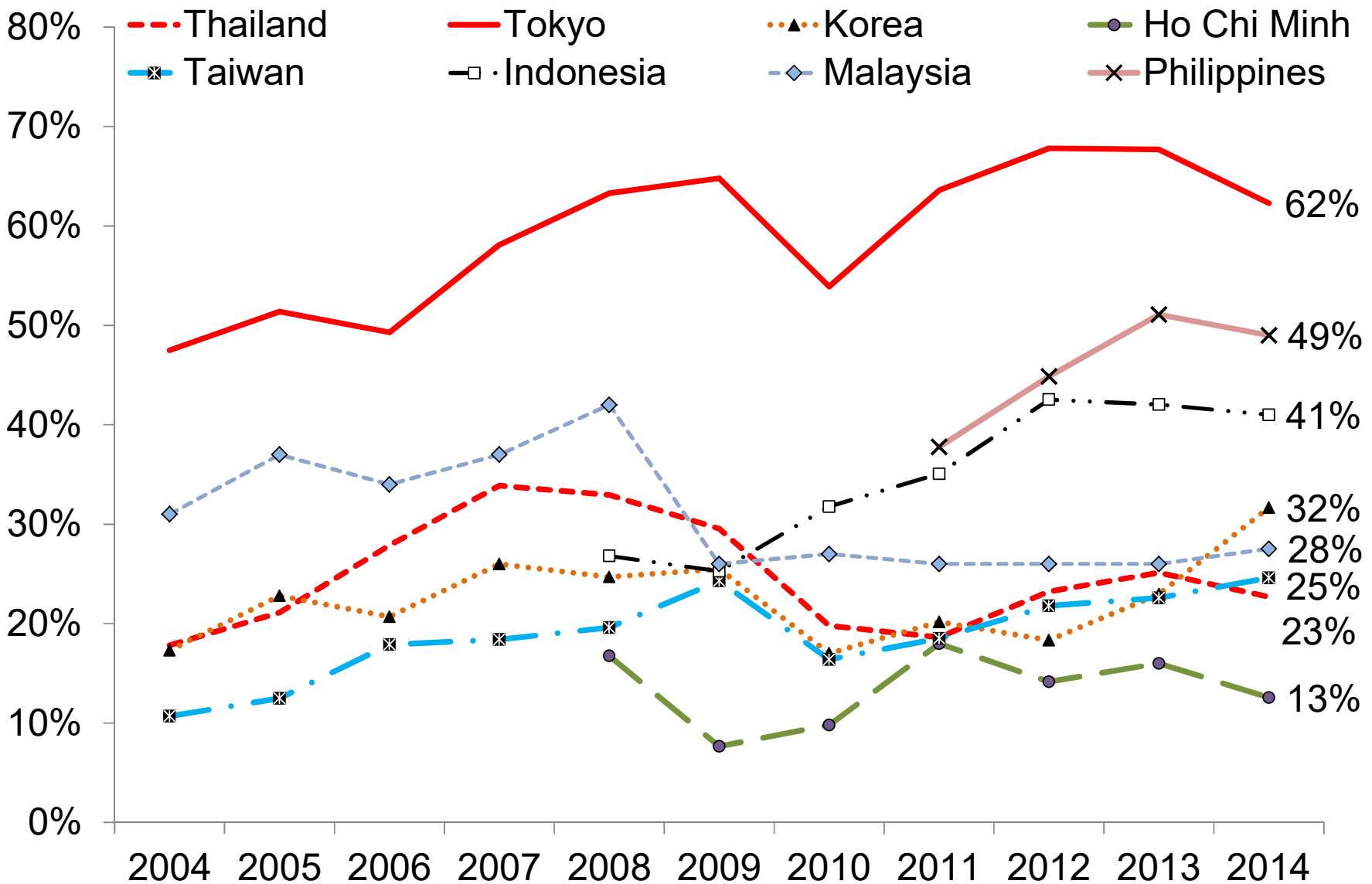
Source: various stock Exchanges

# 1-g. Historical turnover ratios (trading value / market capitalization)



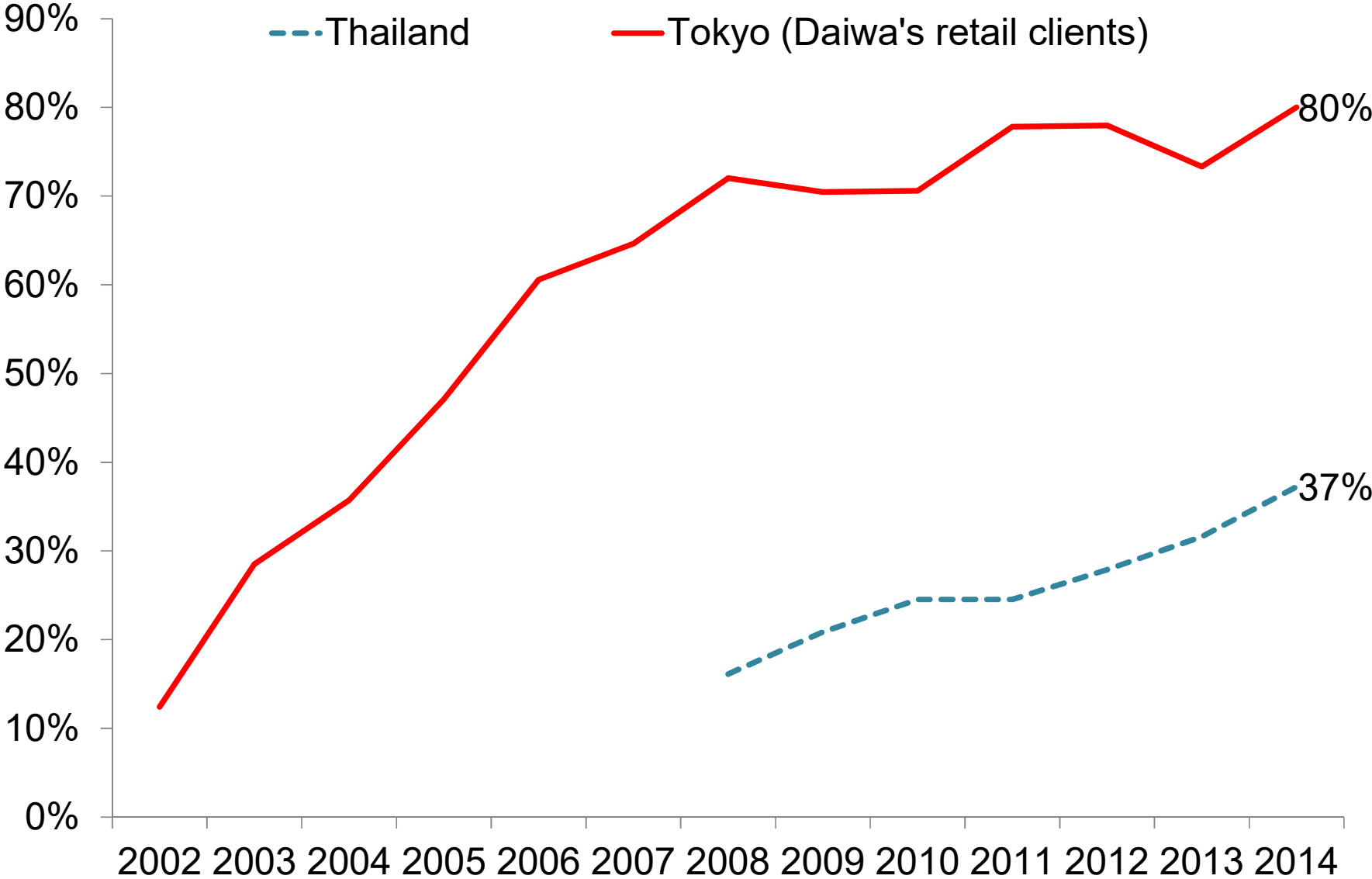
Source: Stock Exchange of Thailand, Japan Exchange Group, Korea Exchange, Shanghai Stock Exchange, Taiwan Stock Exchange

# 1-h. Shares for foreign investors in trading value



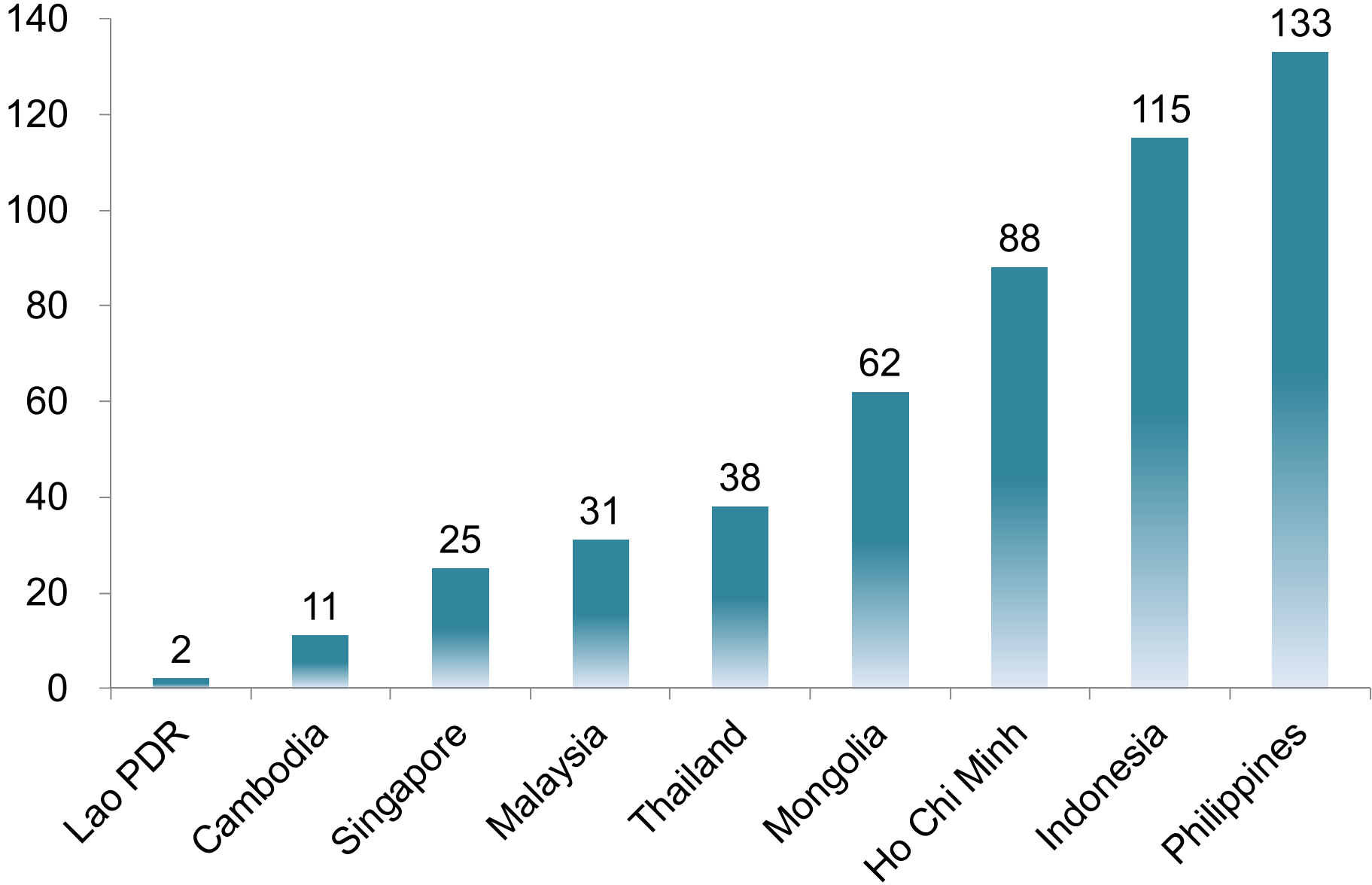
Source: Indonesia Exchange, Bursa Malaysia, Philippine Stock Exchange, Stock Exchange of Thailand, Japan Exchange Group, Korea Exchange, Hochiminh Stock Exchange, Taiwan Stock Exchange

# 1-i. Shares of online trading



Source: Stock Exchange of Thailand, Daiwa Securities Group

# 1-j. Number of member securities companies, end-Dec14



Source: various stock exchanges

## 2-a. Main features of selected stock exchanges in Asia

---

### Japan

- 1) There are multiple number of stock exchanges. Tokyo Stock Exchange has a market share of 90% or over.
- 2) Foreign investors account for 60% or so.
- 3) Share prices are highly influenced by the US market.

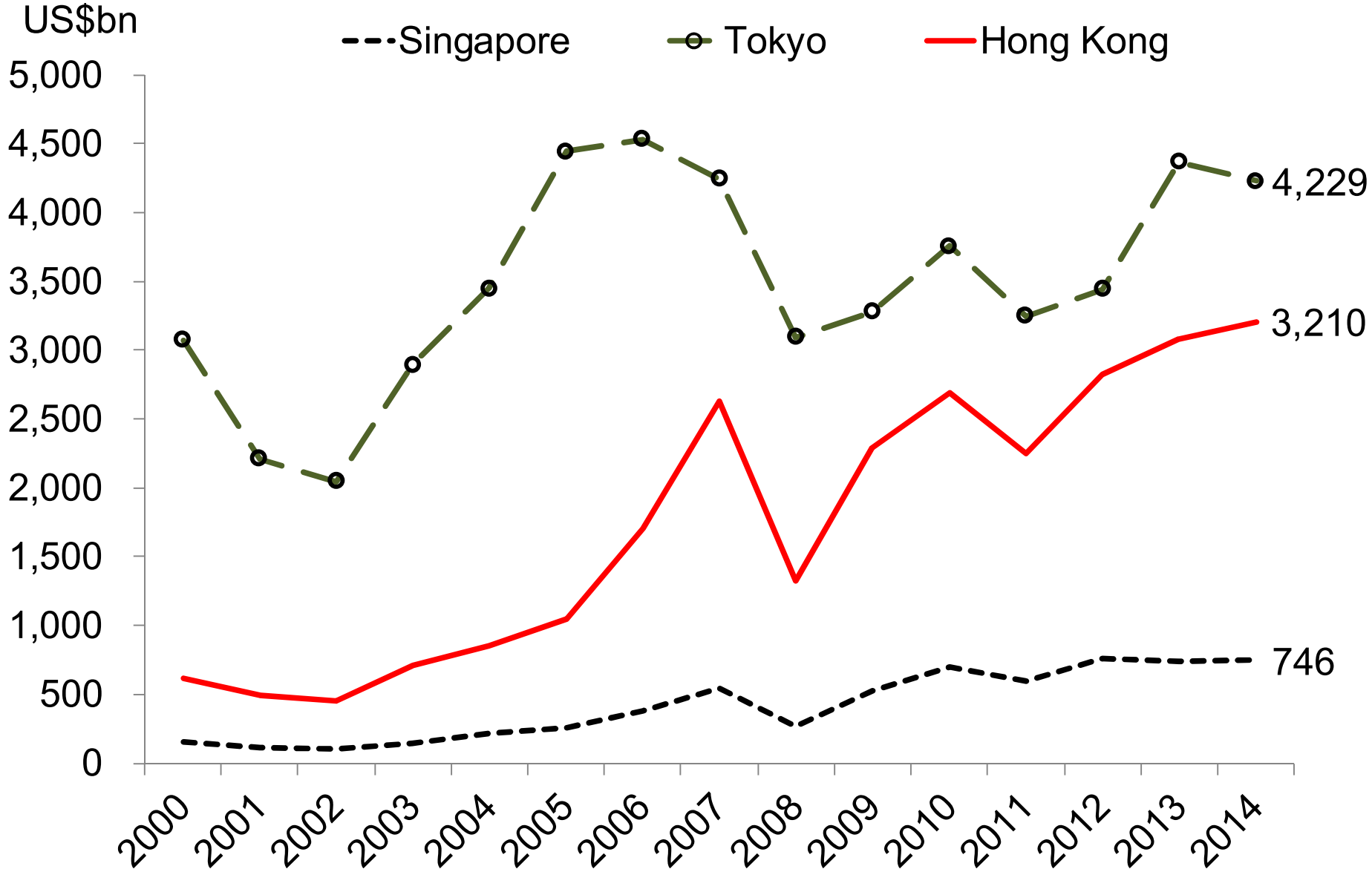
### Hong Kong

- 1) Many of large-cap Hongkong-origin stocks are property and service companies.
- 2) China-related stocks have been the biggest driving force.
- 3) Foreign companies' IPO activities are relatively popular.

### Taiwan

- 1) Highly concentrated in the electronics sector.
- 2) Retail investors are very active.
- 3) Share bonus scheme has helped the market to develop.

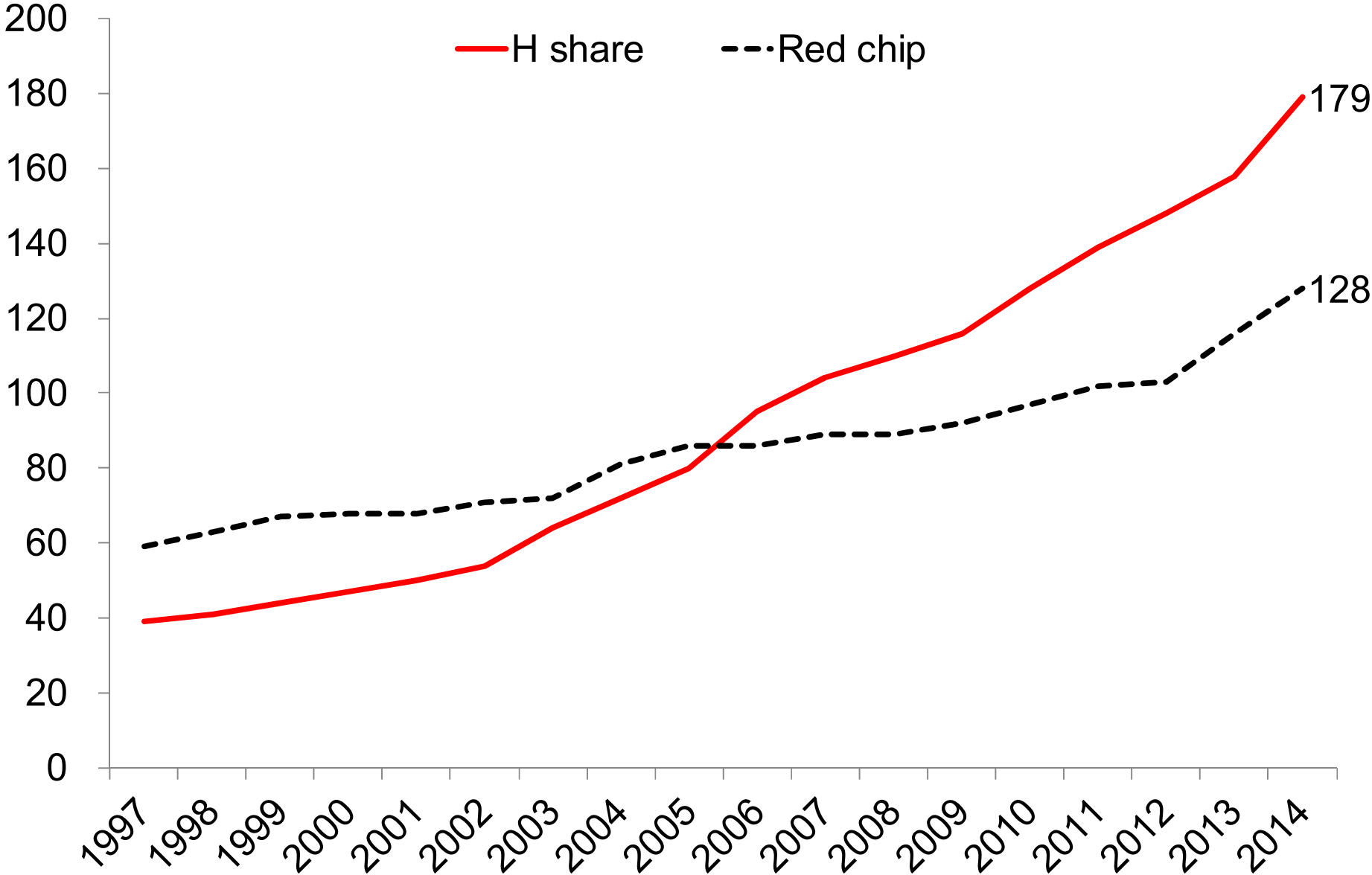
## 2-b. Hong Kong: Historical market capitalization



Source: Singapore Exchange, Tokyo Stock Exchange, Hong Kong Exchange and Clearing

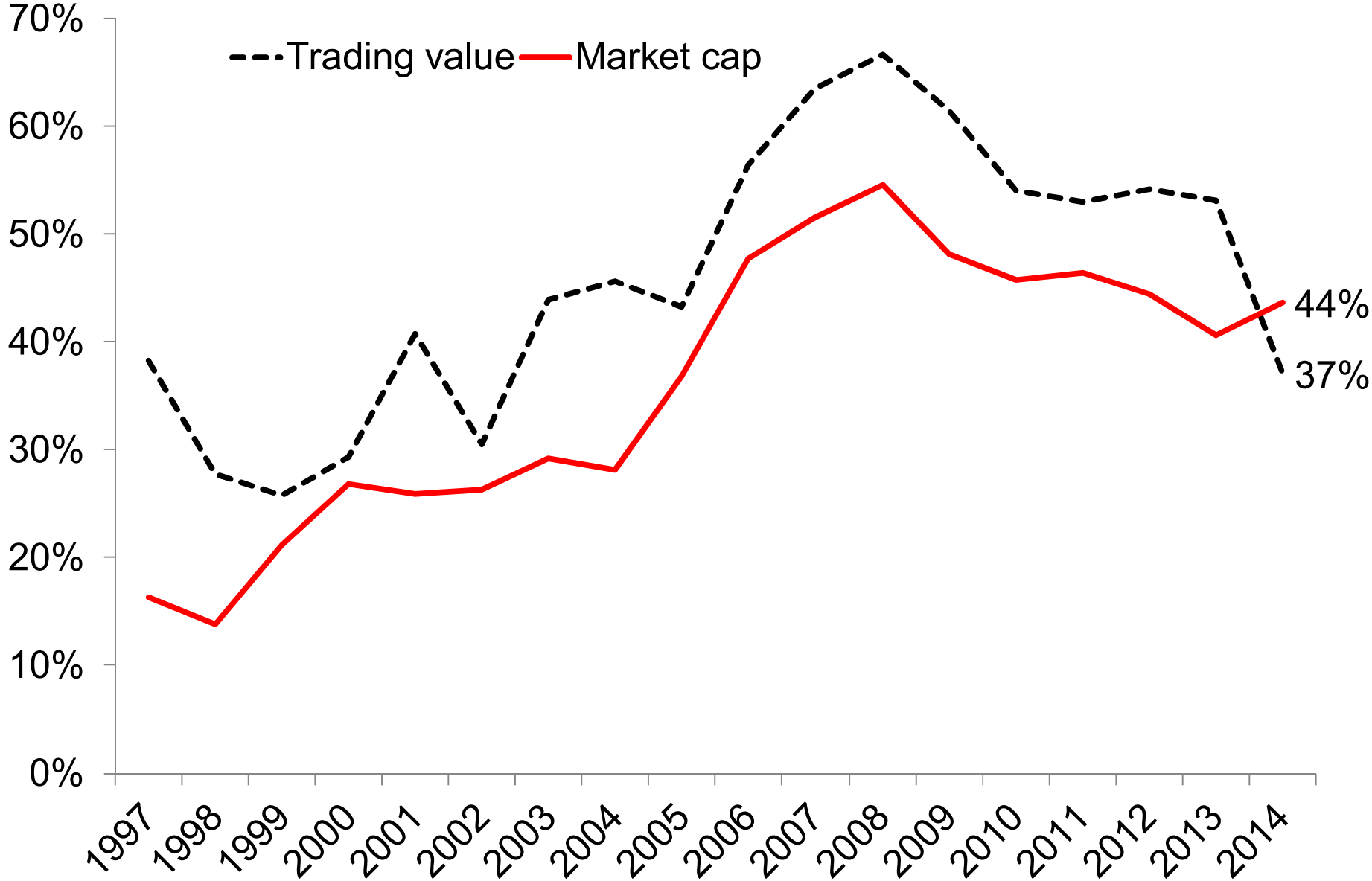


## 2-c. Hong Kong: No of H shares and red chips



Source: Hong Kong Exchange and Clearing

## 2-d. Hong Kong: Share of H shares and red chips in trading value and market cap



Source: Hong Kong Exchange and Clearing

## 2-e. Hong Kong: Listed companies place incorporated, end-Dec13

| Place of incorporation | No of listed companies | Market capitalization |               | Trading value |               |
|------------------------|------------------------|-----------------------|---------------|---------------|---------------|
|                        |                        | HK\$bn                | Share         | HK\$bn        | Share         |
| Cayman Islands         | 599                    | 5,755                 | 24.1%         | 2,564         | 23.0%         |
| Bermuda                | 461                    | 2,210                 | 9.2%          | 1,007         | 9.0%          |
| Hong Kong              | 203                    | 8,703                 | 36.4%         | 2,928         | 26.3%         |
| China                  | 158                    | 4,907                 | 20.5%         | 4,218         | 37.9%         |
| Singapore              | 8                      | 12                    | 0.1%          | 1             | 0.0%          |
| Canada                 | 4                      | 2,005                 | 8.4%          | 317           | 2.8%          |
| UK                     | 4                      | 13                    | 0.1%          | 9             | 0.1%          |
| British Virgin Islands | 4                      | 10                    | 0.0%          | 8             | 0.1%          |
| Jersey                 | 3                      | 40                    | 0.2%          | 5             | 0.0%          |
| Japan                  | 2                      | 58                    | 0.2%          | 39            | 0.4%          |
| Luxembourg             | 2                      | 20                    | 0.1%          | 6             | 0.1%          |
| Brazil                 | 1                      | -                     | -             | 0.001         | 0.0%          |
| Italy                  | 1                      | 177                   | 0.7%          | 38            | 0.3%          |
| US                     | 1                      | -                     | -             | 0.03          | 0.0%          |
| <b>Total</b>           | <b>1,451</b>           | <b>23,909</b>         | <b>100.0%</b> | <b>11,143</b> | <b>100.0%</b> |

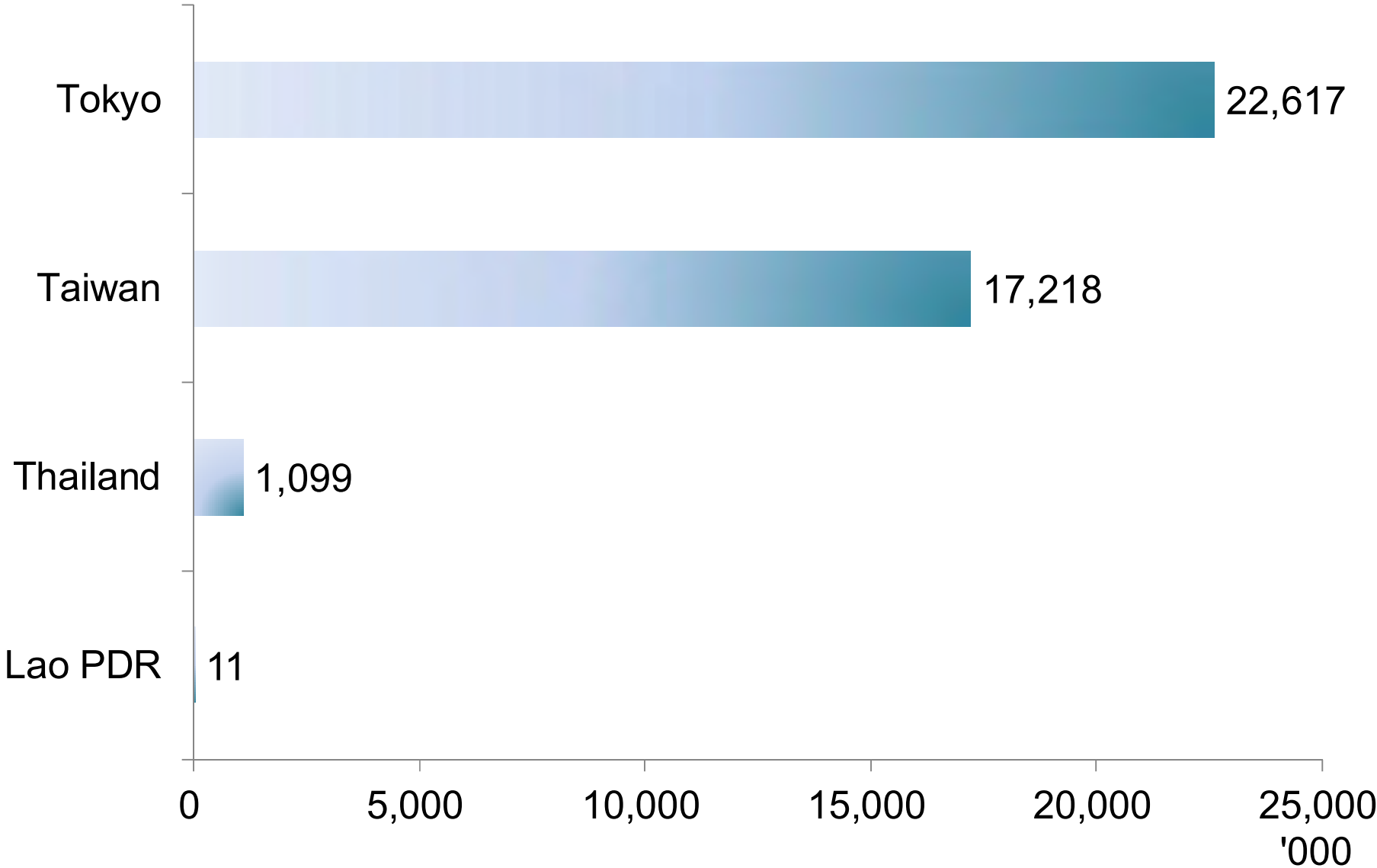
## 2-f. Hong Kong: Top 20 listed companies by market cap, end-Dec14

|    | Code | Company name                                 | Country of origin | Market cap | Share |
|----|------|--|-------------------|------------|-------|
|    |      |  |                   | HK\$bn     |       |
| 1  | 941  | China Mobile Ltd.                            | Red chip          | 1,846      | 7.4%  |
| 2  | 939  | China Construction Bank Corporation          | H share           | 1,531      | 6.2%  |
| 3  | 5    | HSBC Holdings plc                            | England           | 1,422      | 5.7%  |
| 4  | 700  | Tencent Holdings Ltd.                        | China             | 1,054      | 4.2%  |
| 5  | 1299 | AIA Group Ltd.                               | ex-AIG            | 520        | 2.1%  |
| 6  | 1398 | Industrial and Commercial Bank of China Ltd. | H share           | 491        | 2.0%  |
| 7  | 805  | Glencore plc *                               | Swiss             | 482        | -     |
| 8  | 883  | CNOOC Ltd.                                   | Red chip          | 466        | 1.9%  |
| 9  | 2378 | Prudential plc *                             | England           | 466        | -     |
| 10 | 13   | Hutchison Whampoa Ltd.                       | HK                | 381        | 1.5%  |
| 11 | 3988 | Bank of China Ltd.                           | H share           | 365        | 1.5%  |
| 12 | 16   | Sun Hung Kai Properties Ltd.                 | HK                | 334        | 1.3%  |
| 13 | 267  | CITIC Ltd.                                   | Red chip          | 329        | 1.3%  |
| 14 | 1928 | Sands China Ltd.                             | US                | 308        | 1.2%  |
| 15 | 1    | Cheung Kong (Holdings) Ltd.                  | HK                | 302        | 1.2%  |
| 16 | 2318 | Ping An Insurance (Group) Co. of China Ltd.  | H share           | 295        | 1.2%  |
| 17 | 2888 | Standard Chartered PLC                       | England           | 287        | 1.2%  |
| 18 | 945  | Manulife Financial Corporation *             | US                | 279        | -     |
| 19 | 2388 | BOC Hong Kong (Holdings) Ltd.                | Red chip          | 274        | 1.1%  |
| 20 | 3328 | Bank of Communications Co., Ltd.             | H share           | 253        | 1.0%  |

## 2-g. Hong Kong: Selected foreign listed companies

| Place incorporated | Code | Company name                            | Date of listing |
|--------------------|------|---|-----------------|
| England            | 5    | HSBC                                    | n.a.            |
| England            | 847  | Kazakhmys                               | Jun-11          |
| England            | 2378 | Prudential                              | May-10          |
| England            | 2888 | Standard Chartered                      | Oct-02          |
| Canada             | 2099 | China Gold International Resources Corp | Dec-10          |
| Canada             | 1878 | SouthGobi Resources                     | Jan-10          |
| Canada             | 2012 | Sunshine Oilsands                       | Mar-12          |
| Japan              | 6889 | Dynam                                   | Aug-12          |
| Japan              | 6288 | Fast Retailing                          | Mar-14          |
| Luxembourg         | 973  | L'Occitane                              | May-10          |
| Luxembourg         | 1910 | Samsonite International                 | Jun-11          |
| Italy              | 1913 | PRADA                                   | Jun-11          |
| Brazil             | 6210 | Vale                                    | Dec-10          |
| US                 | 6388 | Coach                                   | Dec-11          |

## 2-h. Taiwan: Number of securities accounts, end-Dec14



Source: Taiwan Stock Exchange, Korea Exchange, Japan Exchange Group, Lao Securities Exchange

## 2-i. Taiwan: Some stories about Taiwanese general public

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- 1) If you take a taxi and tells him you work in a securities company, the taxi driver is highly likely to ask you, “Foreign investors’ buying momentum is strong this week, which stock do you recommend ? ”
- 2) Quite a few number of Taiwanese employees at your office are perhaps monitoring their PC screens every morning. They are looking for a chance to place buy/sell orders.
- 3) Taiwanese individuals are also active in investing in unlisted companies. One may say, “One of my friend’s brother used to be an engineer at the largest semiconductor company in Taiwan, and he started up his own company last year. His company’s technology level is leading-edge and a big US smartphone manufacturer has just qualified his company’s products. His company wants to increase its share capital, don’t you want to buy some shares ?”
- 4) If you work at a Taiwanese listed company and you contribute significantly, you may be entitled to receive your company’s shares as bonus stock, which is sometimes much larger than your cash salary.

## 2-j. Taiwan: Top 20 listed companies by market cap, end-Dec14

|    | Code | Company name              | Sector                      | Market cap<br>US\$bn |
|----|------|---------------------------|-----------------------------|----------------------|
| 1  | 2330 | TSMC                      | Electronics - semiconductor | 115                  |
| 2  | 2317 | Hon Hai                   | Electronics - EMS           | 41                   |
| 3  | 2412 | Chunghwa Telecom          | Telecommunications          | 23                   |
| 4  | 2454 | MediaTek                  | Electronics - semiconductor | 23                   |
| 5  | 6505 | Formosa Petrochemical     | Chemical                    | 21                   |
| 6  | 2882 | Cathay Holdings           | Financial                   | 19                   |
| 7  | 1303 | Nanya Plastic             | Chemical                    | 16                   |
| 8  | 2881 | Fubon Financial           | Financial                   | 16                   |
| 9  | 1301 | Formosa Plastic           | Chemical                    | 15                   |
| 10 | 2308 | Delta Electronics         | Electronics – components    | 14                   |
| 11 | 2002 | China Steel               | Steel                       | 13                   |
| 12 | 1326 | Formosa Chemicals & Fiber | Chemical                    | 12                   |
| 13 | 3045 | Taiwan Mobile             | Telecommunications          | 11                   |
| 14 | 3008 | Largan Precision          | Electronics – lens          | 10                   |
| 15 | 2891 | Chinatrust Group          | Financial                   | 10                   |
| 16 | 2382 | Quanta Computer           | Electronics – PC            | 10                   |
| 17 | 2886 | Mega Financial Holding    | Financial                   | 10                   |
| 18 | 2311 | ASE                       | Electronics – semiconductor | 9                    |
| 19 | 1216 | President Enterprise      | Food & Beverage             | 9                    |
| 20 | 2207 | Hotai Motor               | Automobile distributor      | 8                    |

Source: Taiwan Stock Exchange



# **Project for Capacity Building of Capital Market in Mongolia: Investors' Roles**

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29 April 2015

Daiwa Institute of Research  
Japan Economic Research Institute

## 1-a. Investors in Capital Markets

- A company may have different purposes for raising funds by different stages: establishment, expansion, stability, stagnation or reconstruction. Investor types may differ between stages.
- Different types of investors have different investment policies and strategies.

### Establishment: growth stage

- Companies often offer new stocks privately to their founders or their relatives to obtain initial equity capitals or working capitals at the initial stage.
- It is reasonable for new companies to raise funds in capital markets because they do not have enough credit or collaterals required for bank borrowings.

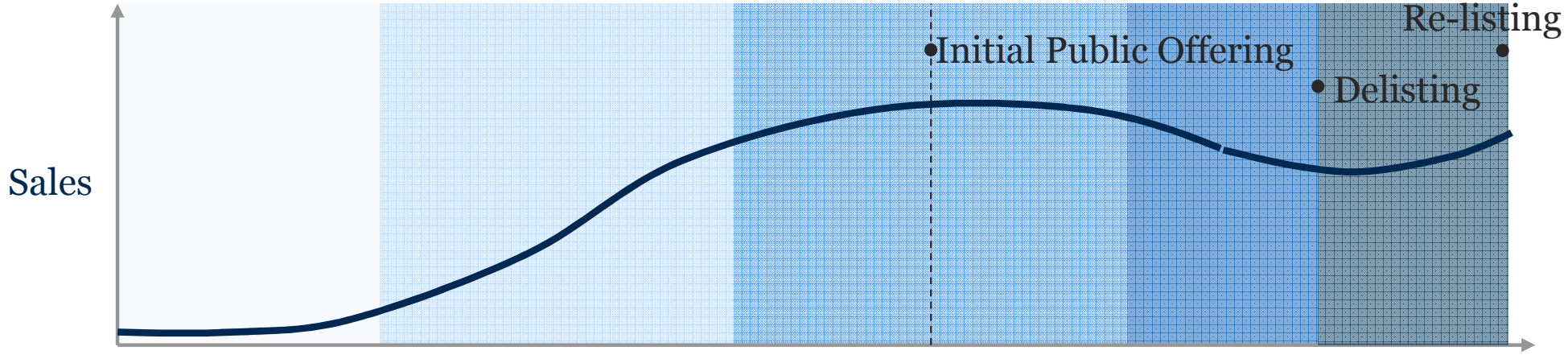
### Enlargement: stability stage

- Number of investors tend to increase after Initial Public Offering (IPO). Investors expect to receive capital gains and dividends.
- By this stage, both individual and institutional investors invest in shares. Individuals trade shares to increase their own assets whereas institutional investors invest their clients' assets and the size of investment is usually much larger than that of the individual.

### Stagnation: revitalization stage

- When the business performance falls steep or in some cases face bankruptcies, “revitalizing funds” may provide necessary finance for restructuring the business in exchange of stocks. Once the successful restructuring take place, revitalizing funds could expect capital gains by selling their re-listed shares or selling the business segment to another company.

# 1-b. Company's development stages and investors

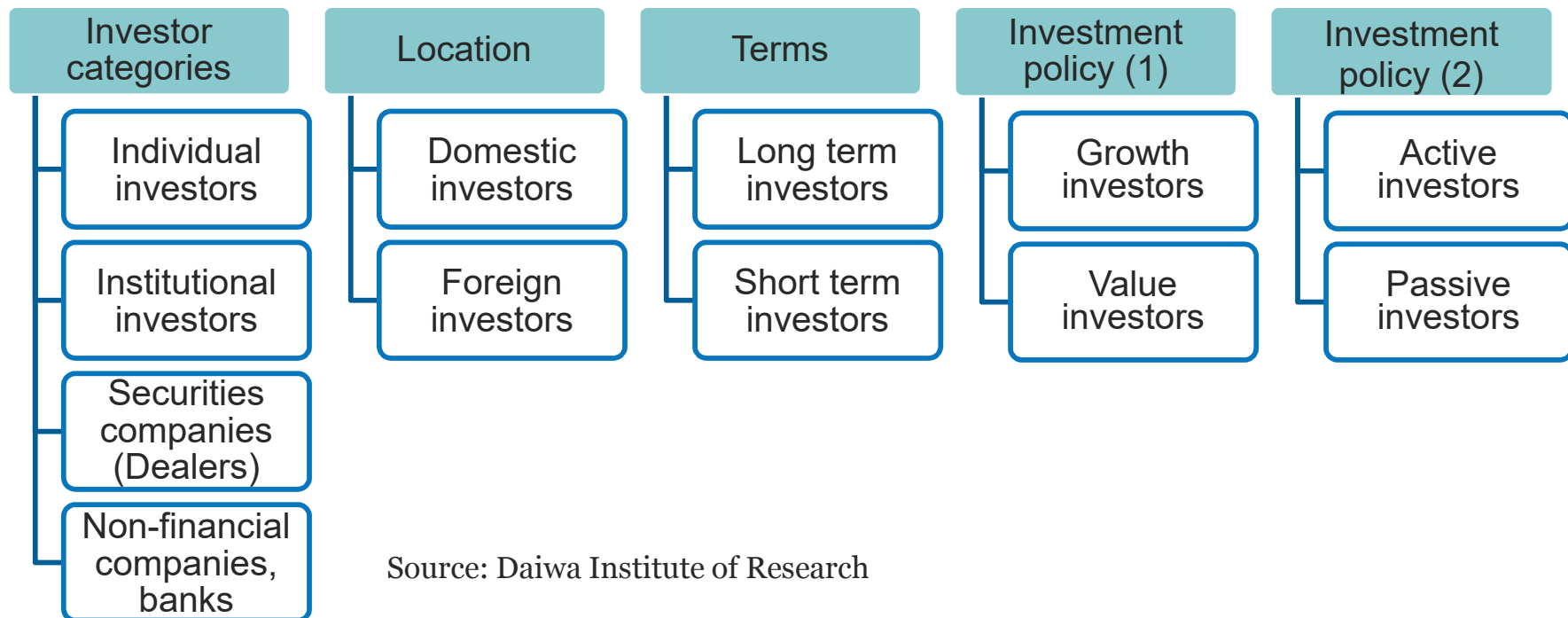


| Stages                  | Establishment   | Growth                              | Enlargement, stability                            | Stagnation                                | Revitalization                     |
|-------------------------|---|-------------------------------------|---|---|------------------------------------|
| Business situation      | Business planning<br>structuring                      | Product development<br>Sales growth | Sales growth<br>Profit increase                   | Growth slowdown<br>Income/profit decrease | New business<br>Profitability rise |
| Demand for fund-raising | Company establishment,<br>foundation                  | R&D<br>Marketing                    | Enlarging production<br>capacity & sales networks | Restructuring                             | Refinancing<br>M&A                 |
| Supplier of funds       | Founders, relatives, friends<br>Venture capital funds | Private equity funds                | Investors<br>(Individuals, institutional)         | Bank borrowings                           | Corporate reconstruction funds     |

Source: Daiwa Principal Investment, Daiwa Institute of Research

## 1-c. Types of Investors

- Investors are mainly categorized to individual and institutional. Securities companies trade stocks on their own account (dealing). Non-financial companies and banks sometimes hold other companies stocks as a means of establishing business relationships.
- Recently, proportions of trade values of foreign investors are rising in Asian countries. Hence, their investment activities depend strongly to the changes in global investment climates.
- Some investors hold stocks for long term, some prefer short term investment based highly on daily price fluctuations.
- “Growth investors” focus more on the future business performances, while “value investors” prefer stocks with low-valued prices. “Active investors” target higher performance than the market indices, while “passive investors” aim the same performance with the market indices.

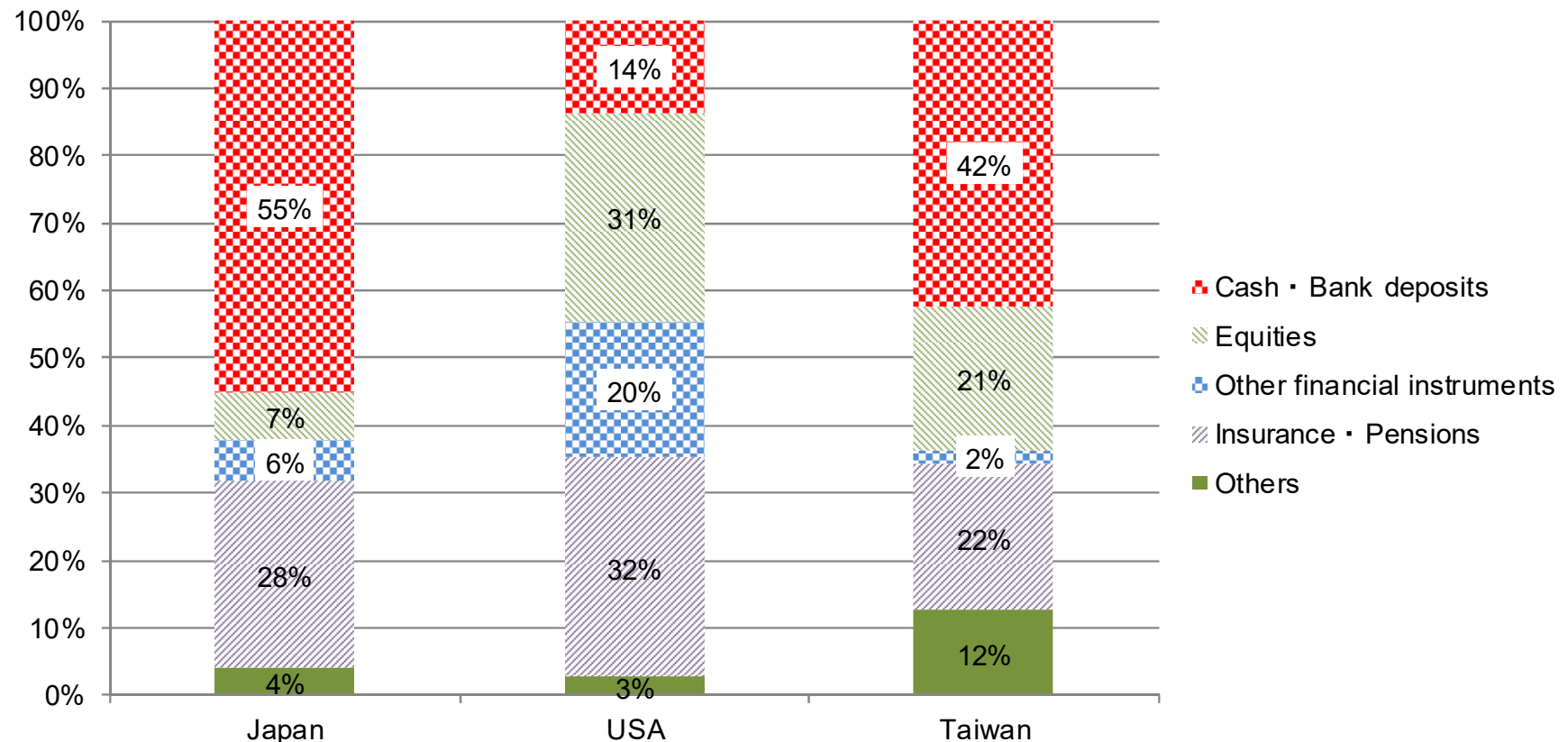


Source: Daiwa Institute of Research

## 2-a. Individual investors

- Individual investors invest their own assets thus investment size tend to be smaller.
- Recently, proportion of online trading is increasing. There are investors called “day-traders” who solely depend on online trading to make their livings.
- Japanese people are conservative. 55% of their asset consist of risk-free cash and deposits. Stocks only account for 7%. People in the USA or Taiwan are more positive for taking risks.

**Proportion of households' financial assets in Japan, USA and Taiwan, 2012**



Note: USA & Taiwan household data includes NGOs

Source: Bank of Japan, Federal Reserve Board, Central Bank of the Republic of China

## 2-b. Institutional investors (1) Categories

- “Institutional investors” are corporates who invest funds on behalf of their clients or on their own surplus money. Well known ones are insurance companies, investment trusts, pension funds, sovereign wealth funds, investment advisors.
- Their investment size are large. They usually hold various types of stocks. Some of them invest in nearly all stocks listed on the exchange, some also invest in foreign stocks and fixed income securities.
- They invest according to their own investment policies; short term / long term, growth investing / value investing, passive investing / active investing.

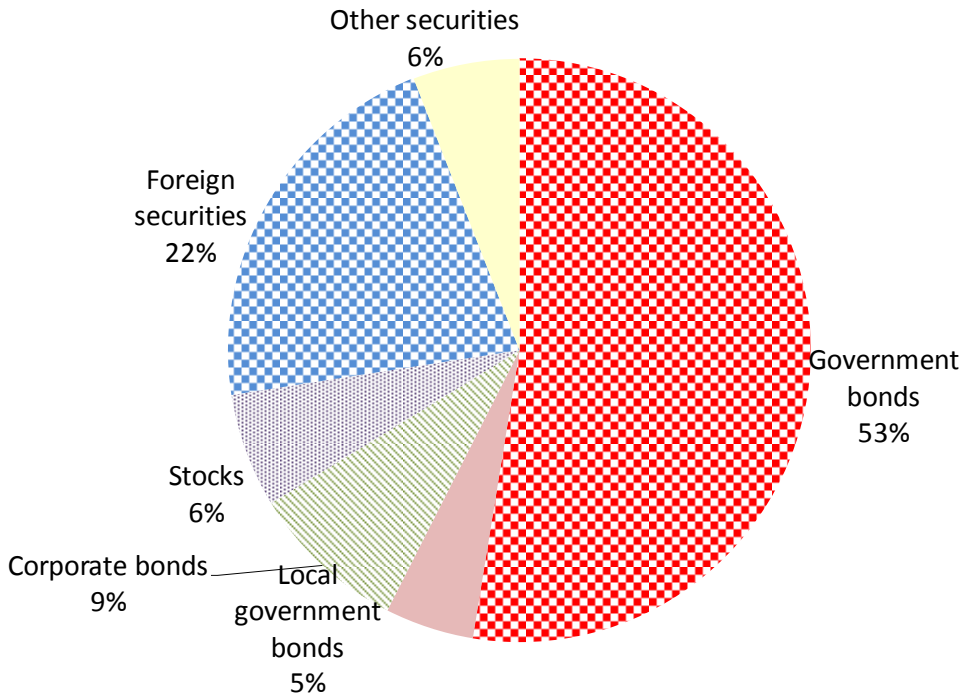
| Major categories                        | Funds   | Investment policy                              |
|---|---|--|
| Life insurance                          | Insurers' money                                   | Mid- to long-term                              |
| General insurance                       | Insurers' money                                   | Mid- to long-term                              |
| Mutual fund/investment trust/unit trust | Investors' invested money                         | Policies are defined by each financial product |
| Pension fund                            | Pensioners' money                                 | Mid- to long-term                              |
| Sovereign wealth fund                   | National financial assets (foreign reserves etc.) | Differs by funds                               |
| Investment advisor                      | Clients' assets                                   | Short-term                                     |
| Hedge fund                              | Institutional and wealthy investors' money        | Short-term                                     |

Source: Daiwa Institute of Research

## 2-b. Institutional investors (2) Life and general insurance companies

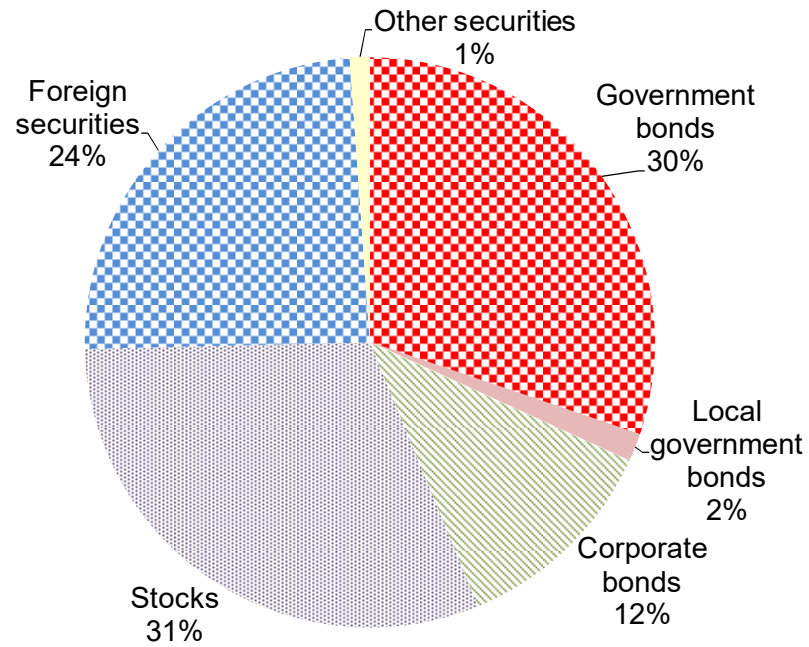
- There are life and general insurance companies.
- A life insurance product is on a super-long term. Therefore, long-term Government bonds (such as 30-year government bonds) take up a larger share in life insurers' portfolios than those of general insurance companies.

**Breakdown of securities portfolio by life insurance companies in Japan, end-March 2014**



Source: The Life Insurance Association of Japan

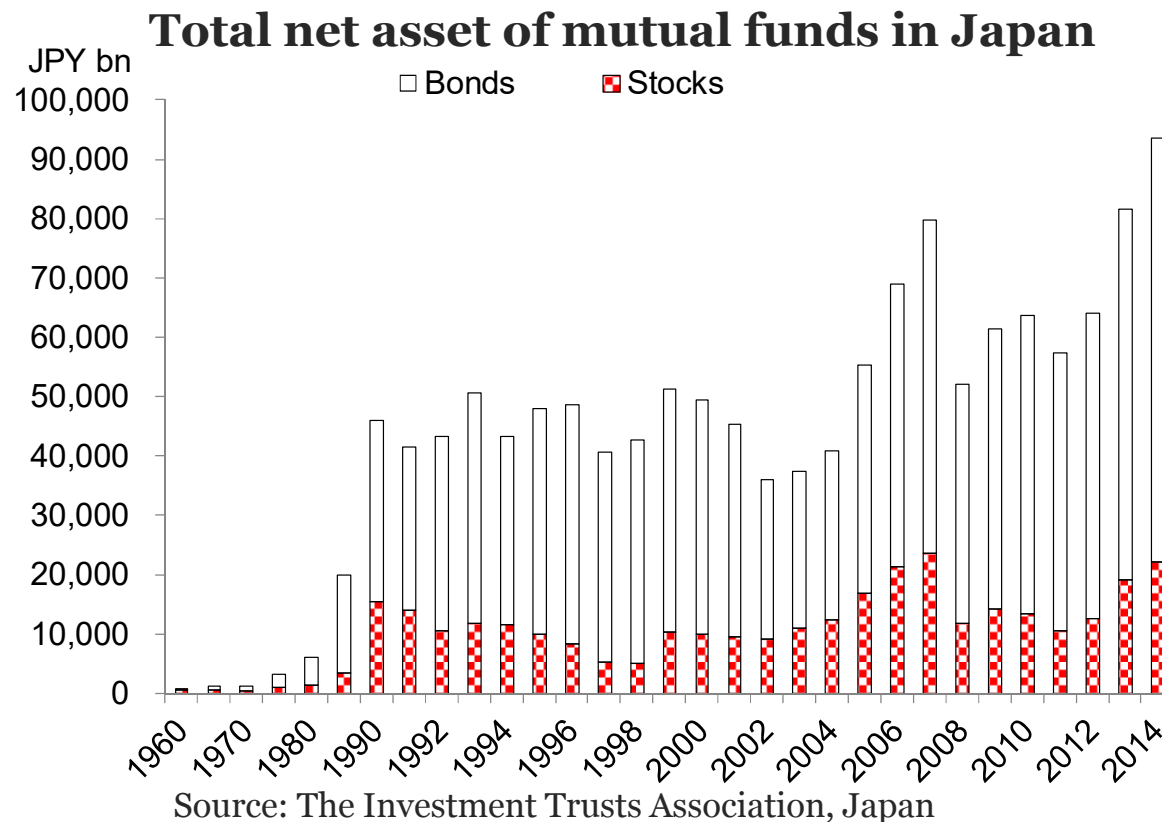
**Breakdown of securities portfolio by general insurance companies in Japan, end-March 2014**



Source: The General Insurance Association of Japan

## 2-b. Institutional investors (3) Mutual funds

- Mutual funds (unit trust/investment trust) accept funds from wide range of customers (mainly individual investors). Fund managers and portfolio managers, known as “professional investors”, invest the fund on behalf of their customers.
- According to their investment performance, dividends are paid to customers each fiscal year and funds are redeemed after a certain period.
- Investment trusts enable individuals to invest in smaller size of different stocks as opposed to buying individual stocks. They could also reduce risks by diverting their investments.

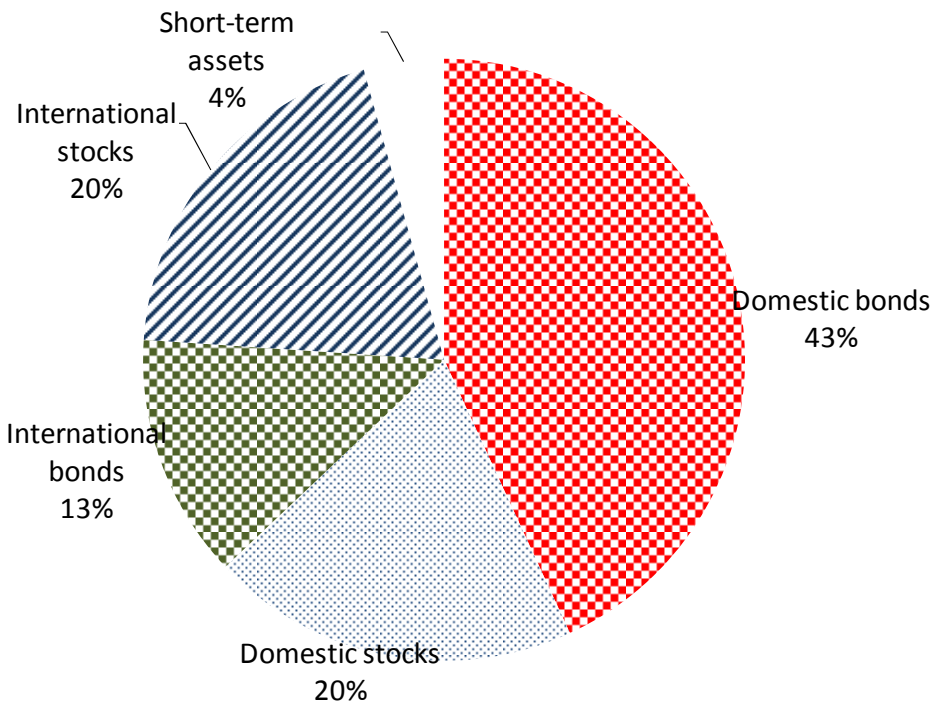




## 2-b. Institutional investors (4) Pension funds

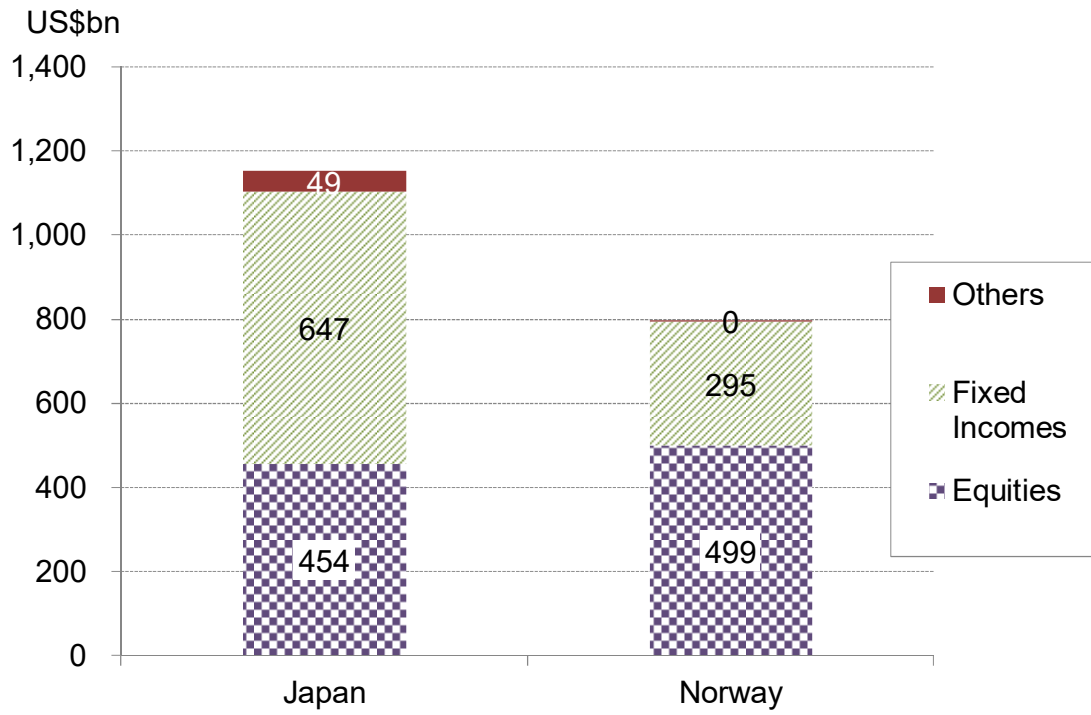
- Government Pension Investment Fund (GPIF) in Japan is the largest institutional investor in the World. More than half of the GPIF's portfolio consists of bonds, which is quite large compared to that of other pension funds.
- While the total assets managed by Norwegian Government Pension Fund Global (GPF) is smaller than GPIF, GPF's equity investment is much larger than GPIF. GPF is considered to be an active investor, while GPIF is regarded as a passive investor.

**Asset proportion of GPIF in Japan (Dec 2014)**



Source: Government Pension Investment Fund

**Comparison of portfolio: Japanese GPIF (Sep 2014) and Norwegian GPF (Dec 2014)**



Source: Government Pension Fund Global

## 2-b. Institutional investors (5) Sovereign wealth funds (SWF)

- Sovereign Wealth Funds (SWF) manage government funds and are recognized as an active investment type of investors. Natural-resource rich countries and countries with large amount of foreign reserves typically have SWFs. Recently, Middle Eastern countries and China have increased their assets under management by their SWF.

### Sovereign Wealth Fund Ranking

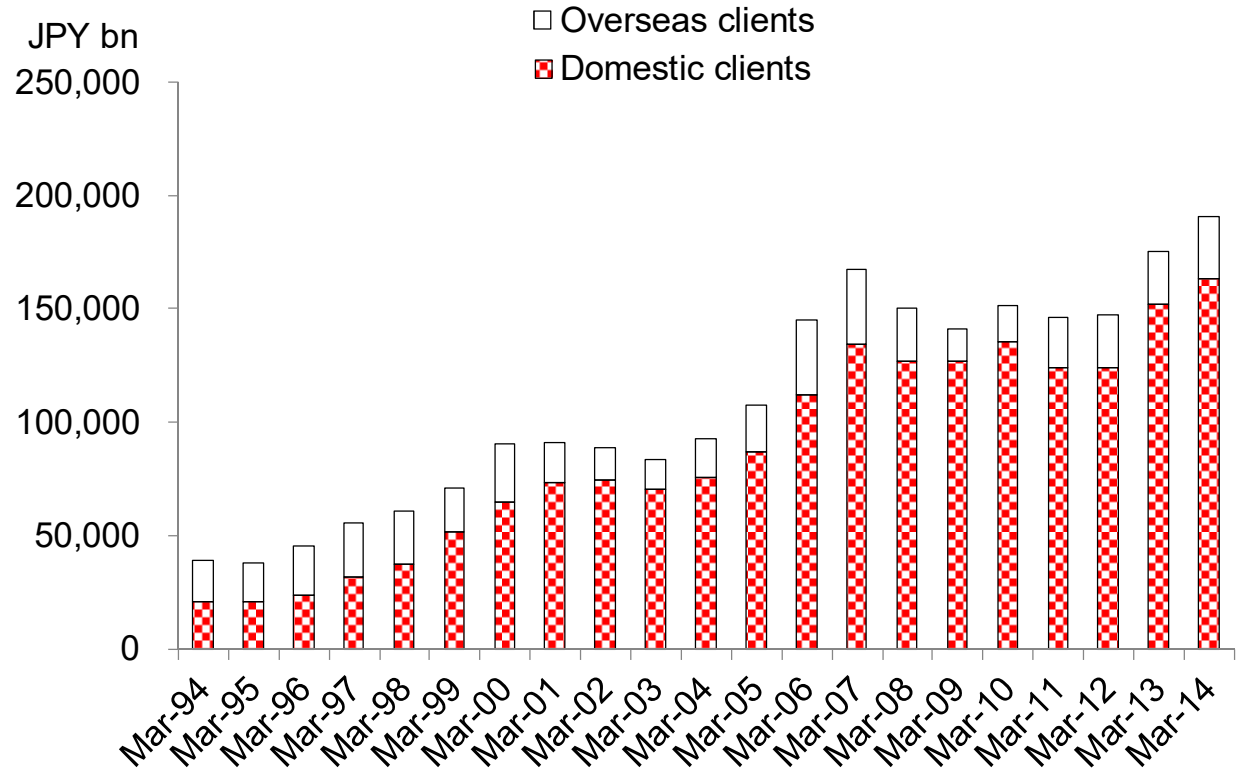
|   | Government        | Assets US\$bn | Inception |
|---|-------------------|---------------|-----------|
| Government Pension Fund – Global                  | Norway            | 863           | 1990      |
| Abu Dhabi Investment Authority                    | UAE - Abu Dhabi   | 773           | 1976      |
| SAMA Foreign Holdings                             | Saudi Arabia      | 757           | n.a.      |
| China Investment Corporation                      | China             | 652           | 2007      |
| SAFE Investment Company                           | China             | 567           | 1997      |
| Kuwait Investment Authority                       | Kuwait            | 548           | 1953      |
| Hong Kong Monetary Authority Investment Portfolio | China – Hong Kong | 400           | 1993      |
| Government of Singapore Investment Corporation    | Singapore         | 320           | 1981      |
| Qatar Investment Authority                        | Qatar             | 256           | 2005      |
| National Social Security Fund                     | China             | 236           | 2000      |

Source: SWF Institute

## 2-b. Institutional investors (6) Investment advisors

- Asset management companies or advisors manage assets on behalf of their clients (investors) based on investment discretion contracts. Usually, clients leave all investment decisions and the actual investments to the asset managers while some receive only the advisories but make investment decisions on their own.
- Public pension funds also seek investments and advisories from such asset managers.

**Assets Under Management by Investment Management Members**

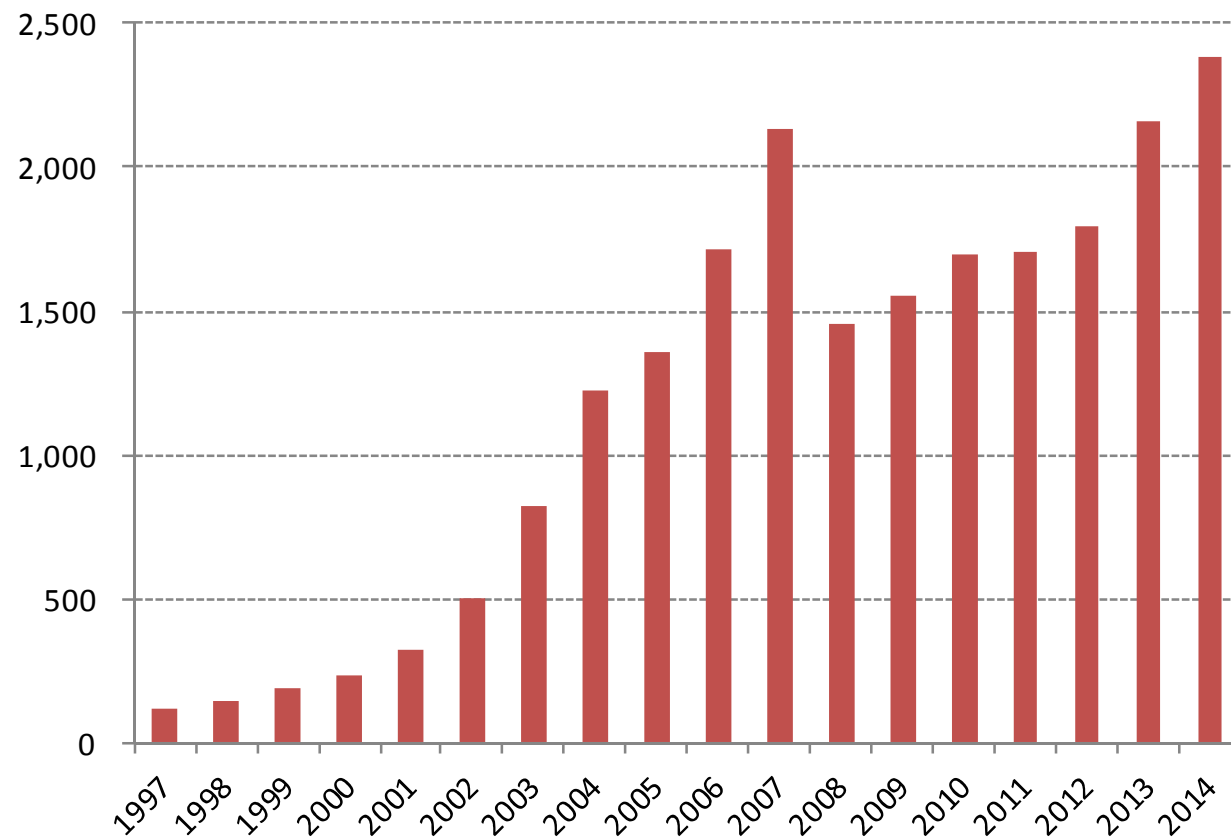


Source: Japan Investment Advisors Association

## 2-b. Institutional investor (7) Hedge funds

- Hedge funds usually manage assets accumulated from institutional investors and wealthy households. They occasionally appear on news for being the key market makers.
- They are eager to achieve high return on investment through aggressive buy and short selling strategies.

**Hedge Funds - total assets under management**  
(US\$bln)



Source: Barclay Hedge

## 2-c. Foreign investors

- Foreign investors are permitted to invest in many stock exchanges with certain limitations.
- With few exceptions, usually foreign investors are defined either institutional or retail.
- Foreign investors have high presence in recent years. In some stock exchanges, more than half of the transactions come from foreign investors.

### Presence and restrictions on foreign investors in selected ASEAN countries

| Country     | % of foreign investors (trading value) |      | Restriction on foreign investors   |
|-------------|--|------|--|
|             | 2013                                   | 2014 |  |
| Thailand    | 22%                                    | 23%  | Upper limit differ by listed companies but usually 49%. (Financial institutions 25%) |
| Vietnam     | 32%                                    | n.a. | 49% (Banks 30%)  |
| Lao PDR     | 63%                                    | 69%  | Determined by the government or else by the shareholders' meetings                   |
| Cambodia    | n.a.                                   | n.a. | None   |
| Philippines | 51%                                    | 49%  | Limitation only for those listed on the negative list of foreign investments.        |
| Indonesia   | 42%                                    | 41%  | None   |

Source: various stock exchanges

## 2-d. Private equity funds and venture capital funds

- Private equity (PE) funds usually inject equity investments to non-listed companies and expect high return on investments by increasing the value of such companies through providing necessary management advisories as a majority shareholder. Typical PE funds spend 6-10 years per deal from initiating the fund to exiting by sharing profits to investors
- Venture capital also invests in an emerging (usually non-listed) companies but with smaller amount. In general, PE funds and venture capitals earn profits through selling equity shares.

**Global PE Funds Assets under Management (US\$bn)**

| Company name                        | Location | Assets |
|-------------------------------------|----------|--------|
| Kohlberg Kravis Roberts             | USA      | 46.7   |
| TPG                                 | USA      | 46.5   |
| Blackstone Group                    | USA      | 41.7   |
| Carlye Group                        | USA      | 40.6   |
| CVC Capital Partners                | UK       | 37.0   |
| Apollo Global Management            | USA      | 30.6   |
| Bain Capital                        | USA      | 29.1   |
| Goldman Sachs Merchant Banking Div. | USA      | 28.8   |
| Apax Partners                       | UK       | 24.8   |
| Adevent International               | USA      | 21.7   |
| Hellman & Friedman                  | USA      | 20.7   |
| Permira                             | UK       | 18.0   |
| Providence Equity Partners          | USA      | 16.4   |
| JC Flowers & Co                     | USA      | 14.4   |
| Silver Lake                         | USa      | 14.1   |

Note: Total accumulated assets between 2000 and 2010

Source: Preqin

## 2-e. Revitalization funds

- Revitalization funds invest in a company that suffers stagnation. They provide funds as well as their know-hows for restructuring and try to improve management and company values.
- They could restructure the whole company or focus on particular department or operations.
- Their goal is to gain huge profit from selling their shares at an IPO or re-listing on a stock exchange.

### Restructuring Japan Airlines (JAL)

- In January 2010, JAL filed an application to the Enterprise Turnaround Initiative Corporation of Japan (ETIC) for support for restructuring. At the same time, JAL also filed the petitions for commencement of corporate reorganization proceedings with the Tokyo District court under the Corporate Rehabilitation Law.

- ✓ ETIC injected JPY350 bn
- ✓ Debt forgiveness (JPY520 bn)
- ✓ 100% reduction of capitals for the existing stocks

- ✓ Reduction of businesses
- ✓ Personnel reduction
- ✓ Reduction of labor costs
- ✓ Reduction of company pension
- ✓ Divestiture

|                  | JPY bn  |         |         |         |
|------------------|---------|---------|---------|---------|
|                  | FY2009  | FY2010  | FY2011  | FY2012  |
| Income           | 1,494.8 | 1,325.0 | 1,222.9 | 1,273.3 |
| Operating profit | -133.7  | 64.1    | 75.7    | 117.5   |

Returned to profitability in one year

Re-listed in September 2012 on TSE 1<sup>st</sup> section  
(ETIC sold its shares and completed its support)

Source: Enterprise Turnaround Initiative Corporation (ETIC)

### 3-a. Share price valuation (1) Price-earnings ratio (P/E)

Price - earnings ratio = share price / EPS (earnings per share)

EPS = Net income / total number of shares outstanding (period average)

Sugi Corp's FY2015 earnings forecast:

|                   |                 |
|-------------------|-----------------|
| Revenues          | MNT 100 million |
| Expenditures      | MNT 70 million  |
| Income before tax | MNT 30 million  |
| Net income        | MNT 20 million  |

Total number of shares: 100,000

Sugi Corp's EPS forecast for FY 2015  
= MNT 20 million / 100,000 shares  
= MNT **200**

(1) When Sugi Corp's share price is MNT 4,000  
P/E ratio = MNT 4,000 / MNT 200 = **20x**

(2) When Sugi Corp's share price is MNT 2,000  
P/E ratio = MNT 2,000 / MNT 200 = **10x**

- ✓ P/E ratio compares the current share price with its earnings.
- ✓ Whether the company's share price is trading at a premium or a discount is judged from the comparison with the P/E ratio of companies in the similar sector, or a historical range of its P/E ratios.
- ✓ P/E ratio trends may vary amongst sectors or the economic trends of the country and timing.



### 3-b. Share price valuation (2) Price-book ratio (P/B ratio)

Price - book ratio = share price / BPS (book value per share)

BPS = shareholders' equity (net assets) / total number of shares outstanding

Sugi Corp's FY2015 financial forecast

|                      |                |
|----------------------|----------------|
| Total assets         | MNT500 million |
| Liabilities          | MNT300 million |
| Shareholders' equity | MNT200 million |

Total number of shares: 100,000

BPS = MNT 200 million / 100,000 shares  
= MNT **2,000**

(1) When the share price is MNT 4,000  
P/B ratio = MNT 4,000 / MNT 2,000 = **2x**

(2) When the share price is MNT 2,000  
P/B ratio = MNT 2,000 / MNT 2,000 = **1x**

- ✓ P/B ratio is a ratio that is often used in a down cycle to judge downside potential of the a stock.
- ✓ When the P/B ratio is 1x or below 1x, it suggests that the price may be undervalued.

### 3-c. Share price valuation (3) Dividend yield

$$\text{Dividend yield (\%)} = \text{dividend per share} / \text{share price} \times 100$$

Sugi Corp's FY2015 dividend forecast

|                    |          |
|--------------------|----------|
| Dividend per share | MNT150   |
| Share price        | MNT4,000 |

(1) Dividend yield for Sugi Corp  
= MNT150 / MNT4,000 = **3.75%**

Urade Trading's FY2015 dividend forecast

|                    |          |
|--------------------|----------|
| Dividend per share | MNT100   |
| Share price        | MNT2,000 |

(2) Dividend yield for Urade Trading  
= MNT100 / MNT2,000 = **5.00%**

-> Investors can receive more dividends from Urade Trading when investing the same amount of money.

- ✓ Generally, dividend yields of companies in a growing stage are lower, some even pay no dividends (for example Microsoft did not pay any dividends until FY2003).
- ✓ On the other hand, there are cases where institutional investors claim more dividends against companies that profit growth become moderate or those have too much cash.

Source: Daiwa Institute of Research

# **Project for Capacity Building of Capital Market in Mongolia: The Roles of Securities Firms and the Implications**

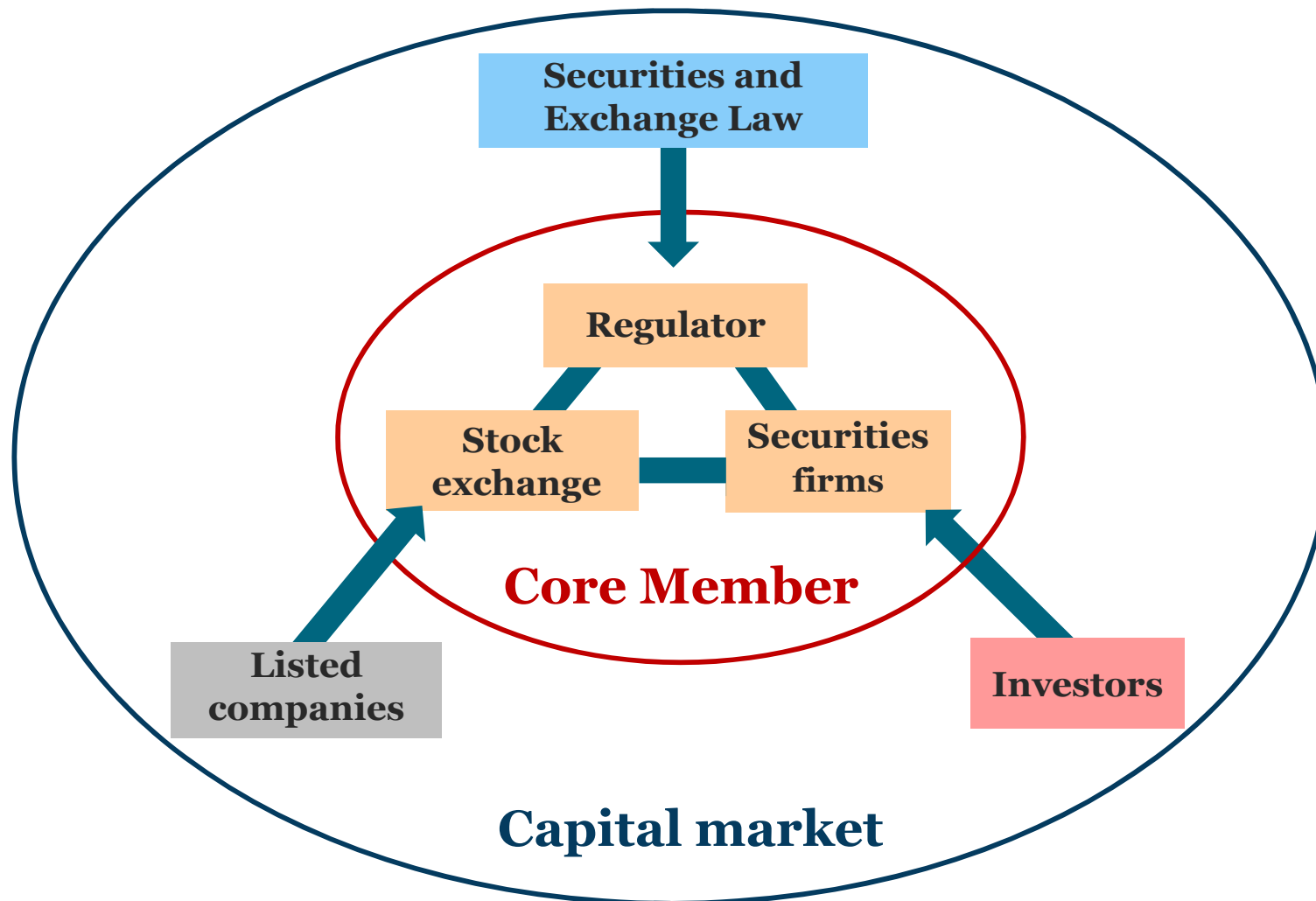
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29 April 2015

Masa Igata, JICA Consultant

# Participants in capital markets

Without securities firms, the formation of the capital market will not happen. If no securities firms exist, companies cannot be listed on the stock exchange, and investors cannot be brought in.

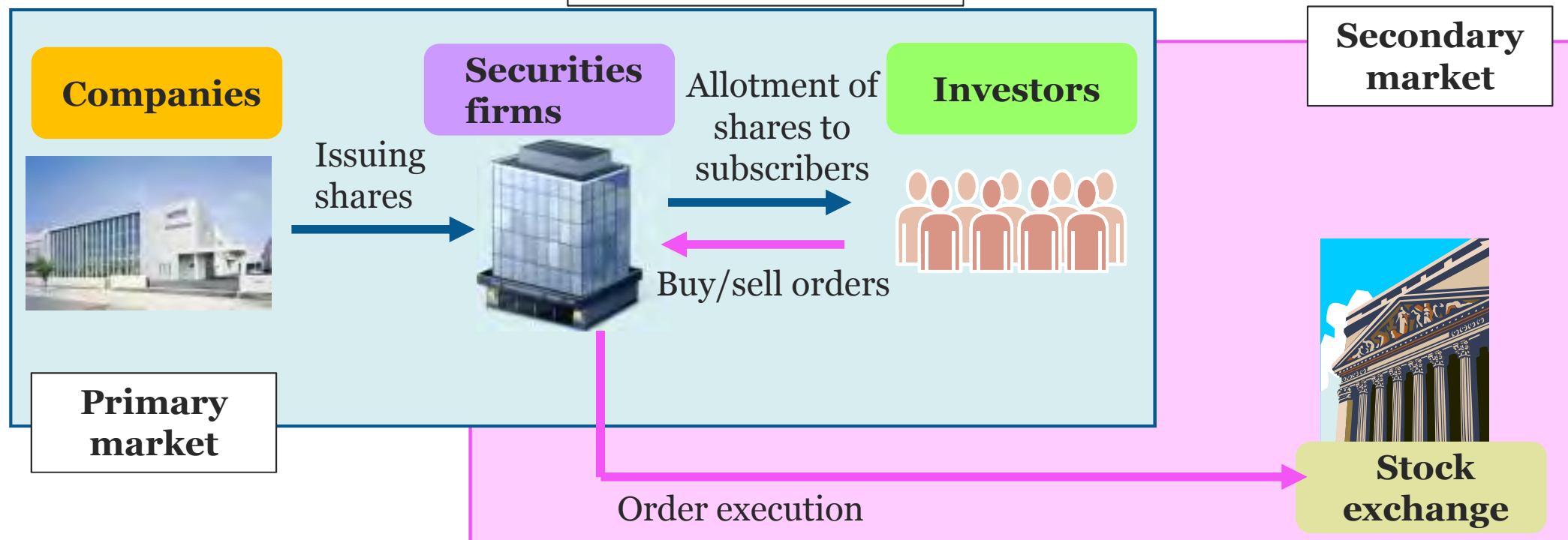


Source: Daiwa Institute of Research.

# The Function of securities firms

- 1) Capital markets consist of the primary market and the secondary market.
- 2) The primary market is where companies issue new shares, which are underwritten by securities firms, to sell to investors.
- 3) The secondary market is where an investor buys/sells shares from/to another investor by placing orders to a securities firm, which executes orders at the stock exchange.
- 4) Securities firms are involved both in the primary and the secondary market.

## Capital markets



# Categories of securities licenses and the Expectations of Sec firms

## The Securities and Exchange Law(2013)

The securities firms shall, after obtaining any type of license issued by Commission, have the **right** to operate the securities business permitted according to the type of license.

- (a) Securities dealing business license.
- (b) Securities brokerage business license.
- (c) Securities underwriting business license. etc

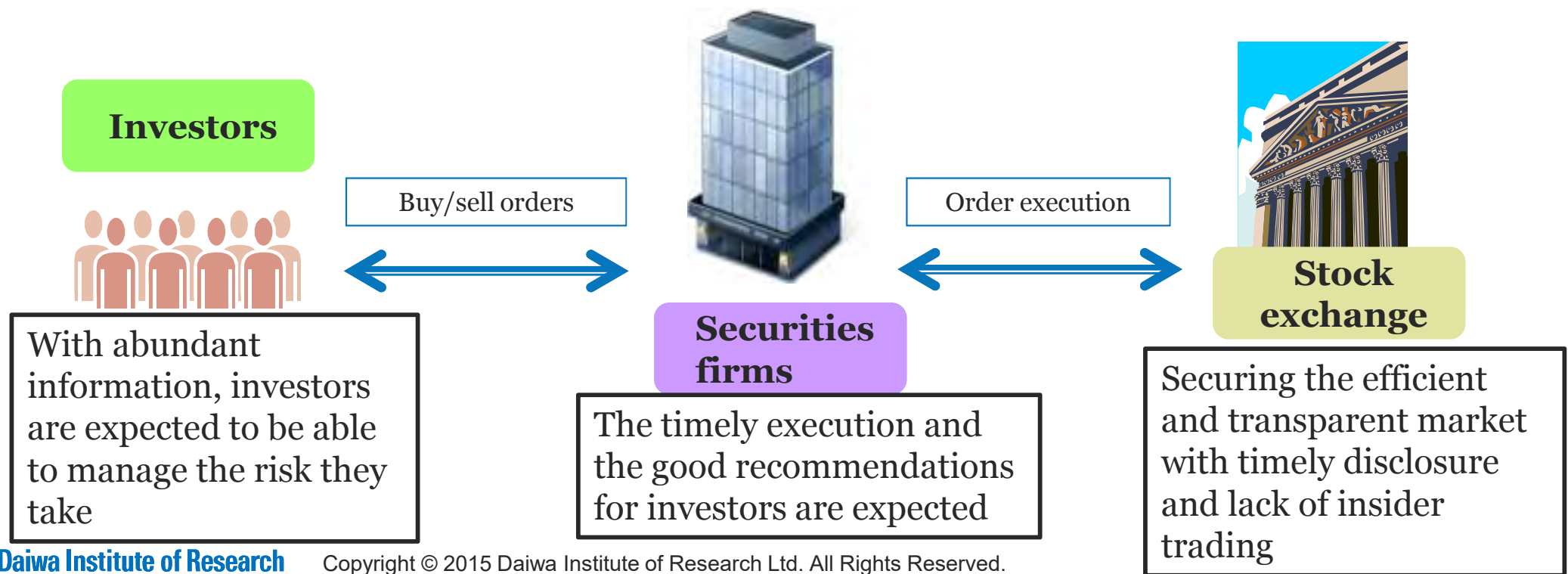
The business that licenses are given should be **reasonably profitable** for the securities firms to continue their business as their costs of complying with rules and regulations are higher than companies in the unregulated industries. Followings are some **guidelines** for international securities firms to conduct their business in a long run.

1. The **market capitalization**: The minimum 300mil USD for analyst coverage and 1 billion USD for underwriting business are generally accepted rule of thumb of **doing business** for international securities firms.
2. The **liquidity of the market**: In addition, at least 25% of float ratio and certain amount of shareholders should be maintained to secure **active trading** at secondary market.

Even in Japan, only around **10%** of the listed companies are **properly covered** by bankers and brokers at securities firms. In case of Mongolia, **none** of the listed firms are eligible for being properly covered by any reputable international securities firms.

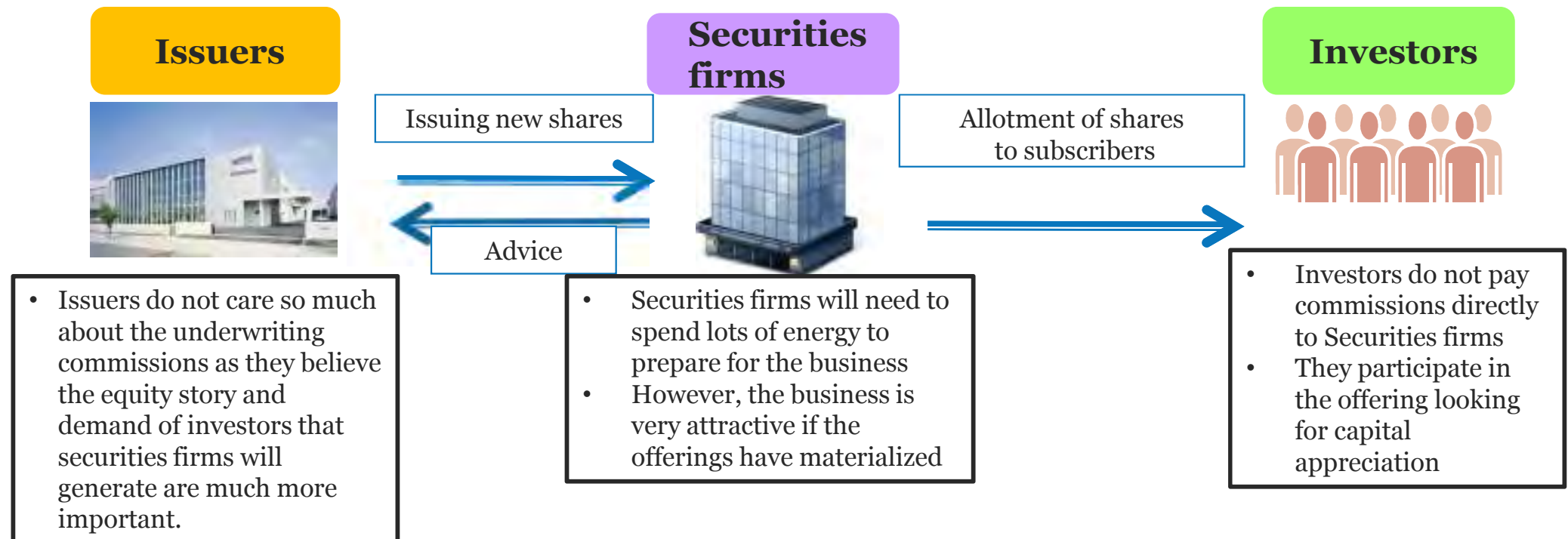
# Brokerage business

- 1) If you want to buy or sell shares of a listed company, you place orders to securities firms.
- 2) You cannot place orders directly to the stock exchange. Securities firms act as intermediaries to execute orders on behalf of investors at the stock exchange.
- 3) Securities firms are paid brokerage commissions by investors.
- 4) Commissions vary based on commission rate and amount of transactions.
- 5) Due to the decline of the commission rate globally in the last few decades, traditional securities firms are less dependent on this business. More market share are taken by internet brokers and smaller local brokers who do not pay so much cost to account maintenance.



# Underwriting business

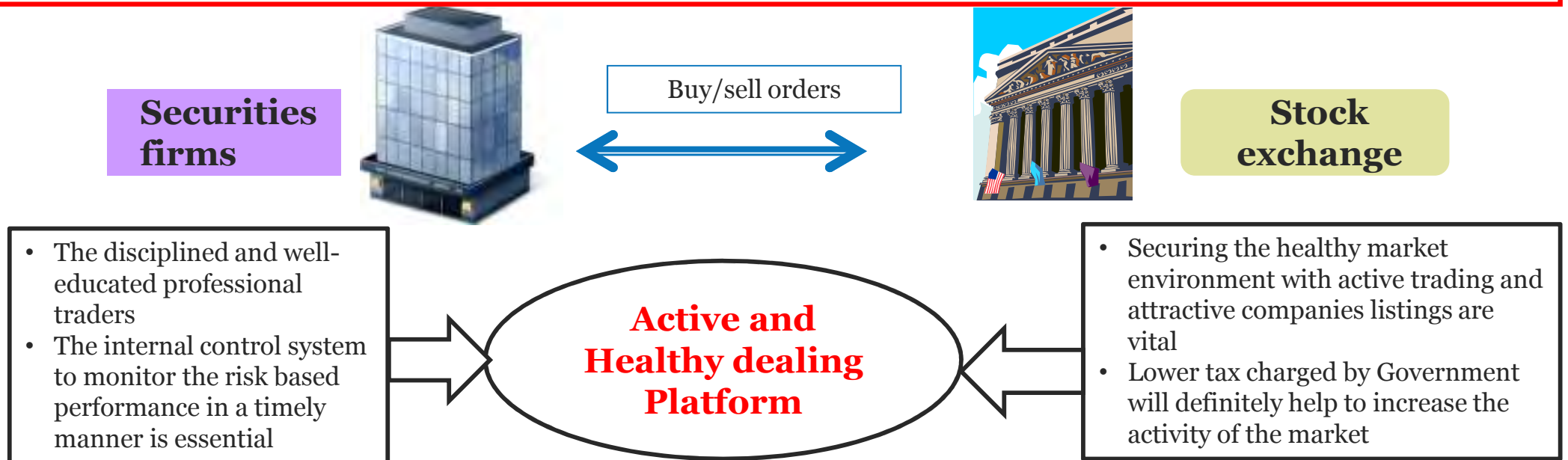
- 1) Securities firms advise targeted issuers for their IPO process (listing application, pricing etc.)
- 2) Securities firms buy newly issued shares from issuers (underwriting).
- 3) Given that securities firms take risks of underwriting, issuers for shares or bonds pay underwriting commissions to securities firms.
- 4) Underwriting commissions fluctuate depending on number of issuers doing IPO and fee charged to each issuer.
- 5) Underwriting commission rate remains to be fat because the business is concentrated by small number of big securities firms who have experience and expertise. However, the business can be influenced by the market.





# Dealing business

- 1) Only major securities firms have the dealing business section.
- 2) Dealing means buying and selling shares or bonds on their own account. In other words, securities firms act as investors in the market.
- 3) Securities firms sometimes can gain huge profit from their dealing activities, but they might make huge losses as well depending on stock market conditions and their buy/sell decisions.
- 4) As brokerage business has become thin margin business in major capital markets, brokers tend to seek higher profits doing dealing business recently. However, whether brokers can make profits depends on market direction and trading techniques. In addition, securities firms normally seek for short term profits. Hence, liquidity of the market is essential for them to enter into this business.



# Advisory business

## M&A

- Advise on acquisitions for enhancing corporate value.
- Acquisition, a means of business expansion or entry into new field.

- Only small number of Invest Bankers can make satisfactory service to the clients.
- As they can access to the very high level of corporate secrets, certain rules and regulations are required.

## Business tie-ups

Advise on business tie-ups for enhancing corporate value, which could entail equity alliances.

## Dividend/capital policy

Advise on dividend policy, new share issues, secondary offerings by existing shareholders, to reward shareholders adequately and to maximize corporate value.

**Wide range of expertise and experience with high ethical standard will be required.**



**Securities firms**

**Companies**



**Management advice**  
(drawing up mid-term business plans/  
incentive programs)

Advise on business policies or performance-based pay system to encourage further corporate growth.

## Timely disclosure

Advise on prompt and accurate corporate disclosure

- More and more companies realize the importance of enhancing corporate value.
- They believe raising capital effectively will be key to win in the market.

## Investor relations

Propose and advise on investor relations programs, which report business conditions to shareholders, introduce corporate strengths to potential investors.

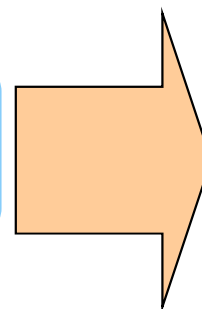
## Contributions by securities firms

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1) Support equity financing for issuers and advise for investors' wealth

2) Developing government bond market

3) Financial support for social issues

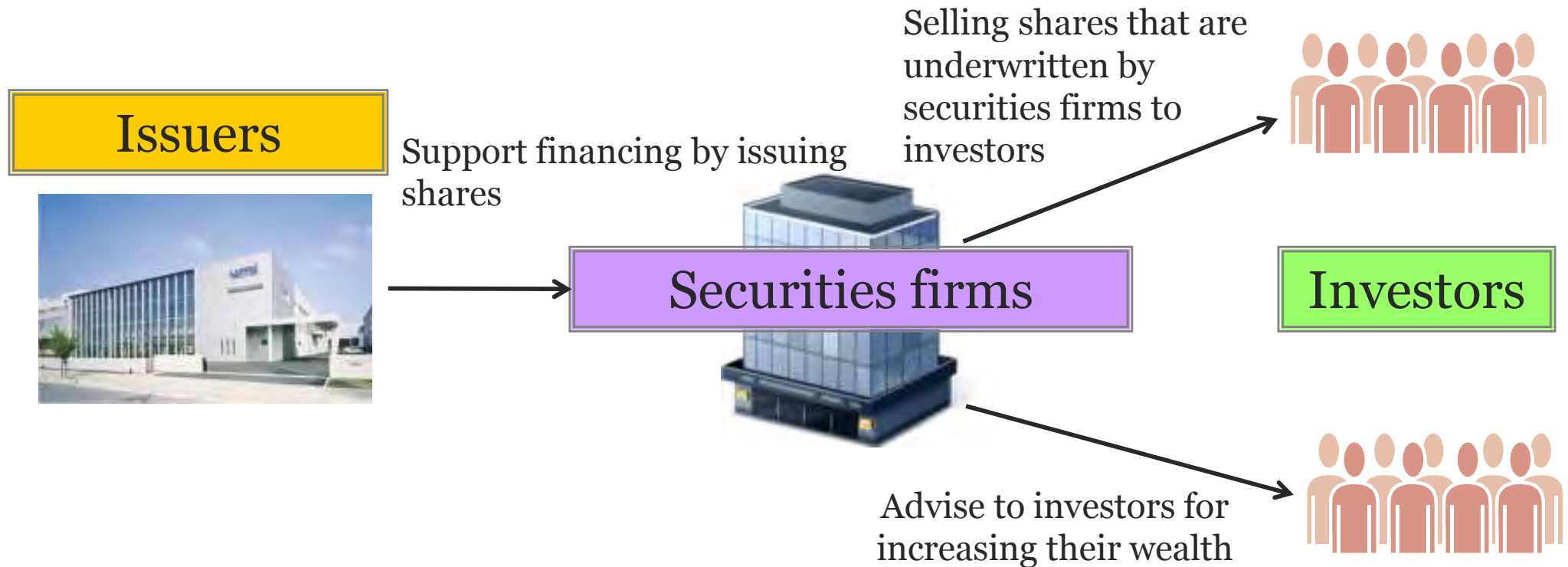


**Contributions to economic growth by securities firms**

As the regulator, it is important to secure the **attractive and healthy platform** for them

# Support equity financing for corporates and advise for investors

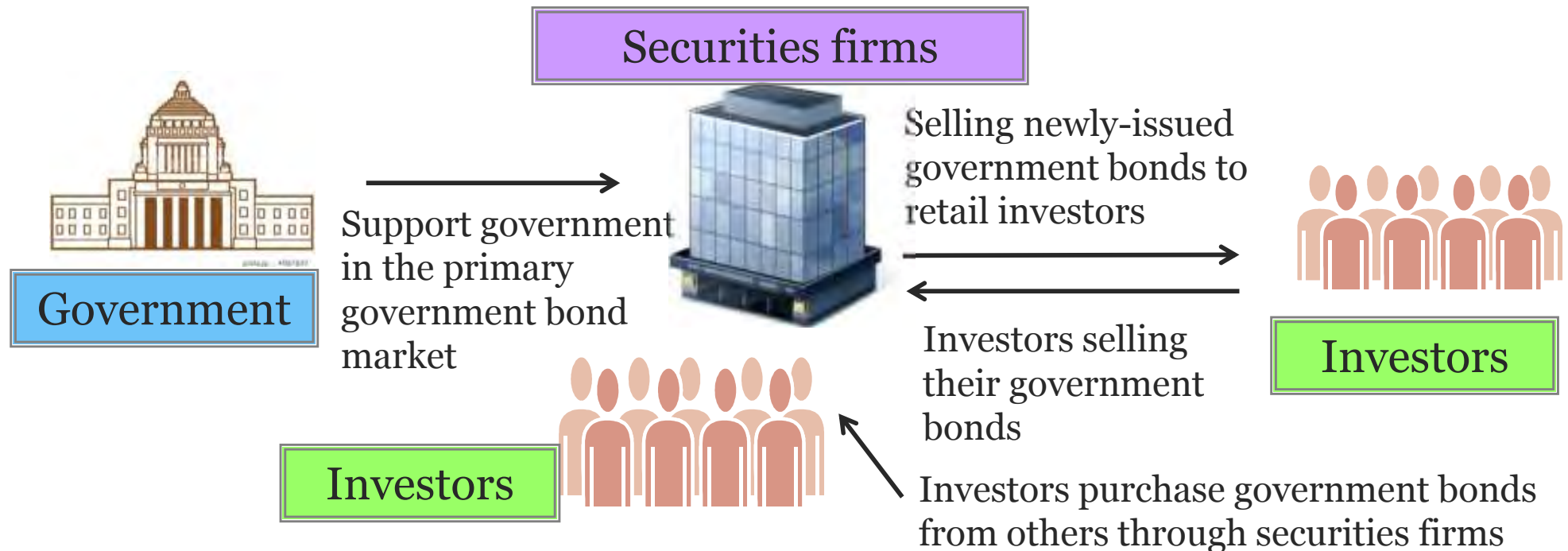
Issuers are able to obtain cash by issuing shares at attractive cost, with help of bankers at securities firms. As a result of financing, issuers can increase their operational capacity. In addition, brokers at securities firms can provide advices to investors.



# Developing government bond market

Securities firms can help develop the government bond market. Government needs to continuously issue government bonds for financing its public sector projects, and securities firms purchases newly-issued government bonds for investors. In addition, securities firms play a role as brokers for government bond holders including banks and other institutional investors, if investors need to trade.

Government bonds prices are variable with the result that investors may incur losses. Sales representatives must have sufficient knowledge to deal with this, in other words, government bonds should be handled by securities firms.



Government Bond is very important for capital market at this moment because of the high demand of issuing the bond and interest to participate into the deal from investors in public sector in foreign countries. However, securing the transparency and timely disclosure of the money being spent are not properly done for the previous bond. Therefore, monitoring the issuance of the bond is important for the success of the future issuance.

# Financial support for social issues

| Social bonds            | Issues         | Use of funds  |
|-------------------------|----------------|---|
| Microfinance bonds      | Poverty        | Financing for microfinance institutions             |
| Poverty reduction bonds | Poverty        | Poverty reduction                                   |
| Green bonds             | Global warming | Reduce global warming                               |
| Ecology bonds           | Global warming | Renewable energy and low-power consumption projects |
| Vaccine bonds           | Medical        | Vaccine for kids in low-developed countries         |
| Water bonds             | Water          | Water treatment                                     |
| Education bonds         | Education      | Support educational programs for low-income public  |

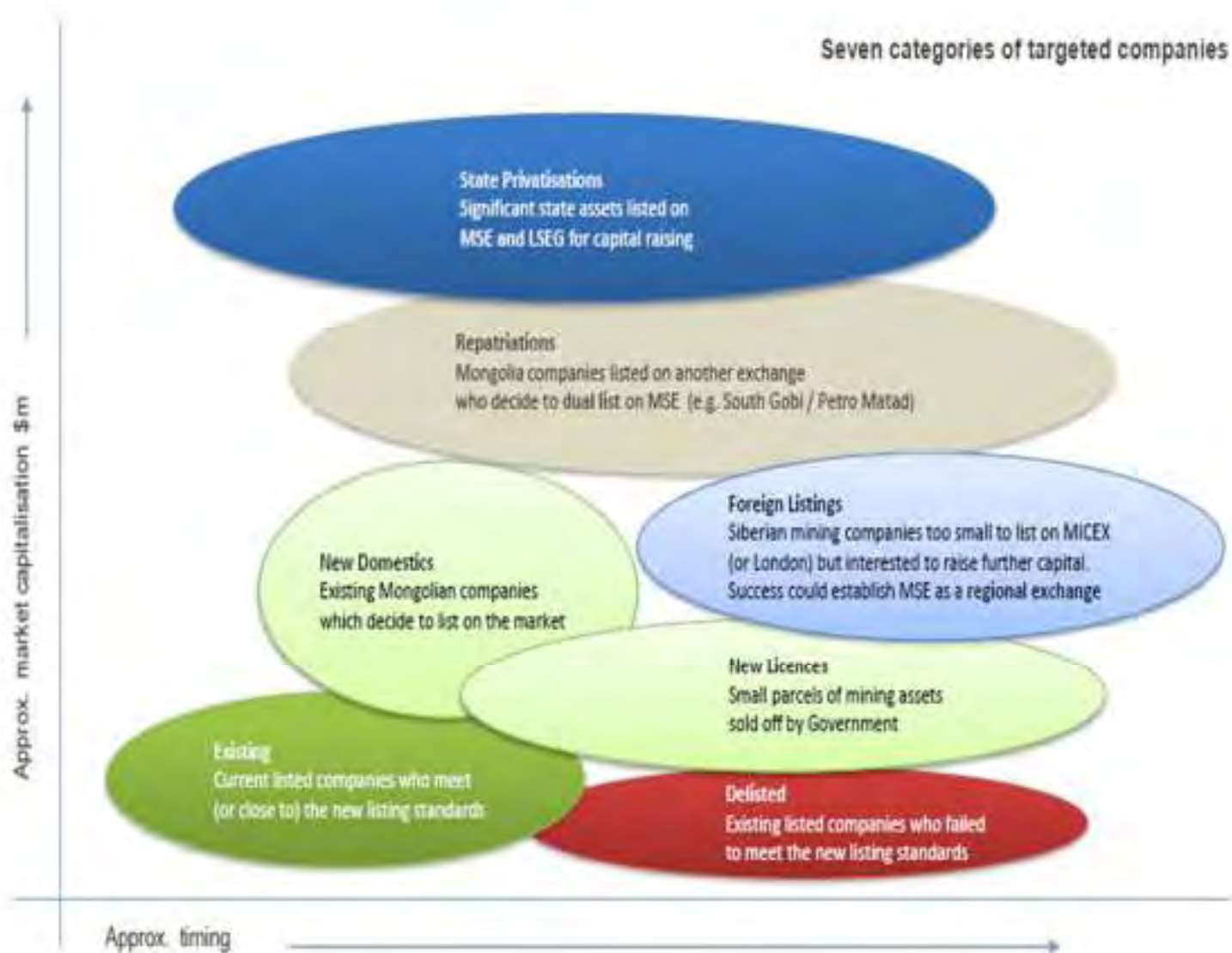
Securities companies also propose to international organization to issue

particular bonds for tackling social issues and promote to investors.



The challenges are 1. the potential size of the issuance is too small for international investors. 2. investors are mainly social funds and multi-national agencies. So, fostering the environment to encourage local companies to establish the fund should be considered.

# PROFILE OF TARGET LISTED COMPANIES



## TOP-10 Local Cos of year 2014

|    |                            |
|----|----------------------------|
| 1  | Erdenet LLC                |
| 2  | MCS group                  |
| 3  | Khan bank                  |
| 4  | Mobicom Corporation        |
| 5  | Trade and Development bank |
| 6  | Golomt bank                |
| 7  | XAC Bank                   |
| 8  | MAK LLC                    |
| 9  | NIC LLC                    |
| 10 | Sod Mongol Group LLC       |

Source: Chamber of Commerce, Mongolia

Source: Presentation by Mongolian Stock Exchange, 2014

# **Project for Capacity Building of Capital Market in Mongolia: 'Finance 101'**

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April 30, 2015

Daiwa Institute of Research  
Japan Economic Research Institute



## **1. Financial Statement Analysis**

- Structure of Financial Statements
- Key Points of Financial Statement Analysis
- Ratio Analysis (Profitability, Stability, Efficiency, Growth)
- Other Analysis Methods
- Window, Dressing

## **2. Corporate Finance**

- Objectives
- Investment Decision Making
- Equity Financing vs Debt Financing
- Financing Decision
- Corporate Finance vs Project Finance

## **3. Relevant Issues**

- PPP
- Privatization

# **1. Financial Statement Analysis**

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## Why Analyze Financial Statements ? (1)

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**Companies' activities & capacity are finally reflected to " Financial Statements "**

**Financial Statements = Reflect past accumulation & present condition of Company**

**The " **Mirror** " of Company**

**To asses this " mirror " properly is Financial Analysis**

(Major Financial Statements)

- ✓ **Balance Sheet (B/S)**
- ✓ **Income (or Profit & Loss) Statement (I/S or P/L)**
- ✓ **Cash Flow Statement**

## Why Analyze Financial Statements ? (2)

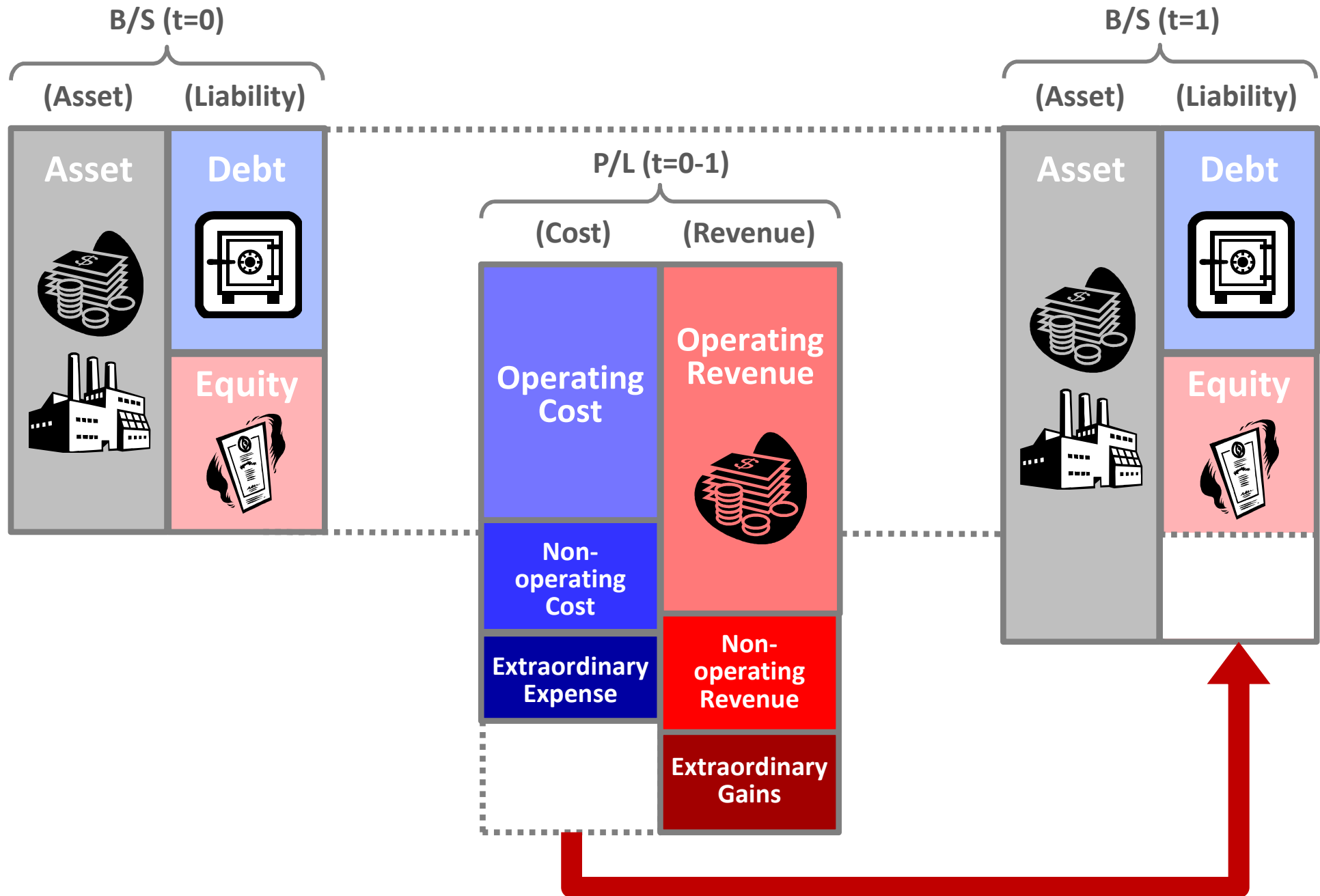
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Financial statements are used for financial analysis to understand the company's present strengths & weaknesses through its activities & capacity.

There are several objectives of financial analysis:

| User               | Purpose   |
|--------------------|---|
| Corporate managers | To formulate management strategies                          |
| Financial managers | To make investment/fund raising decisions                   |
| Banks              | To examine the creditability of customers (credit analysis) |
| Investors          | To investigate possible acquisitions                        |

# Structure of Financial Statements



# Structure of Financial Statements: B/S (1)

Prepared to show **financial situation** as of the end (=closing date) of the accounting period

(Unit Million JPY)

|                       |                             | FY2009     | FY2010     | FY2011     |   |   | FY2009     | FY2010     | FY2011      |
|-----------------------|-----------------------------|------------|------------|------------|---|---|------------|------------|-------------|
| <b>Assets</b>         |                             |            |            |            | <b>Liabilities</b>                      |   |            |            |             |
| <b>Current Assets</b> |                             | 5,279,382  | 5,580,410  | 6,345,835  | <b>Current Liabilities</b>              |   | 3,988,694  | 3,856,858  | 4,380,545   |
|                       | Cash                        | 3,632,714  | 802,410    | 998,822    |   | Account payable                         | 621,904    | 1,001,287  | 1,181,469   |
|                       | Accounts Receivables        | 429,078    | 641,154    | 738,950    |   | Short-term borrowings                   | 660,956    | 349,427    | 593,095     |
|                       | Securities                  | 126,968    | 50,641     | 158,012    |   | current portion of long term borrowings | 770,494    | 695,655    | 933,976     |
|                       | Inventory                   | 760,070    | 802,278    | 982,233    |   | Commercial paper                        | 639,152    | 174,393    | 256,601     |
|                       | Other                       | 429,228    | 3,375,380  | 3,549,773  |   | current portion of bonds                | 220,884    | 407,130    | 87,280      |
|                       | Allowance for Doubtful      | (98,676)   | (91,453)   | (81,955)   |   | Others                                  | 1,075,304  | 1,228,966  | 1,328,124   |
| <b>Fixed Assets</b>   |                             | 4,960,158  | 4,634,410  | 4,390,858  | <b>Long term liabilities</b>            |   | 3,324,793  | 3,342,857  | 3,082,365   |
|                       | Property, Plant and         | 4,110,047  | 3,858,129  | 3,637,042  |   | Bonds                                   | 595,309    | 507,142    | 640,850     |
|                       | Buildings                   | 668,943    | 679,829    | 645,414    |   | Long term borrowings                    | 1,700,015  | 1,791,983  | 1,422,478   |
|                       | Machinery                   | 2,149,693  | 1,980,991  | 1,841,480  |   | Others                                  | 1,029,469  | 1,043,732  | 1,019,037   |
|                       | Land                        | 688,704    | 675,029    | 659,985    | <b>Total Liabilities</b>                |   | 7,313,487  | 7,199,715  | 7,462,910   |
|                       | others                      | 602,707    | 522,280    | 490,163    | <b>Net Assets</b>                       |   |            |            |             |
|                       | Intangible Fixed Assets     | 167,218    | 143,911    | 133,769    |   | Shareholders' Equity                    | 3,556,479  | 3,598,966  | 3,981,513   |
|                       | Investment and other assets | 682,893    | 632,370    | 620,047    |   | Accumulated other                       | (930,846)  | (891,615)  | (1,040,098) |
|                       |                             |            |            |            |   | others                                  | 300,420    | 307,754    | 332,368     |
| <b>Total Assets</b>   |                             | 10,239,540 | 10,214,820 | 10,736,693 | <b>Total Net Assets</b>                 |   | 2,926,053  | 3,015,105  | 3,273,783   |
|                       |                             |            |            |            | <b>Total Liabilities and Net Assets</b> |   | 10,239,540 | 10,214,820 | 10,736,693  |

(source : Nissan Motor Co., Ltd)

## Structure of Financial Statements: B/S (2)

- Good Assets on the left side (**debit**), and Bad Assets & Net Assets on the right side (**credit**) of the balance sheet

|        |             |
|--------|-------------|
| Assets | Liabilities |
|        | Equity      |

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

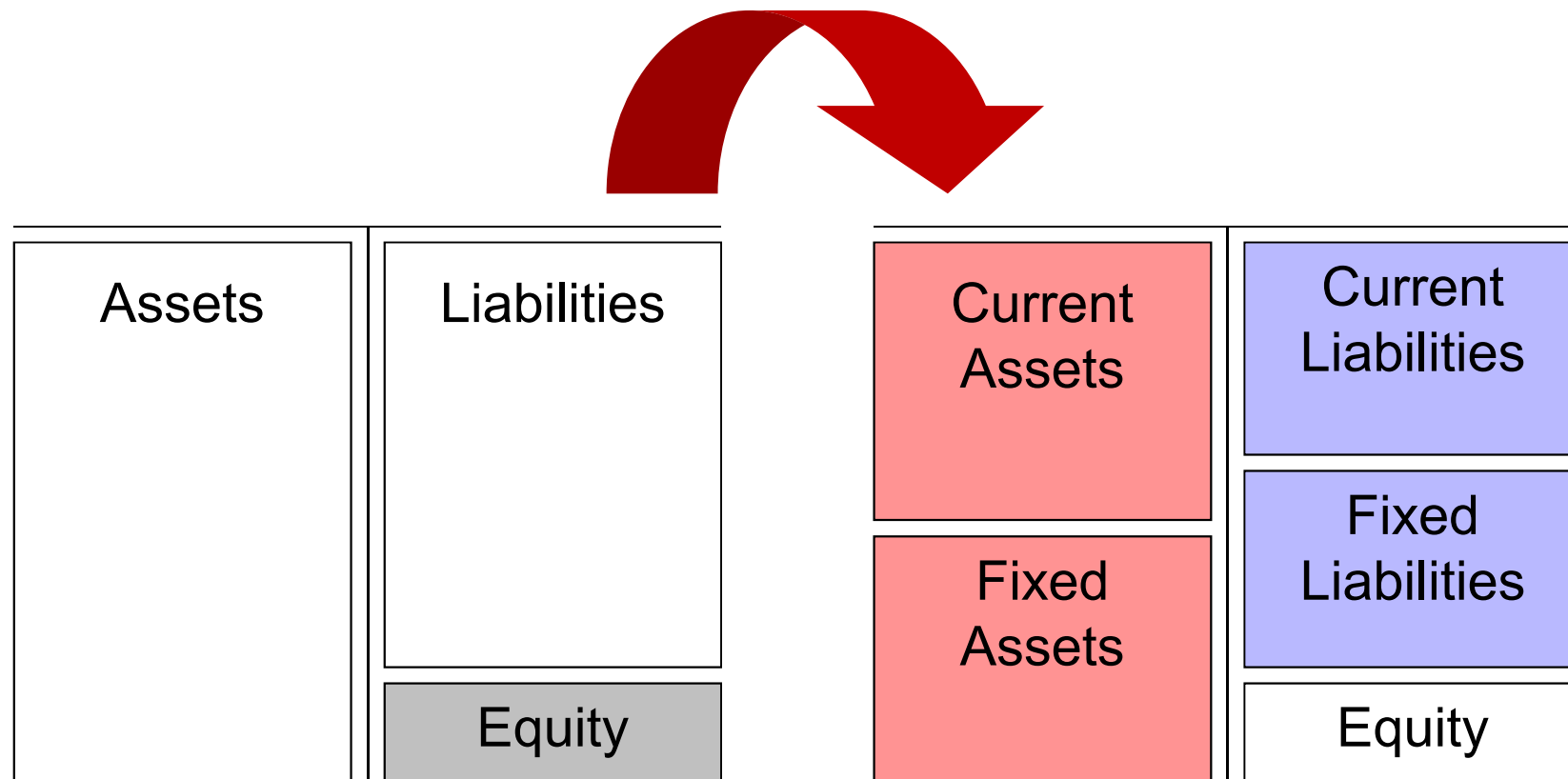
- 「**Assets**」・・・ Good assets  
(Ex) Cash, goods, equipment
- 「**Liabilities**」・・・ Bad assets  
(Ex) borrowings
- 「**Capital**」・・・ Net assets  
(Ex) Share capital, Retained earnings

## Structure of Financial Statements: B/S (3)

---

The left side (Debit) : shows how you spent money

The right side (Credit): shows how you collect money



Assets = Current Assets + Fixed Assets

Liabilities = Current Liabilities + Fixed Liabilities



# Structure of Financial Statements: B/S (4)

The point to divide current/fixed is **one year**



**One Year Rule**

(Unit Million JPY)

|                             | FY2011            |   | FY2011            |
|-----------------------------|-------------------|---|-------------------|
| <b>Assets</b>               |                   | <b>Liabilities</b>                      |                   |
| <b>Current Assets</b>       | <b>6,345,835</b>  | <b>Current Liabilities</b>              | <b>4,380,545</b>  |
| Cash                        | 998,822           | Account payable                         | 1,181,469         |
| Accounts Receivables        | 738,950           | Short-term borrowings                   | 593,095           |
| Securities                  | 158,012           | current portion of long term borrowings | 933,976           |
| Inventory                   | 982,233           | Commercial paper                        | 256,601           |
| Other                       | 3,549,773         | current portion of bonds                | 87,280            |
| Allowance for Doubtful      | (81,955)          | Others                                  | 1,328,124         |
|                             |                   | <b>Long term liabilities</b>            | <b>3,082,365</b>  |
| <b>Fixed Assets</b>         | <b>4,390,858</b>  | Bonds                                   | 640,850           |
| Property, Plant and         | 3,637,042         | Long term borrowings                    | 1,422,478         |
| Buildings                   | 645,414           | Others                                  | 1,019,037         |
| Machinery                   | 1,841,480         | <b>Total Liabilities</b>                | <b>7,462,910</b>  |
| Land                        | 659,985           | <b>Net Assets</b>                       |                   |
| others                      | 490,163           | Shareholders' Equity                    | 3,981,513         |
| Intangible Fixed Assets     | 133,769           | Accumulated other                       | (1,040,098)       |
| Investment and other assets | 620,047           | others                                  | 332,368           |
|                             |                   | <b>Total Net Assets</b>                 | <b>3,273,783</b>  |
| <b>Total Assets</b>         | <b>10,736,693</b> | <b>Total Liabilities and Net Assets</b> | <b>10,736,693</b> |

Current assets:  
cash, accounts receivable, inventories, etc.  
→ Convertible into cash within one year

Fixed assets:  
building, equipment, (right to use) land, etc.  
→ Useful life more than one year

Current liabilities:  
accounts payable, short, term debt, etc.  
→ Payment due within one year

Fixed liabilities:  
Long, term debts/ bonds, etc.  
→ Repayment due later than one year

(source : Nissan Motor Co., Ltd)

## Structure of Financial Statements: P/L (1)

P/L are prepared to show  
the results of operations (Revenue – Expenses = Profit)  
 for the year ended the closing date.

Unit : Million JPY

|  | FY2009    | FY2010    | FY2011    |
|--|-----------|-----------|-----------|
| <b>Net Revenues (Sales)</b>                          | 8,436,974 | 7,517,277 | 8,773,093 |
| - <b>Cost of Sales</b>                               | 7,118,862 | 6,146,219 | 7,155,100 |
| <b>Gross Profit</b>                                  | 1,318,112 | 1,371,058 | 1,617,993 |
| - <b>Selling General and administrative expenses</b> | 1,456,033 | 1,059,449 | 1,080,526 |
| <b>Operating Income</b>                              | ▲ 137,921 | 311,609   | 537,467   |
| + <b>Non operating income</b>                        | 38,121    | 29,126    | 86,603    |
| - <b>Non operating expenses</b>                      | 72,940    | 132,988   | 86,256    |
| <b>interest expense</b>                              | 33,798    | 28,995    | 28,357    |
| <b>Ordinary Income</b>                               | ▲ 172,740 | 207,747   | 537,814   |
| + <b>Special gains</b>                               | 62,156    | 20,552    | 27,989    |
| - <b>Special losses</b>                              | 108,187   | 86,679    | 85,662    |
| <b>Income before income taxes and others</b>         | ▲ 218,771 | 141,620   | 480,141   |
| - <b>Income taxes and others</b>                     | 14,938    | 99,230    | 160,920   |
| <b>Net Income</b>                                    | ▲ 233,709 | 42,390    | 319,221   |

(source: NissanMotor Co., Ltd)

## Structure of Financial Statements: P/L (2)

- Revenue on the right side (**credit**), and Expenses & Profit on the left side (**debit**) of the P/L
- P/L shows how profits are generated.

|          |         |
|----------|---------|
| Expenses | Revenue |
| Profit   |         |

$$\text{Revenue} - \text{Expenses} = \text{Profit}$$

- 「**Revenue**」・・・Resources of Profit  
e.g. sales
- 「**Expenses**」・・・Items required to acquire profit  
e.g. cost of sales, rents, salaries
- 「**Profit**」・・・Revenue – Expenses > 0
- 「**Loss**」・・・ Revenue – Expenses < 0

# Structure of Financial Statements: P/L (3)

## Five Stages of Profits

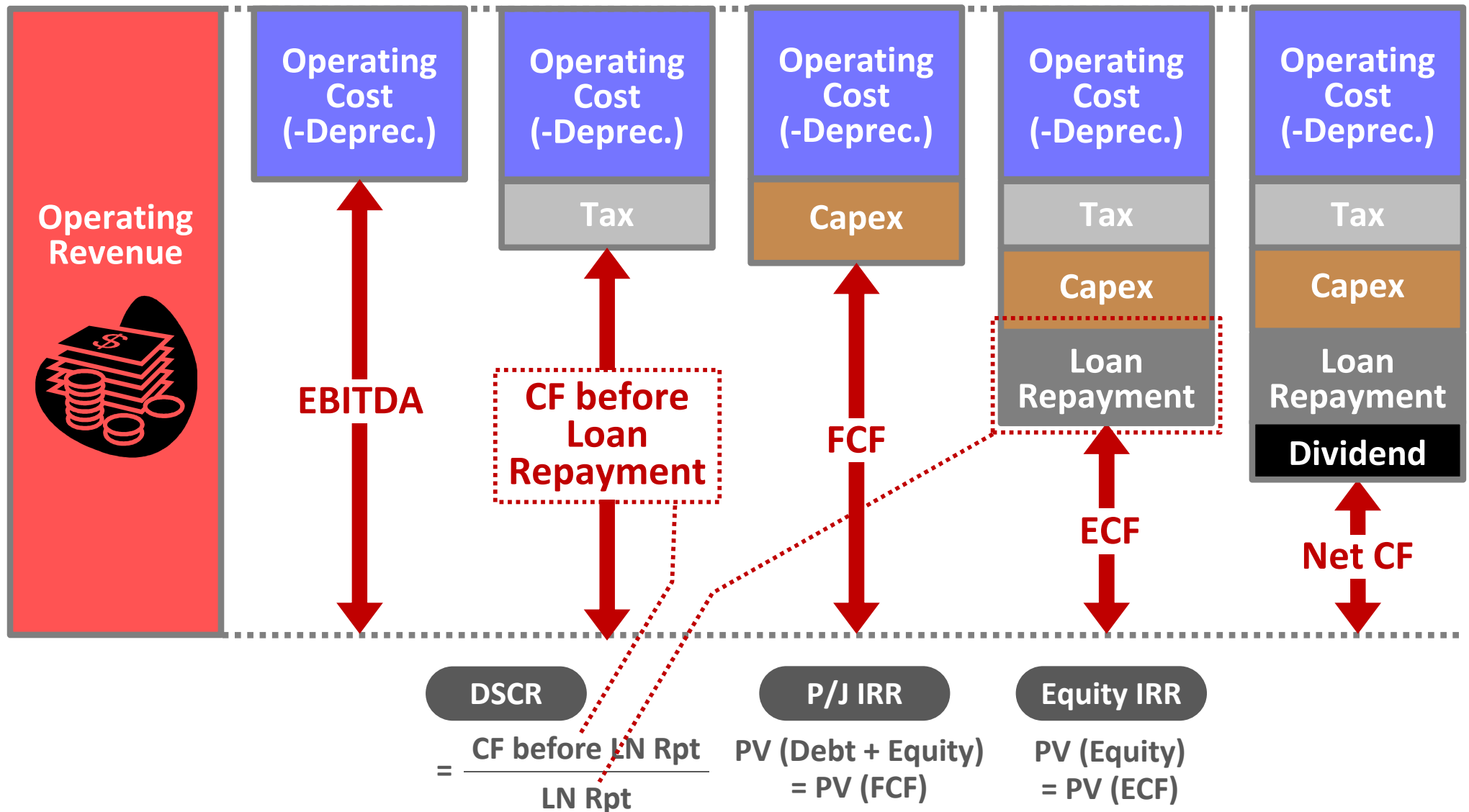
1. **Gross Profit;**  
→ Sales minus the cost of Sales
2. **Operating Profit;**  
→ Income by main profession
3. **Ordinary Profit;**  
→ Consider non, operating accounts  
after Operating Profit
4. **Profit before Taxes;**  
→ Consider extraordinary accounts after  
Ordinary Profit
5. **Net Profit;**  
→ Income less all expenses

Unit : Million JPY

|  |  | FY2011    |
|--|--|-----------|
| <b>Net Revenues (Sales)</b>                  |  | 8,773,093 |
| -  | <b>Cost of Sales</b>                               | 7,155,100 |
| <b>Gross Profit</b>                          |  | 1,617,993 |
| -  | <b>Selling General and administrative expenses</b> | 1,080,526 |
| <b>Operating Profit</b>                      |  | 537,467   |
| +  | <b>Non operating income</b>                        | 86,603    |
| -  | <b>Non operating expenses</b>                      | 86,256    |
|  | <b>interest expense</b>                            | 28,357    |
| <b>Ordinary Profit</b>                       |  | 537,814   |
| +  | <b>Special gains</b>                               | 27,989    |
| -  | <b>Special losses</b>                              | 85,662    |
| <b>Profit before income taxes and others</b> |  | 480,141   |
| -  | <b>Income taxes and others</b>                     | 160,920   |
| <b>Net Profit</b>                            |  | 319,221   |

(source: NissanMotor Co., Ltd)

# Structure of Financial Statements: Cash Flows



# Key Points of Financial Statement Analysis (1)

## After seeing the Forest, checking the Woods

1. To check the sales figure
2. To check the profit level
3. To check the equity
4. To check the repayment capacity

|   | FY2011    |
|---|-----------|
| <b>Net Revenues (Sales)</b>                   | 8,773,093 |
| - Cost of Sales                               | 7,155,100 |
| <b>Gross Profit</b>                           | 1,617,993 |
| - Selling General and administrative expenses | 1,080,526 |
| <b>Operating Profit</b>                       | 537,467   |
| + Non operating income                        | 86,603    |
| - Non operating expenses                      | 86,256    |
| interest expense                              | 28,357    |
| <b>Ordinary Profit</b>                        | 537,814   |
| + Special gains                               | 27,989    |
| - Special losses                              | 85,662    |
| <b>Profit before income taxes and others</b>  | 480,141   |
| - Income taxes and others                     | 160,920   |
| <b>Net Profit</b>                             | 319,221   |

(Unit Million JPY)

|                                      |                   | FY2011                                  |                              |         | FY2011    |
|--------------------------------------|-------------------|---|------------------------------|---------|-----------|
| <b>Assets</b>                        |                   |   | <b>Liabilities</b>           |         |           |
| <b>Current Assets</b>                |                   | 6,345,835                               | <b>Current Liabilities</b>   |         | 4,380,545 |
| Cash                                 | 998,822           | Account payable                         | 1,181,469                    |         |           |
| Accounts Receivables                 | 738,950           | Short-term borrowings                   | 593,095                      |         |           |
| Securities                           | 158,012           | current portion of long term borrowings | 933,976                      |         |           |
| Inventory                            | 982,233           | Commercial paper                        | 256,601                      |         |           |
| Other                                | 3,549,773         | current portion of bonds                | 87,280                       |         |           |
| Allowance for Doubtful Accounts      | (81,955)          | Others                                  | 1,328,124                    |         |           |
| <b>Fixed Assets</b>                  |                   | 4,390,858                               | <b>Long term liabilities</b> |         | 3,082,365 |
| <b>Property, Plant and equipment</b> |                   | 3,637,042                               | Bonds                        | 640,850 |           |
| Buildings                            | 645,414           | Long term borrowings                    | 1,422,478                    |         |           |
| Machinery                            | 1,841,480         | Others                                  | 1,019,037                    |         |           |
| Land                                 | 659,985           | <b>Total Liabilities</b>                | <b>7,462,910</b>             |         |           |
| others                               | 490,163           | <b>Net Assets</b>                       |                              |         |           |
| Intangible Fixed Assets              | 133,769           | Shareholders' Equity                    | 3,981,513                    |         |           |
| Investment and other                 | 620,047           | Accumulated other                       | (1,040,098)                  |         |           |
|                                      |                   | others                                  | 222,368                      |         |           |
| <b>Total Assets</b>                  | <b>10,736,693</b> | <b>Total Liabilities and Net Assets</b> | <b>10,736,693</b>            |         |           |

(source : Nissan Motor Co., Ltd)

## Image the company

## Key Points of Financial Statement Analysis (2)

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### Balance Sheet

- Account fluctuations
- Relation between Sales and Account Receivables
- Obsolete Inventory
- Transactions with other banks (loan size, conditions)
- Irrecoverable Investments and loans
- Balance between long,/short, term Liabilities and Assets

### Income Statement

- Breakdown of Production Costs
- Breakdown of Expenses
- Depreciation  $\Rightarrow$  Life Span for Fixed Assets by Type and Depreciation Method
- Ratio of Interest Expense to Sales  $\Rightarrow$  Conditions of Loans
- Ratio of Dividends to Profit

### Common Check Point

(Financial Balance)

Check the account of big outstanding in each account, Assets (cash, etc.)/Liabilities (loan, etc.)/Equities.

## Major Index for Ratio Analysis

### Profitability

- Gross Profit Margin
- Operating Profit Margin
- Return on Assets
- Return on Equity

### Efficiency

- Account Receivables Turnover Period
- Inventory Turnover Period
- Total Assets Turnover
- Working Capital Required

### Stability

- Current Ratio
- Quick Ratio
- Debt to Total Asset Ratio
- Debt/Equity Ratio
- Interest Coverage Ratio

### Growth

- Growth Ratio

(Purpose of Ratio Analysis)

To understand actual condition of business & business efficiency by analysis linking B/S & P/L



# Ratio Analysis: Profitability (1)

## Gross Profit Margin

$$\frac{\text{Gross profit}}{\text{Sales}} (\%)$$

**Nissan Case**  
**Gross Profit :1,617,993**  


---

**Sales:8,773,093**



**18.4%**

Unit : Million JPY

|                                       |   | FY2011    |
|---------------------------------------|---|-----------|
| Net Revenues (Sales)                  |   | 8,773,093 |
| -                                     | Cost of Sales                               | 7,155,100 |
| Gross Profit                          |   | 1,617,993 |
| -                                     | Selling General and administrative expenses | 1,080,526 |
| Operating Profit                      |   | 537,467   |
| +                                     | Non operating income                        | 86,603    |
| -                                     | Non operating expenses                      | 86,256    |
|                                       | interest expense                            | 28,357    |
| Ordinary Profit                       |   | 537,814   |
| +                                     | Special gains                               | 27,989    |
| -                                     | Special losses                              | 85,662    |
| Profit before income taxes and others |   | 480,141   |
| -                                     | Income taxes and others                     | 160,920   |
| Net Profit                            |   | 319,221   |

(source: NissanMotor Co., Ltd)

# Ratio Analysis: Profitability (2)

## Operating Profit Margin

**Operating profit**  
-----  
**Sales** (%)

**Nissan Case**  
**Gross Profit :537,467**  
-----  
**Sales:8,773,093**

**6.1%**

Unit : Million JPY

|  |  | FY2011    |
|--|--|-----------|
| <b>Net Revenues (Sales)</b>                  |  | 8,773,093 |
| -  | <b>Cost of Sales</b>                               | 7,155,100 |
| <b>Gross Profit</b>                          |  | 1,617,993 |
| -  | <b>Selling General and administrative expenses</b> | 1,080,526 |
| <b>Operating Profit</b>                      |  | 537,467   |
| +  | <b>Non operating income</b>                        | 86,603    |
| -  | <b>Non operating expenses</b>                      | 86,256    |
|  | <b>interest expense</b>                            | 28,357    |
| <b>Ordinary Profit</b>                       |  | 537,814   |
| +  | <b>Special gains</b>                               | 27,989    |
| -  | <b>Special losses</b>                              | 85,662    |
| <b>Profit before income taxes and others</b> |  | 480,141   |
| -  | <b>Income taxes and others</b>                     | 160,920   |
| <b>Net Profit</b>                            |  | 319,221   |

(source: NissanMotor Co., Ltd)

### ROA (Return on Assets)

How well do the assets in total generate profits?

$$\frac{\text{Net Profit}}{\text{Total Assets}^*} (\%)$$

\*Beginning and ending average

|  |
|--|
| <p style="text-align: center;"><b>Nissan Case</b></p> <p style="text-align: center;">Net Profit : 319,221</p> <hr/> <p style="text-align: center;">Total Assets: (10,214,820 + 10,736,696) / 2</p> |
|--|



|                    |
|--------------------|
| <p><b>3.0%</b></p> |
|--------------------|

### ROE (Return on Equity)

How well does the stockholder's equity generate money?

$$\frac{\text{Net Profit}}{\text{Shareholder's Equity}^*} (\%)$$

\*Beginning and ending average

|  |
|--|
| <p>Nissan Case</p> <hr/> <p>Net Profit : 319,221</p> <hr/> <p>Shareholder's Equity:(3,598,966+3,981,513)/2</p> |
|--|



|             |
|-------------|
| <p>8.4%</p> |
|-------------|

# Ratio Analysis: Stability , Liquidity Ratio (1)

## Current Ratio

How Liquid are the current liabilities?

(Unit Million JPY)

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} (\%)$$

**Nissan Case**

**Current Assets :6,345,835**

---

**Current Liabilities:4,380,545**



**144.9%**

|                             | FY2011            |   | FY2011            |
|-----------------------------|-------------------|---|-------------------|
| <b>Assets</b>               |                   | <b>Liabilities</b>                      |                   |
| Current Assets              | 6,345,835         | Current Liabilities                     | 4,380,545         |
| Cash                        | 998,822           | Account payable                         | 1,181,469         |
| Accounts Receivable         | 738,950           | Short-term borrowings                   | 593,095           |
| Securities                  | 158,012           | current portion of long term borrowings | 933,976           |
| Inventory                   | 982,233           | Commercial paper                        | 256,601           |
| Other                       | 3,549,773         | current portion of bonds                | 87,280            |
| Allowance for Doubtful      | (81,955)          | Others                                  | 1,328,124         |
|                             |                   | <b>Long term liabilities</b>            | <b>3,082,365</b>  |
| <b>Fixed Assets</b>         | <b>4,390,858</b>  | Bonds                                   | 640,850           |
| Property, Plant and         | 3,637,042         | Long term borrowings                    | 1,422,478         |
| Buildings                   | 645,414           | Others                                  | 1,019,037         |
| Machinery                   | 1,841,480         | <b>Total Liabilities</b>                | <b>7,462,910</b>  |
| Land                        | 659,985           | <b>Net Assets</b>                       |                   |
| others                      | 490,163           | Shareholders' Equity                    | 3,981,513         |
| Intangible Fixed Assets     | 133,769           | Accumulated other                       | (1,040,098)       |
| Investment and other assets | 620,047           | others                                  | 332,368           |
|                             |                   | <b>Total Net Assets</b>                 | <b>3,273,783</b>  |
| <b>Total Assets</b>         | <b>10,736,693</b> | <b>Total Liabilities and Net Assets</b> | <b>10,736,693</b> |

(source : Nissan Motor Co., Ltd)

# Ratio Analysis: Stability , Liquidity Ratio (2)

## Quick Ratio

Can the current liabilities be covered by assets immediately convertible into cash?

(Unit Million JPY)

$$\frac{\text{Cash} + \text{Marketable Securities} + \text{Account Receivable}}{\text{Current Liabilities}} (\%)$$

**Nissan Case**

$$\frac{998,822 + 738,950 + 158,012}{4,380,545}$$



**43.3%**

|                             | FY2011     |   | FY2011      |
|-----------------------------|------------|---|-------------|
| <b>Assets</b>               |            | <b>Liabilities</b>                      |             |
| <b>Current Assets</b>       | 6,345,835  | <b>Current Liabilities</b>              | 4,380,545   |
| Cash                        | 998,822    | Account payable                         | 1,161,469   |
| Accounts Receivables        | 738,950    | Short-term borrowings                   | 500,095     |
| Securities                  | 158,012    | current portion of long term borrowings | 933,976     |
| Inventory                   | 982,233    | Commercial paper                        | 256,601     |
| Other                       | 3,549,773  | current portion of bonds                | 87,280      |
| Allowance for Doubtful      | (81,955)   | Others                                  | 1,328,124   |
|                             |            | <b>Long term liabilities</b>            | 3,082,365   |
| <b>Fixed Assets</b>         | 4,390,858  | Bonds                                   | 640,850     |
| Property, Plant and         | 3,637,042  | Long term borrowings                    | 1,422,478   |
| Buildings                   | 645,414    | Others                                  | 1,019,037   |
| Machinery                   | 1,841,480  | <b>Total Liabilities</b>                | 7,462,910   |
| Land                        | 659,985    | <b>Net Assets</b>                       |             |
| others                      | 490,163    | Shareholders' Equity                    | 3,981,513   |
| Intangible Fixed Assets     | 133,769    | Accumulated other                       | (1,040,098) |
| Investment and other assets | 620,047    | others                                  | 332,368     |
|                             |            | <b>Total Net Assets</b>                 | 3,273,783   |
| <b>Total Assets</b>         | 10,736,693 | <b>Total Liabilities and Net Assets</b> | 10,736,693  |

(source : Nissan Motor Co., Ltd)

# Ratio Analysis: Stability , Debt Utilization Ratio (1)

## Debt to Total Asset Ratio

How is the whole company financed?

(Unit Million JPY)

|                             | FY2011     |   | FY2011      |
|-----------------------------|------------|---|-------------|
| <b>Assets</b>               |            | <b>Liabilities</b>                      |             |
| <b>Current Assets</b>       | 6,345,835  | <b>Current Liabilities</b>              | 4,380,545   |
| Cash                        | 998,822    | Account payable                         | 1,181,469   |
| Accounts Receivables        | 738,950    | Short-term borrowings                   | 593,095     |
| Securities                  | 158,012    | current portion of long term borrowings | 933,976     |
| Inventory                   | 982,233    | Commercial paper                        | 256,601     |
| Other                       | 3,549,773  | current portion of bonds                | 87,280      |
| Allowance for Doubtful      | (81,955)   | Others                                  | 1,328,124   |
|                             |            | <b>Long term liabilities</b>            | 3,082,365   |
| <b>Fixed Assets</b>         | 4,390,858  | Bonds                                   | 640,850     |
| Property, Plant and         | 3,657,042  | Long term borrowings                    | 1,422,478   |
| Buildings                   | 645,414    | Others                                  | 1,019,037   |
| Machinery                   | 1,841,480  | <b>Total Liabilities</b>                | 7,462,910   |
| Land                        | 659,985    | <b>Net Assets</b>                       |             |
| others                      | 490,163    | Shareholders' Equity                    | 3,981,513   |
| Intangible Fixed Assets     | 133,769    | Accumulated other                       | (1,040,098) |
| Investment and other assets | 620,047    | others                                  | 332,368     |
|                             |            | <b>Total Net Assets</b>                 | 3,273,783   |
| <b>Total Assets</b>         | 10,736,693 | <b>Total Liabilities and Net Assets</b> | 10,736,693  |

**Total Liabilities**  
-----  
**Total Assets** (%)

**Nissan Case**

**Total Liabilities: 7,462,910**

**Total Assets: 10,736,693**



**69.5%**

(source : Nissan Motor Co., Ltd)

# Ratio Analysis: Stability , Debt Utilization Ratio (2)

## Debt/Equity Ratio

How is the whole company financed?

(Unit Million JPY)

|                             | FY2011     |   | FY2011      |
|-----------------------------|------------|---|-------------|
| <b>Assets</b>               |            | <b>Liabilities</b>                      |             |
| <b>Current Assets</b>       | 6,345,835  | <b>Current Liabilities</b>              | 4,380,545   |
| Cash                        | 998,822    | Account payable                         | 1,181,469   |
| Accounts Receivables        | 738,950    | Short-term borrowings                   | 593,095     |
| Securities                  | 158,012    | current portion of long term borrowings | 933,976     |
| Inventory                   | 982,233    | Commercial paper                        | 256,601     |
| Other                       | 3,549,773  | current portion of bonds                | 87,280      |
| Allowance for Doubtful      | (81,955)   | Others                                  | 1,328,124   |
|                             |            | <b>Long term liabilities</b>            | 3,082,365   |
| <b>Fixed Assets</b>         | 4,390,858  | Bonds                                   | 640,850     |
| Property, Plant and         | 3,637,042  | Long term borrowings                    | 1,422,478   |
| Buildings                   | 645,414    | Others                                  | 1,019,037   |
| Machinery                   | 1,841,480  | <b>Total Liabilities</b>                | 7,462,910   |
| Land                        | 559,985    | <b>Net Assets</b>                       |             |
| others                      | 490,163    | Shareholders' Equity                    | 3,981,513   |
| Intangible Fixed Assets     | 133,769    | Accumulated other                       | (1,040,098) |
| Investment and other assets | 620,047    | others                                  | 332,368     |
|                             |            | <b>Total Net Assets</b>                 | 3,273,783   |
| <b>Total Assets</b>         | 10,736,693 | <b>Total Liabilities and Net Assets</b> | 10,736,693  |

**Total Liabilities**  
-----  
**Shareholder's Equity** (%)

**Nissan Case**

**Total Liabilities:7,462,910**

**Shareholder's Equity:3,981,513**

**187.4%**

(source : Nissan Motor Co., Ltd)



## Interest Coverage Ratio

How are the interest payments assured?

Unit : Million JPY

|                                       |   | FY2011    |
|---------------------------------------|---|-----------|
| Net Revenues (Sales)                  |   | 8,773,093 |
| -                                     | Cost of Sales                               | 7,155,100 |
| Gross Profit                          |   | 1,617,993 |
| -                                     | Selling General and administrative expenses | 1,080,526 |
| Operating Profit                      |   | 537,467   |
| +                                     | Non operating income                        | 86,603    |
| -                                     | Non operating expenses                      | 86,256    |
|                                       | Interest expense                            | 28,357    |
| Ordinary Profit                       |   | 537,814   |
| +                                     | Special gains                               | 27,989    |
| -                                     | Special losses                              | 85,662    |
| Profit before income taxes and others |   | 480,141   |
| -                                     | Income taxes and others                     | 160,920   |
| Net Profit                            |   | 319,221   |

**Profit before  
Tax & Interest Expense**  
-----  
**Interest** (%)

$$\frac{\text{Nissan Case } 480,141 + 28,357}{\text{Interest } 28,357}$$

**1,793%**

(source: NissanMotor Co., Ltd)

## Account Receivables Turnover Period

Are Account Receivables properly collected ?

$$\frac{\text{Account Receivables}^*}{\text{Average Sales per month}} \quad (\text{month})$$

\*Beginning and ending average

Nissan Case

$$\frac{\text{Account Receivables: } (641,154 + 738,950) / 2}{\text{Average Sales per month : } 8,773,093 / 12}$$



0.9 month



### Inventory Turnover Period

How large are the inventories in terms of monthly sales ?

$$\frac{\text{Inventory}^*}{\text{Average Sales per month}} \quad (\text{month})$$

\*Beginning and ending average

|  |
|--|
| <p>Nissan Case</p> $\frac{\text{Inventory: } (802,278+998,822)/2}{\text{Average Sales per month : } 8,773,093/12}$ |
|--|



|                  |
|------------------|
| <p>1.2 month</p> |
|------------------|



### Total Assets Turnover

How do the total assets generate sales? (asset utilization efficiency)

$$\frac{\text{Sales}}{\text{Total Assets}^*} \quad (\text{Number of times/year})$$

\*Beginning and ending average

|  |
|--|
| <p>Nissan Case</p> $\frac{\text{Sales : 8,773,093}}{\text{Total Assets: (10,214,820+10,736,693)/2}}$ |
|--|



0.8times



### Working Capital Required

Cash is the lifeblood of a business. It keeps operation going. Required cash balances should be set aside for operating needs. Working capital required is calculated as follows.

#### Calculation Formula of Working Capital

1. Account Receivables Turnover Period(months) ..... **A**
2. Trade-Payables Turnover Period(months) ..... **B**
3. Inventory Turnover Period (months) ..... **C**
4. Working Capital Required (months) = **A - B + C**

## Growth Ratio

How well is the company growth?

Unit : Million JPY

|  | FY2009    | FY2010    | FY2011    |
|--|-----------|-----------|-----------|
| <b>Net Revenues (Sales)</b>                          | 8,436,974 | 7,517,277 | 8,773,093 |
| - <b>Cost of Sales</b>                               | 7,118,862 | 6,146,219 | 7,155,100 |
| <b>Gross Profit</b>                                  | 1,318,112 | 1,371,058 | 1,617,993 |
| - <b>Selling General and administrative expenses</b> | 1,456,033 | 1,059,449 | 1,080,526 |
| <b>Operating Income</b>                              | ▲ 137,921 | 311,609   | 537,467   |
| + <b>Non operating income</b>                        | 38,121    | 29,126    | 86,603    |
| - <b>Non operating expenses</b>                      | 72,940    | 132,988   | 86,256    |
| <b>interest expense</b>                              | 33,798    | 28,995    | 28,357    |
| <b>Ordinary Income</b>                               | ▲ 172,740 | 207,747   | 537,814   |
| + <b>Special gains</b>                               | 62,156    | 20,552    | 27,989    |
| - <b>Special losses</b>                              | 108,187   | 86,679    | 85,662    |
| <b>Income before income taxes and others</b>         | ▲ 218,771 | 141,620   | 480,141   |
| - <b>Income taxes and others</b>                     | 14,938    | 99,230    | 160,920   |
| <b>Net Income</b>                                    | ▲ 233,709 | 42,390    | 319,221   |

**Current Figure** ←

— 1 (%)

**Previous Figure** ←

**Nissan Case (sales)**

$$\frac{8,773,093}{7,517,277} - 1(\%)$$

**16.7%**

(source: NissanMotor Co., Ltd)

## Other Analysis Methods (1): Trend Analysis

---

### Method

**Compare the past 5 years order (If possible, 10 years)**

### Purpose

**Assess the actual condition of the company by understanding tendency of performance through checking business activity in a continuous year**

### Point

**Determine causes of those tendency**

### Example of Analysis

- ✓ **Protracted account receivables turnover period**
  - it is impossible to collect account receivables due to financial trouble of customers (Bad debt)
- ✓ **Protracted inventory turnover period**
  - Record dummy products, obsolete products as inventory, and report window-dressing profit

## Other Analysis Methods (2): Cross Sectional Analysis

---

### Methods

**Comparison with the target company and sector peer/benchmarking companies in the field of profit level, financial ratio, turnover period.**

### Purpose / Background

**Competition in the field of same sector is severe. Therefore, it is important to assess whether the target company can survive in this sector or not through comparison.**

### Example of Analysis

- ✓ **Low profitability : High procurement cost, Low productivity**
- ✓ **Inventory turnover period is longer : Low productivity, dead-stock, bad production plan**
- ✓ **Low total assets turnover : Low assets efficiency, the company doesn't make good use of assets**



# Window, Dressing

---

*Some examples...*

## **1. Large fluctuation in sales**

- , Sales should be recognized in next fiscal year unless it is booked this fiscal year's sales.
- , Book the dummy sales etc.

## **2. Large fluctuation in profitability**

- , Expense should be recognized in this fiscal year unless it is booked next fiscal year's expense.
- , Price adjustment to subsidiaries
- , Change of evaluation method of assets.

## **3. Interest**

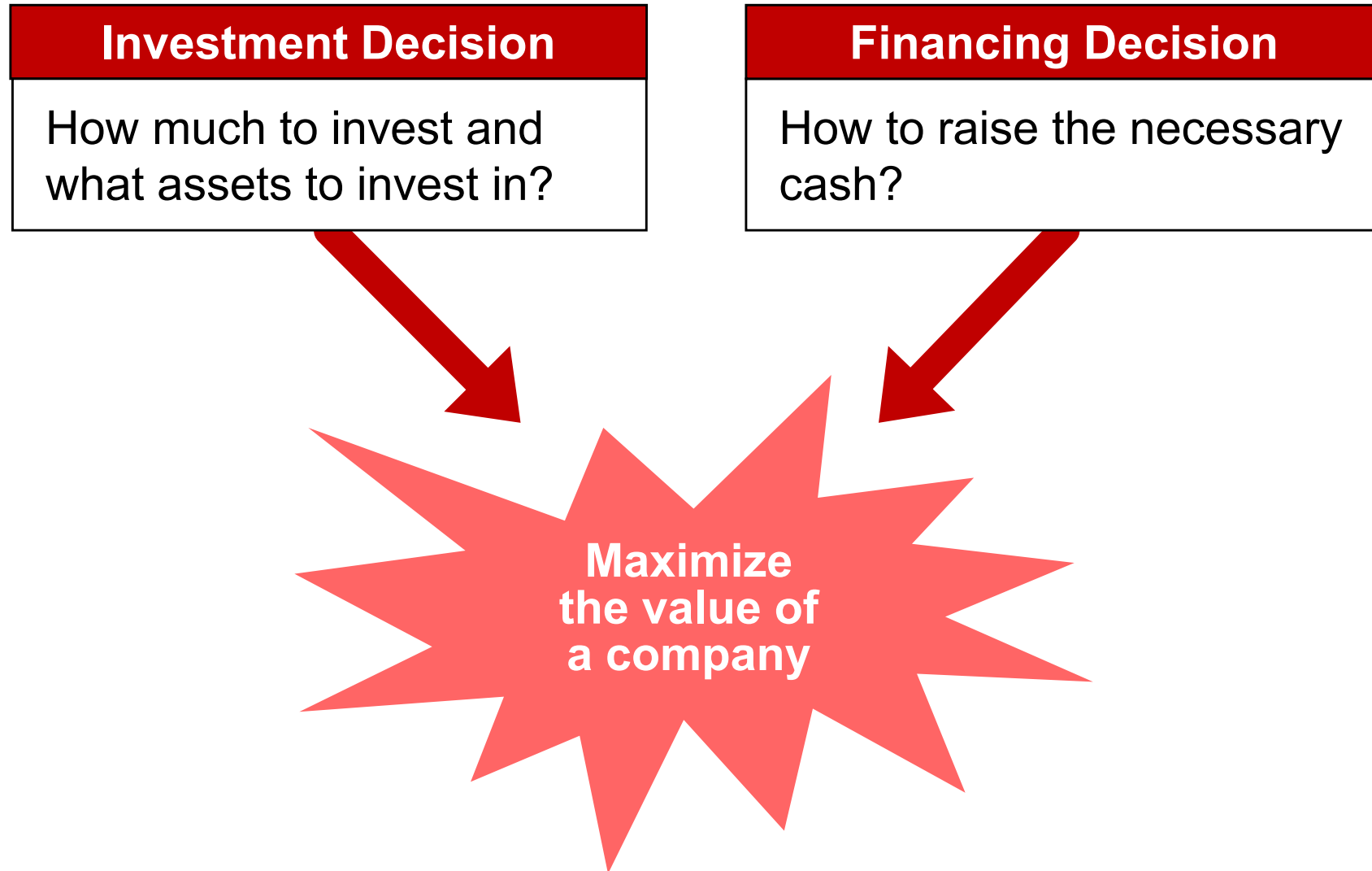
- , High interest rate  
the possibility of loan from loan shark and off, balance sheet debt
- , Low interest rate  
the possibility of delinquency or transfer of account (expense , assets).

## **2. Corporate Finance**

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# Corporate Finance: Objectives

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## Investment Decision Making (1)

---

|        | <u>Project A</u> | <u>Project B</u> |
|--------|------------------|------------------|
| Year 0 | ,100             | ,100             |
| Year 1 | 50               | 10               |
| Year 2 | 40               | 30               |
| Year 3 | 30               | 40               |
| Year 4 | 10               | 60               |

- Suppose you are a CFO of company X.
- Now company X needs to choose one of two projects, Project A and Project B.
- Which project do you choose and why?

## Investment Decision Making (2)

---

|        | <u>Project A</u> | Cumulative CF | <u>Project B</u> | Cumulative CF |
|--------|------------------|---------------|------------------|---------------|
| Year 0 | ,100             | ,100          | ,100             | ,100          |
| Year 1 | 50               | ,50           | 10               | ,90           |
| Year 2 | 40               | ,10           | 30               | ,60           |
| Year 3 | 30               | <u>20</u>     | 40               | ,20           |
| Year 4 | 10               |               | 60               | <u>40</u>     |

### Payback

- The payback period of a project is found by counting the number of years it takes before cumulative forecasted cash flows equal the initial investment.
- The payback period of Project A is 3 years, while that of Project B is 4 years.  
→ Then, you will choose Project A when you apply payback period.
- This approach might underestimate future cash flows after the payback period.

## Investment Decision Making (3)

---

|        | <u>Project A</u> | Total future CF      | <u>Project B</u> | Total future CF      |
|--------|------------------|----------------------|------------------|----------------------|
| Year 0 | ,100             |                      | ,100             |                      |
| Year 1 | 50               |                      | 10               |                      |
| Year 2 | 40               |                      | 30               |                      |
| Year 3 | 30               |                      | 40               |                      |
| Year 4 | 10               | <b>Year 1-4: 130</b> | 60               | <b>Year 1-4: 140</b> |

### Simple Addition of CF

- Total future cash flows of Project A is 130, while that of Project B is 140.  
→ Then, you will choose Project B.
- This approach does not consider the concept of time value of money.

## c.f. Present Value

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**“A dollar today is worth more than a dollar tomorrow.”**

- Suppose you have \$100 now (Year 0) and deposit this \$100 in a bank with 10%/year interest rate.
  - In Year 1, your \$100 now will be \$110. ( $100 \times 1.1 = 110$ )
  - In Year 2, your \$100 now will be \$121. ( $100 \times 1.1^2 = 121$ )
- The present value of \$100 one year from now is \$90.9. ( $100 / 1.1 = 90.9$ )  
The present value of \$100 two years from now is \$82.6. ( $100 / (1.1)^2 = 82.6$ )
- Present value is sum of discounted future cash flows.

## Investment Decision Making (4)

|        | <u>Project A</u> | <u>PV of future CF</u> | <u>Project B</u> | <u>PV of future CF</u> |
|--------|------------------|------------------------|------------------|------------------------|
| Year 0 | ,100             | ,100                   | ,100             | ,100                   |
| Year 1 | 50               | 45.45                  | 10               | 9.09                   |
| Year 2 | 40               | 33.06                  | 30               | 24.79                  |
| Year 3 | 30               | 22.54                  | 40               | 30.05                  |
| Year 4 | 10               | 6.83                   | 60               | 40.98                  |
| NPV    |                  | <u>7.88</u>            |                  | <u>4.92</u>            |

### Net Present Value (NPV)

- Present value is calculated by multiplying discount factor,  $1/(1+r)^n$ . In this case,  $1/(1+0.1)$  in Year 1,  $1/(1+0.1)^2$  in Year 2, R  
NPV is sum of current cash flows and discounted future cash flows.
- NPV of Project A is 7.88, while NPV of Project B is 4.92.  
→ Then, you will choose Project A.



## Investment Decision Making (5)

---

|        | <u>Project A</u> | <u>IRR</u>   | <u>Project B</u> | <u>IRR</u>   |
|--------|------------------|--------------|------------------|--------------|
| Year 0 | ,100             |              | ,100             |              |
| Year 1 | 50               |              | 10               |              |
| Year 2 | 40               |              | 30               |              |
| Year 3 | 30               |              | 40               |              |
| Year 4 | 10               | <b>14.5%</b> | 60               | <b>11.8%</b> |

### Internal Rate of Return (IRR)

- The internal rate of return is defined as the rate of discount which makes  $NPV=0$ .
- IRR of Project A is 14.5%, while IRR of Project B is 11.8%.  
→ Then, you will choose Project A.

## Investment Decision Making (6)

---

|               | <u>Project A</u> | <u>Project B</u> |
|---------------|------------------|------------------|
| Year 0        | ,100             | ,100             |
| Year 1        | 50               | 10               |
| Year 2        | 40               | 30               |
| Year 3        | 30               | 40               |
| Year 4        | 10               | 60               |
| <u>Year 5</u> | <u>5</u>         | <u>70</u>        |
| NPV           | <u>10.98</u>     | <u>48.38</u>     |
| IRR           | <u>16.0%</u>     | <u>23.2%</u>     |

- Your choice of project will change when future cash flows in Year 5 is added.
- Hence, projection of future cash flows is very important!

## Investment Decision Making (7)

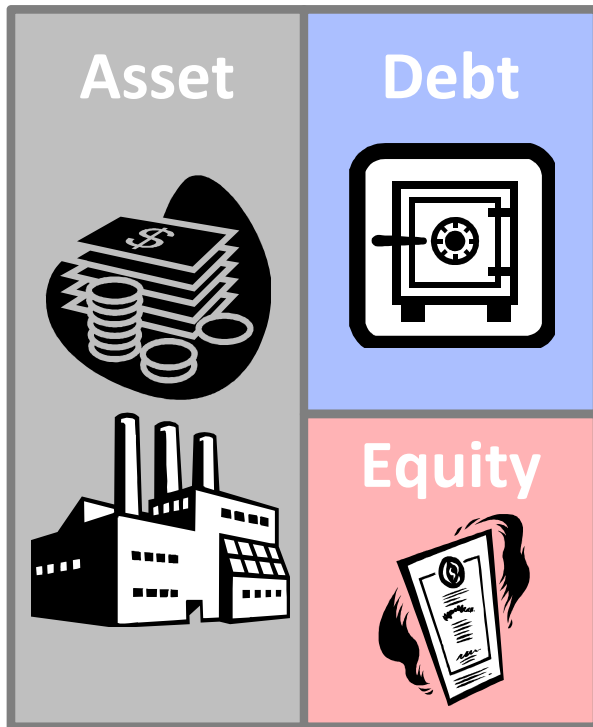
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|            | <u>Project A</u> | <u>Project B</u> |
|------------|------------------|------------------|
| Year 0     | ,100             | ,100             |
| Year 1     | 50               | 10               |
| Year 2     | 40               | 30               |
| Year 3     | 30               | 40               |
| Year 4     | 10               | 60               |
| Year 5     | 5                | 70               |
| <u>NPV</u> | <u>, 6.4</u>     | <u>9.4</u>       |
| IRR        | 16.0%            | 23.2%            |

- Your decision making will change when a discount factor is  $1/(1+0.2)^n$ , instead of  $1/(1+.01)^n$ .
- Hence, picking an appropriate “r”, a rate of return, is also very important.

# Equity Financing vs Debt Financing (1)

*Basic understanding on the differences...*



| From?                   | Repay principal? | Term?      | Collateral, guarantor | Costs?         | Priority in waterfall? |
|-------------------------|------------------|------------|-----------------------|----------------|------------------------|
| Banks, (Bond) Investors | Yes              | Long Short | Necessary             | Interest, Fees | V                      |
| (Equity) Investors      | No               | Long       | Not Necessarily       | Dividend, Fees |                        |

Source: JICA experts

## c.f. IRR & Cost of Capital

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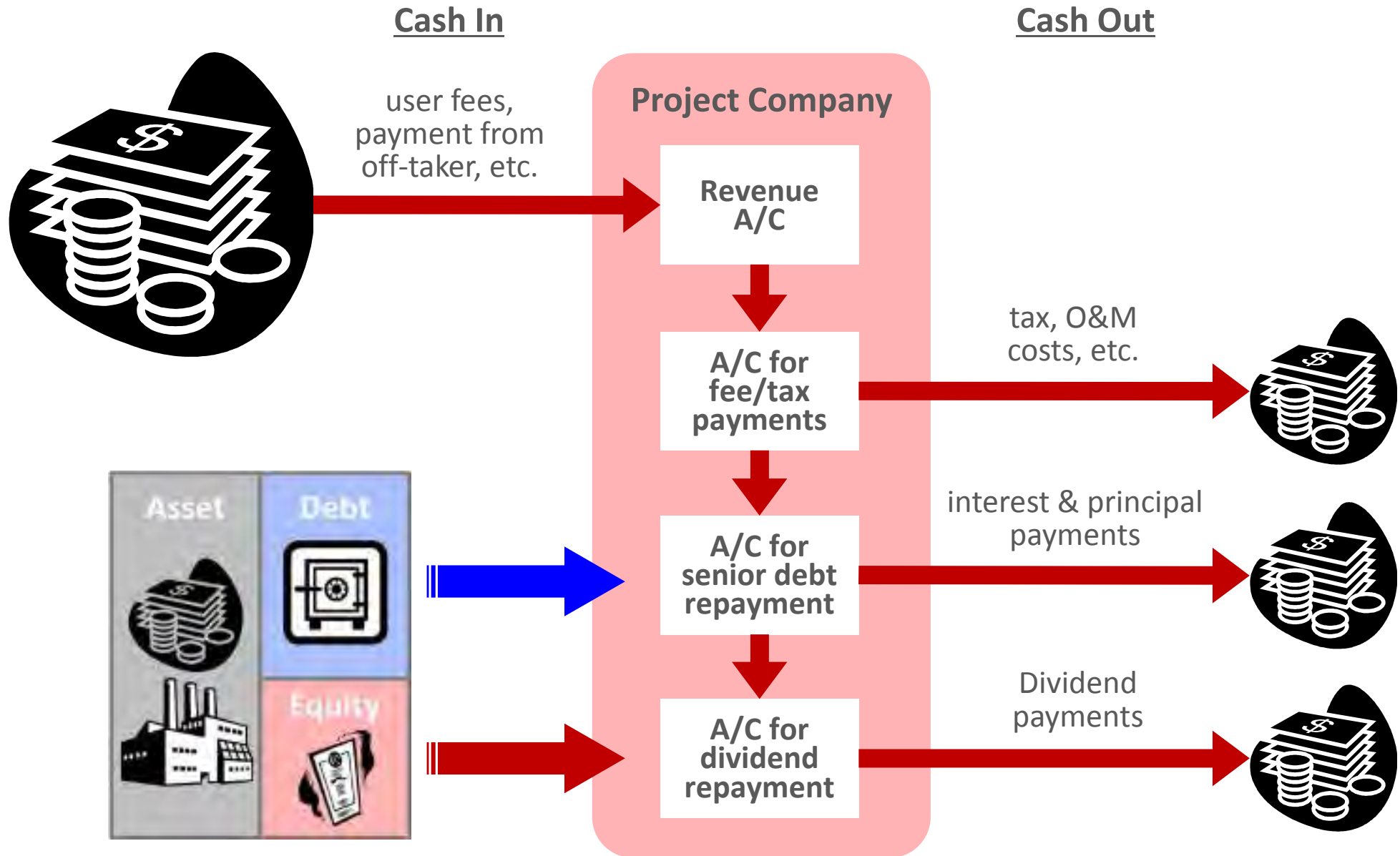
- Cost of Capital refers to the cost of a company's funds (both debt and equity).
- If IRR is smaller than Cost of Capital in a project, you will reject the project.  
If IRR is larger than Cost of Capital, you will go for it.
- Weighted Average Cost of Capital (WACC) is the weighted average of cost of debt and cost of equity.

e.g.) Debt: 20, Equity 30, Cost of debt: 8%, Cost of equity: 15%  
$$\text{WACC} = 8\% \times 20/50 + 15\% \times 30/50 = 12.2\%$$

- In general, cost of debt is cheaper than cost of equity, because debt holders tend to be secured by collateral and have higher priority of being paid in case of bankruptcy, i.e., less risky compared to equity holders.
- Cost of debt of company X is higher, when the amount of debt increases and the default risk rises.

# Equity Financing vs Debt Financing (2)

## Flow of cash under waterfall distribution



## c.f. Scenario Analysis

---

- In today's rapidly changing world, precise projection is very difficult.
- You could attempt to forecast several possible scenarios depending on the state of the economy, etc., and assign probabilities to each scenario.
- For example, NPV of Project A will be one of the following.

|                | <u>Base</u> | <u>Best</u> | <u>Worst</u> |
|----------------|-------------|-------------|--------------|
| NPV            | 50          | 200         | ,100         |
| Probability(%) | 50          | 25          | 25           |

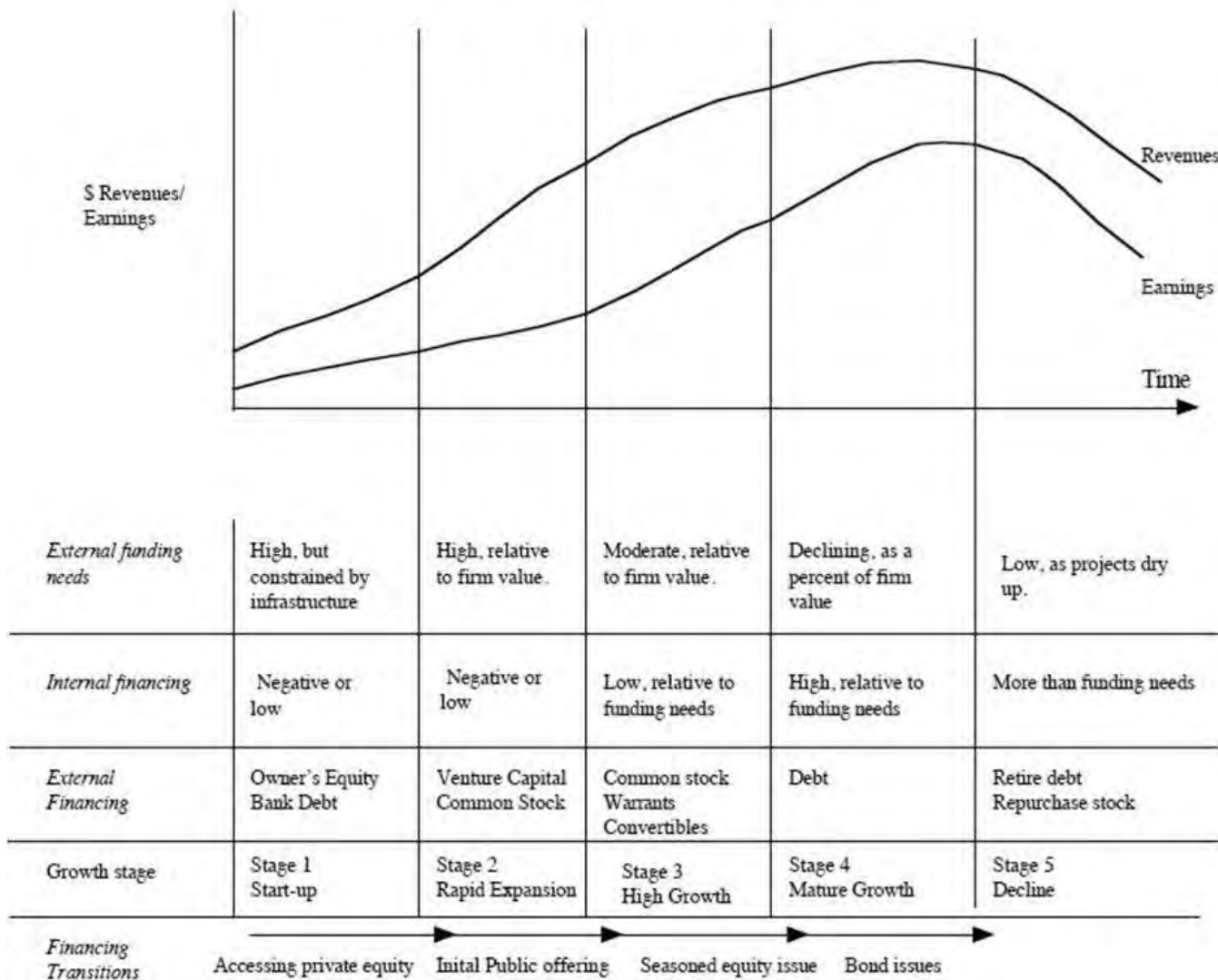
Then, the expected average NPV is 50. ( $= 50 \times 0.5 + 200 \times 0.25 + ,100 \times 0.25$ )

What if probability of each scenario would be Base: 50%, Best: 5%, Worst: 45%?

Then, the expected average NPY is ,10. ( $= 50 \times 0.5 + 200 \times 0.05 + ,100 \times 0.45$ )

# Financing Decision (1)

*Financing Choices across the life cycle*



When company X needs funds for a new project, two common options for financing are equity and debt.

**Equity:** Owner's equity, venture capital, common stock

**Debt:** Bank loan, corporate bond, CP

Financing needs of a company will change depending on its growth stage.



## Financing Decision (2)

---

|                         | Advantages   | Disadvantages  |
|-------------------------|--|--|
| <b>Equity financing</b> | <ul style="list-style-type: none"><li>• No need to pay back money invested.</li><li>• Involvement of high, profile investors may help the credibility of a business</li><li>• Possible to have valuable assistance from investors.</li></ul> | <ul style="list-style-type: none"><li>• Dilution of ownership interests and possible loss of control.</li></ul>  |
| <b>Debt financing</b>   | <ul style="list-style-type: none"><li>• Interest paid on debt financing is tax deductible.</li><li>• Lenders do not gain ownership interest.</li><li>• Adds discipline to management</li></ul>   | <ul style="list-style-type: none"><li>• Too much debt increases the perceived risk and reduces ability to raise additional funds.</li><li>• For new businesses, in which cash flows are not stable, it is difficult to get bank loans.</li></ul> |

The best mix of debt and equity financing depends on various factors such as:

- current debt, to, equity ratio
- the long, term goal of business
- the amount of control managers would like to maintain
- condition of financial market.

Types of debt financing (duration, currency, fixed/floating rate) should be considered based on nature of businesses.

## c.f. Debt, to, Equity Ratio

---

Debt, to, equity ratio varies depending on the industry.

e.g.) Listed companies in Japan

|                         | <u>1999</u> | <u>2009</u> |
|-------------------------|-------------|-------------|
| <u>All industries:</u>  | 254.4       | 168.3       |
| Manufacturing:          | 183.4       | 143.7       |
| [                    ]: | 56.3        | 43.8        |
| Cement:                 | 422.1       | 389.6       |
| Iron & Steel:           | 407.3       | 161.3       |
| Automobiles:            | 243.0       | 199.1       |
| Non, Manufacturing:     | 394.2       | 209.5       |
| Wholesale Trade:        | 1,295.2     | 323.3       |
| Retail:                 | 181.0       | 160.8       |
| Railroads:              | 812.9       | 378.6       |
| [                    ]: | 1,767.5     | 291.2       |

Source: DBJ “Handbook of Industrial Financial Data 2010”

## c.f. Bank Loans & Bonds

---

|            | <b>Bank Loans</b>  | <b>Bonds</b>  |
|------------|--|---|
| Borrower   | Size does not matter   | Should be larger in size  |
| Creditors  | Banks  | Bond holders (institutional investors, banks, general public, etc.)   |
| Repayment  | Regular installments in general  | Bullet payment in general<br>(Early redemption option could be included, but after a certain number of years) |
| Collateral | Required in general  | Not required in general   |
| Covenants  | More strict (Violation of covenant could lead to request for immediate repayment by banks) | Less strict   |
| Procedure  | Quicker  | Time consuming  |

## c.f. Credit Ratings & Default Risk

Sample numbers  
↓

2000 コホート

|       | 1年後   | 2年後   | 3年後   | 4年後   | 5年後   | 6年後   | 7年後   | 8年後   | 9年後   | 10年後  | サンプル数 |
|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| AAA   | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 18    |
| AA    | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 92    |
| A     | 0.00  | 0.38  | 0.76  | 0.76  | 0.76  | 0.76  | 0.76  | 0.76  | 0.76  | 1.15  | 263   |
| BBB   | 0.00  | 0.36  | 0.73  | 0.73  | 1.46  | 1.46  | 1.46  | 1.46  | 1.83  | 2.21  | 279   |
| BB    | 0.00  | 0.00  | 1.39  | 5.62  | 7.05  | 8.48  | 9.91  | 9.91  | 11.36 | 11.36 | 74    |
| B以下   | 18.18 | 36.36 | 54.55 | 54.55 | 54.55 | 65.91 | 65.91 | 65.91 | 65.91 | 65.91 | 11    |
| BBB以上 | 0.00  | 0.31  | 0.62  | 0.62  | 0.93  | 0.93  | 0.93  | 0.93  | 1.09  | 1.41  | 652   |
| BB以下  | 2.35  | 4.71  | 8.32  | 12.04 | 13.30 | 15.81 | 17.07 | 17.07 | 18.34 | 18.34 | 85    |
| 全体    | 0.27  | 0.82  | 1.51  | 1.92  | 2.34  | 2.62  | 2.76  | 2.76  | 3.05  | 3.33  | 737   |

Source: Rating and Investment Information, Inc. "The Relationship between Credit Ratings and Default" (June 30, 2011)

For a company with lower credit rating, default risk will be higher, and hence, cost of borrowing will be more expensive.

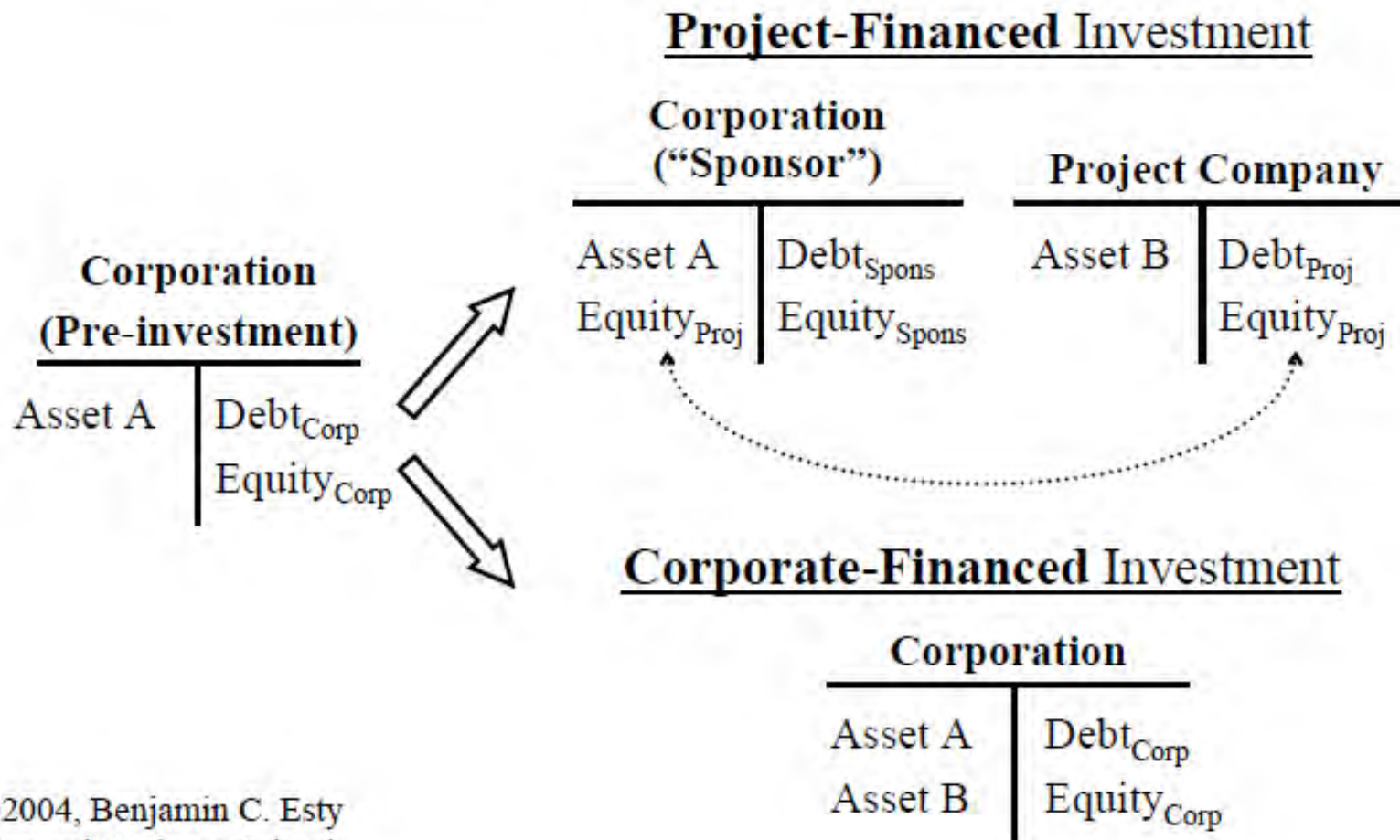
# Corporate Finance vs Project Finance (1)

|  | Corporate Finance  | Project Finance   |
|--|--|---|
| Financing vehicle                          | Multi,purpose organization   | Single,purpose entity   |
| Type of capital                            | Permanent ,, , an indefinite time horizon for equity   | Finite ,, , time horizon matches life of project  |
| Dividend policy and reinvestment decisions | Corporate management makes decisions autonomous from investors and creditors                 | Fixed dividend policy ,, , immediate payout; no reinvestment allowed                                  |
| Capital investment decisions               | Opaque to creditors  | Highly transparent to creditors   |
| Financial structures                       | Easily duplicated; common forms  | Highly,tailored structures which cannot generally be re,used  |
| Transaction costs for financing            | Low costs due to competition from providers, routinized mechanisms and short turnaround time | Relatively higher costs due to documentation and longer gestation period                              |
| Size of financings                         | Flexible   | Might require critical mass to cover high transaction costs   |
| Basis for credit evaluation                | Overall financial health of corporate entity; focus on balance sheet and cashflow            | Technical and economic feasibility; focus on project's assets, cash flow and contractual arrangements |
| Cost of capital                            | Relatively lower   | Relatively higher   |
| Investor / lender base                     | Typically broader participation; deep secondary markets                                      | Typically smaller group; limited secondary markets  |

Source: The Wharton School "Project Finance Teaching Note" (<http://finance.wharton.upenn.edu/~bodnarg/ml/projfinance.pdf>)

# Corporate Finance vs Project Finance (2)

**The Definition of Project Finance:**  
**Comparison of Project- vs. Corporate-Financed Investment**

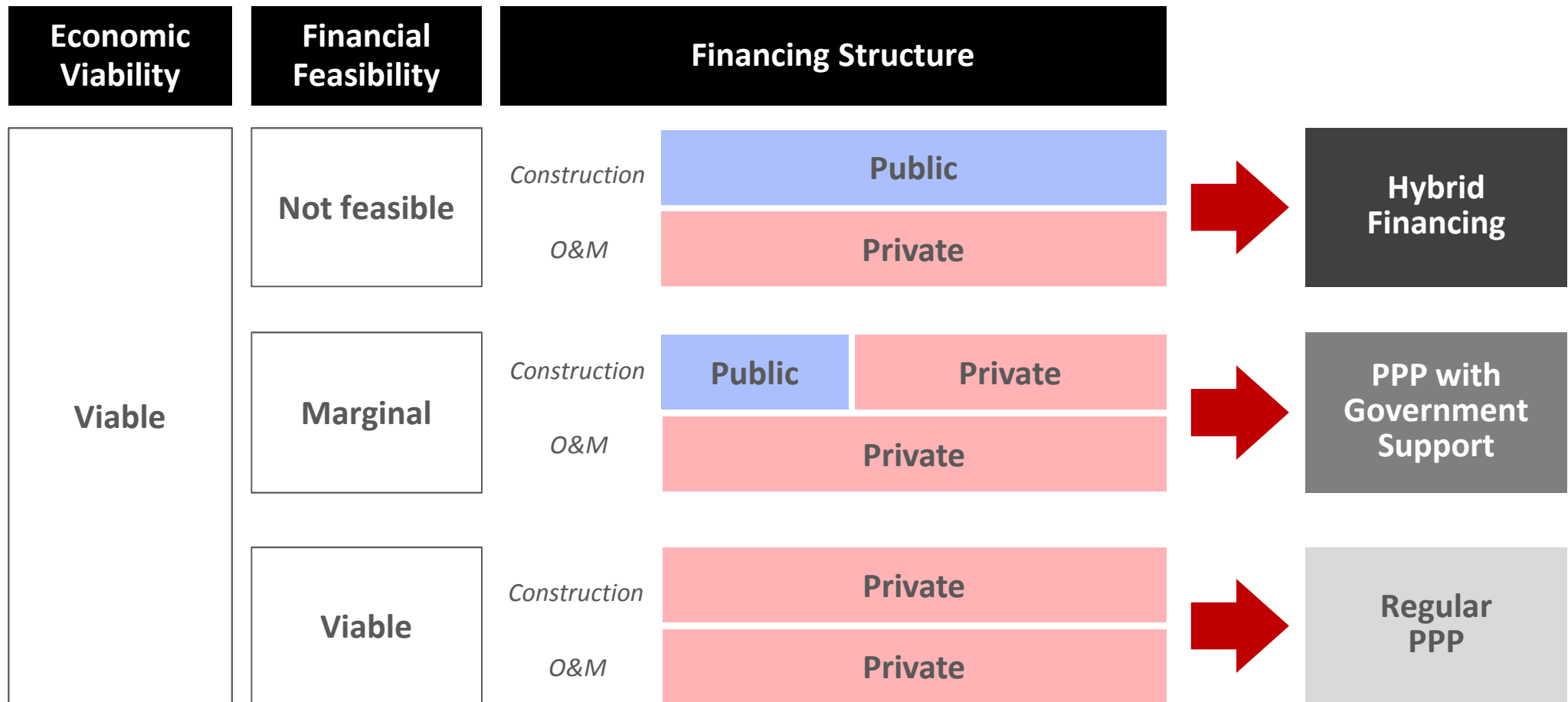


## **3. Relevant Issues**

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# PPP (1)

## How to finance PPP?

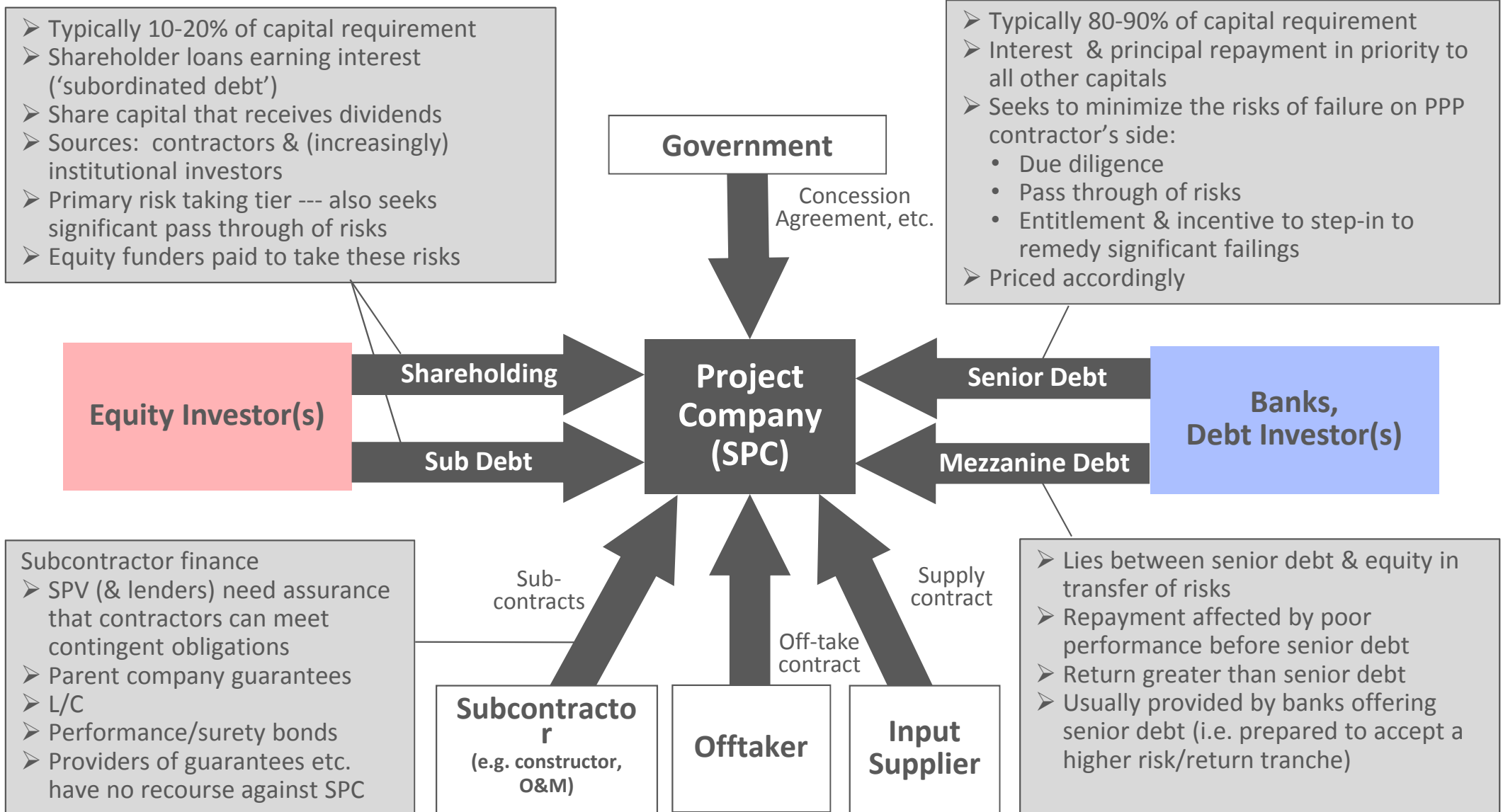


Source: JICA experts from Bastary Pandji Indra, 'Urban Infrastructure PPP –an Indonesian Perspective' (2010)



# PPP (2)

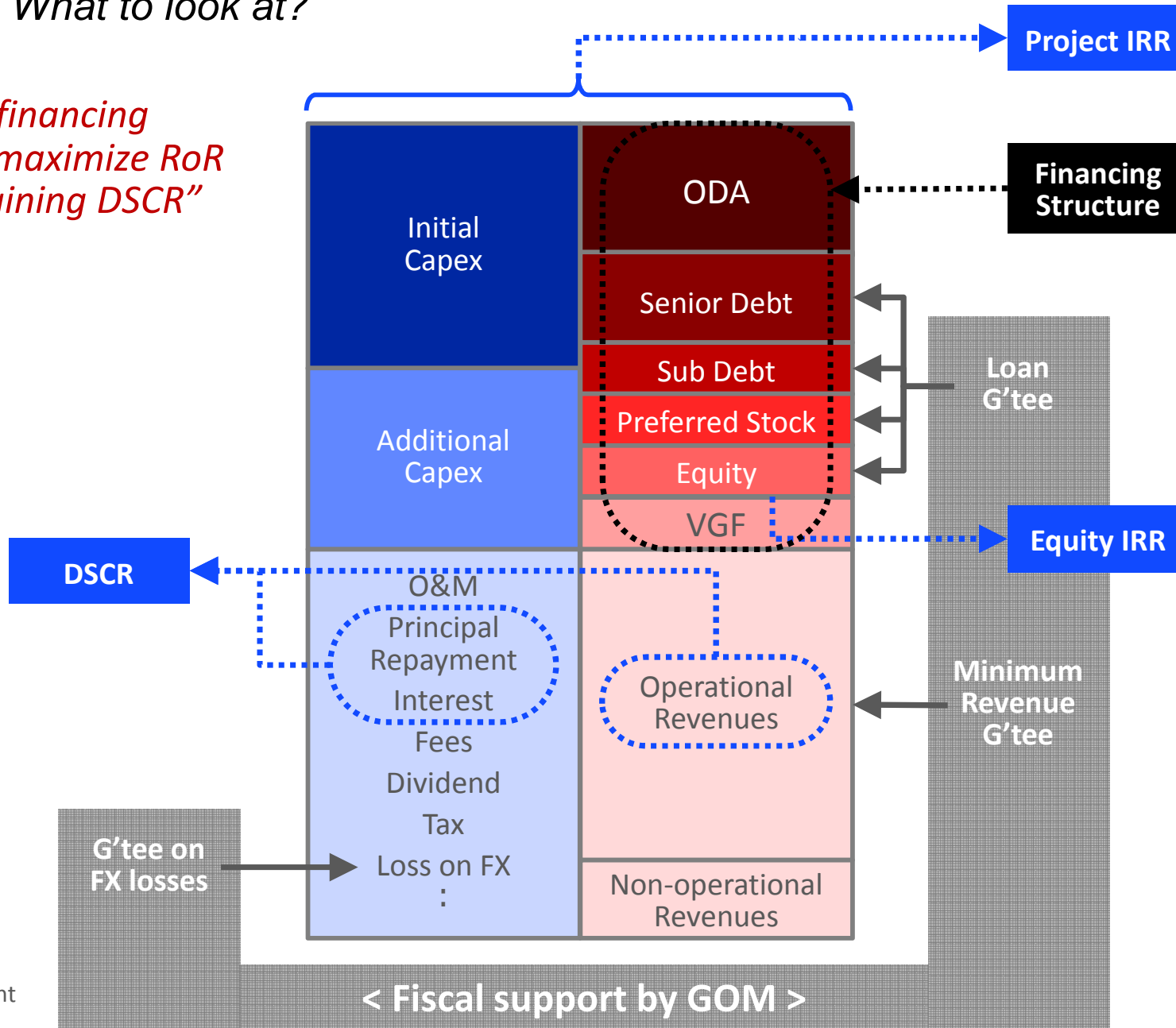
## General financing structure for PPPs



# PPP (3)

## PPP finance: What to look at?

*“Optimizing financing structure to maximize RoR while maintaining DSCR”*



# Privatization (1)

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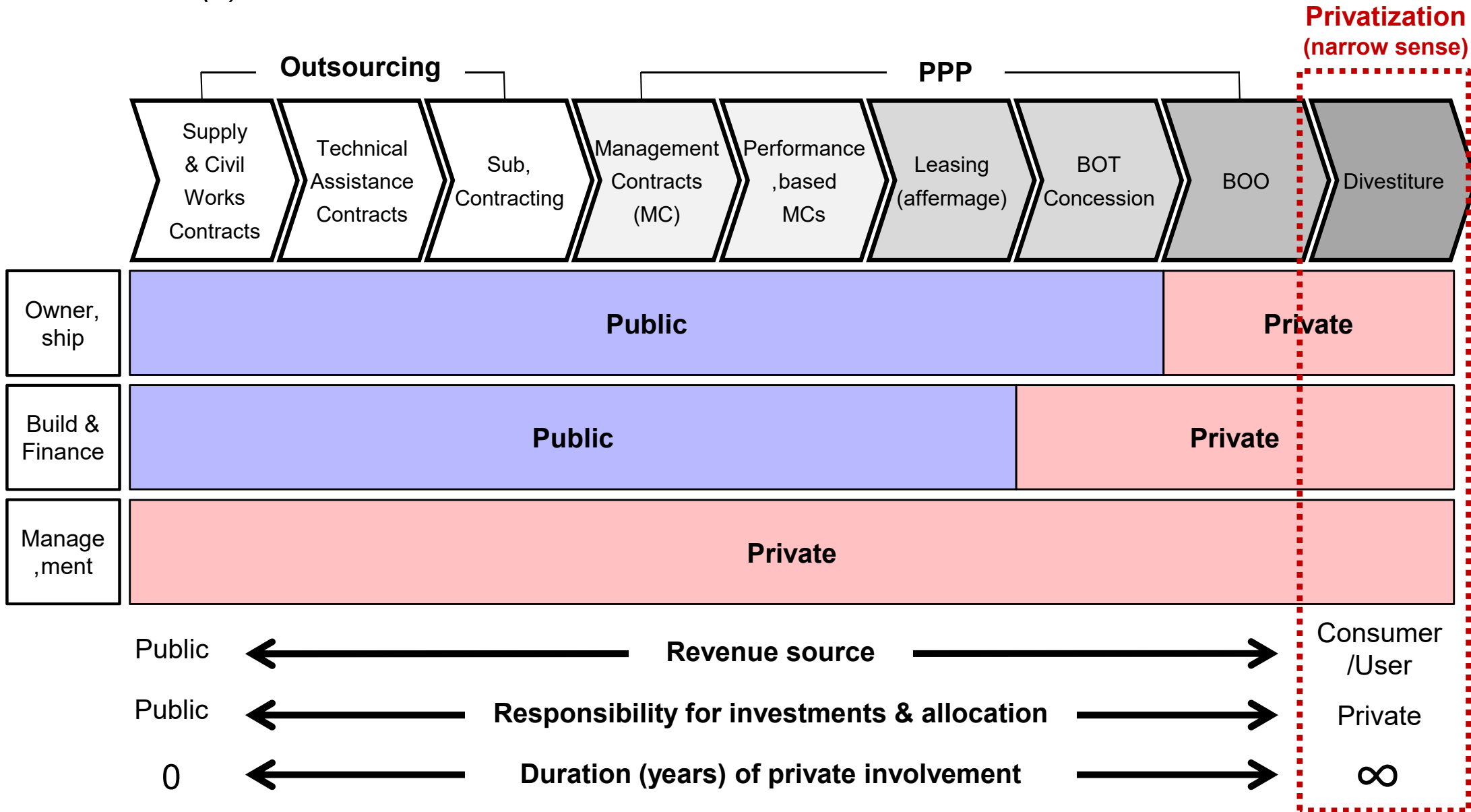
## *Definition (1)*

- Process of transferring ownership of a business, enterprise, agency, public service, or public property from the public sector to the private sector
- Choice of privatization method is influenced by the depth of capital markets, political and company-specific factors



# Privatization (2)

## Definition (2)



## Privatization (3)

### *Why Privatize?*

- **Burden of loss making SOEs on government budget. (SOE losses against GDP)**
  - ✓ **9% Poland (incl. subsidies)**
  - ✓ **9% Argentina in 1989**
  - ✓ **Mongolia?**



- **Benefits (Most cases had shown better results)**
  - ✓ **Productivity increase**
  - ✓ **Faster growth**
  - ✓ **Greater cost savings**
  - ✓ **Enhance domestic capital markets**



# Privatization (4)

## Framework for Privatization Strategy

### Settlement of Political Target

- **Government's budget reconstruction**

- ✓ realize capital gain
- ✓ securement of tax revenue
- ✓ reduction of government spending

- **Enhance service for consumer**

- ✓ reduction of cost
- ✓ improvement of service quality
- ✓ depoliticization

- **Flourish domestic industry**

- ✓ creation of business opportunity
- ✓ enhancement of competitiveness
- ✓ developing capital market

### Analysis of Strategic Key Factors

- **Ownership**

- ✓ pursuing economical efficiency
- ✓ improvement of governance
- ✓ liberation of legal restriction

- **Management know-how**

- ✓ improve efficiency
- ✓ benefit by creating demand
- ✓ enhance convenience

- **Finance**

- ✓ Contribute to government's budget
- ✓ Non,budget system
- ✓ disciplined control

- **Market mechanism**

- ✓ Improving efficiency

### Choice of Method

- **Ownership transfer**

- ✓ IPO
- ✓ Trade sale
- ✓ MBO

- **PPP**

- ✓ PFI
- ✓ Concession
- ✓ BOT / BOO
- ✓ Outsourcing

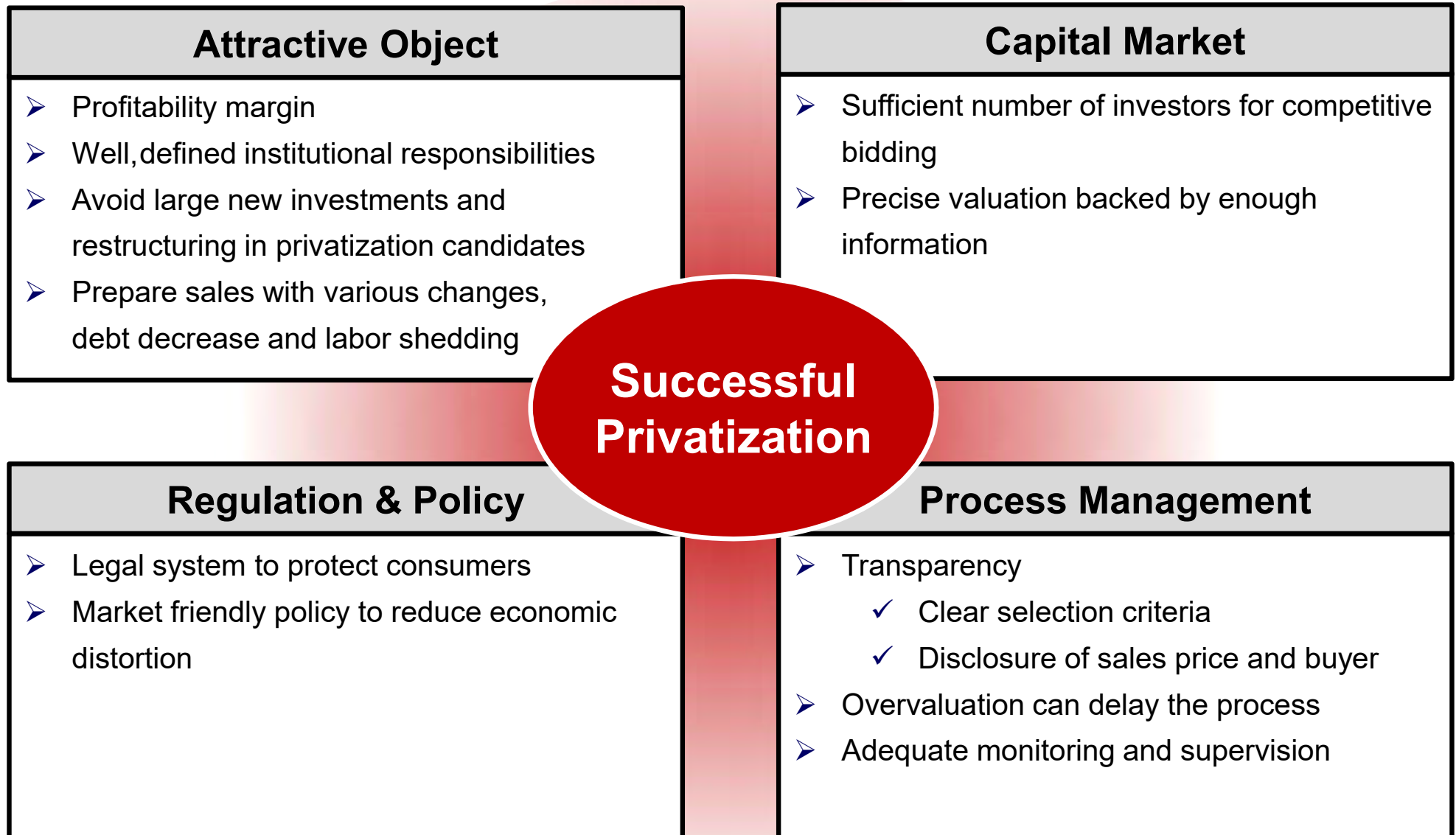
- **Market liberation**

- ✓ bidding
- ✓ deregulation

\* Source: Yumiko NODA, *Strategy and Methods of Privatization* 2004

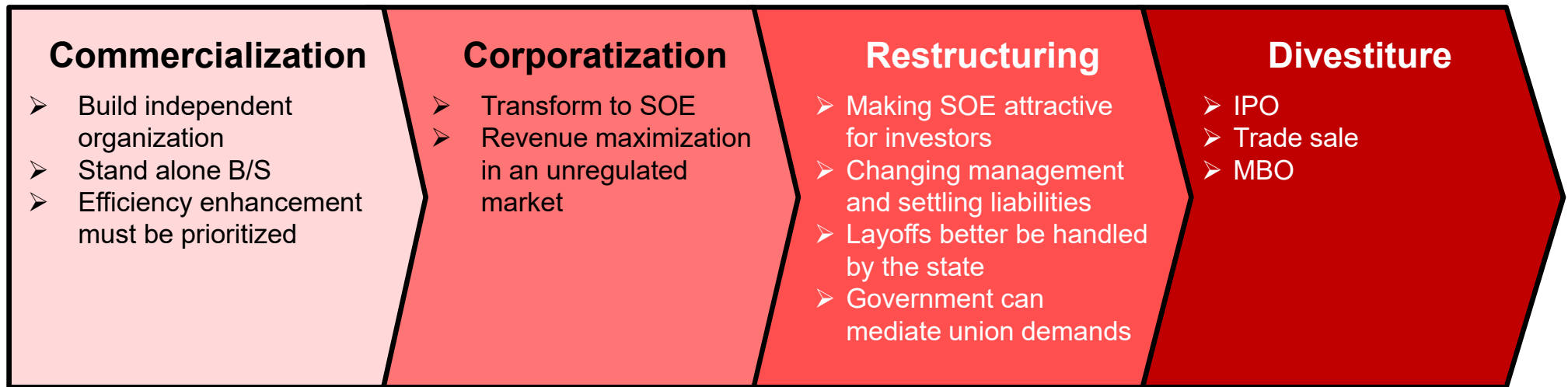
# Privatization (5)

## Keys for Success



# Privatization (6)

## 4 Steps







- Deregulation of the relative markets contributes to the smooth process
- Promoting competition and ensuring competitive market for divestiture in favorable terms



# Privatization (7)

## Cases in Japan

\* Simple sum of the numbers for the group companies

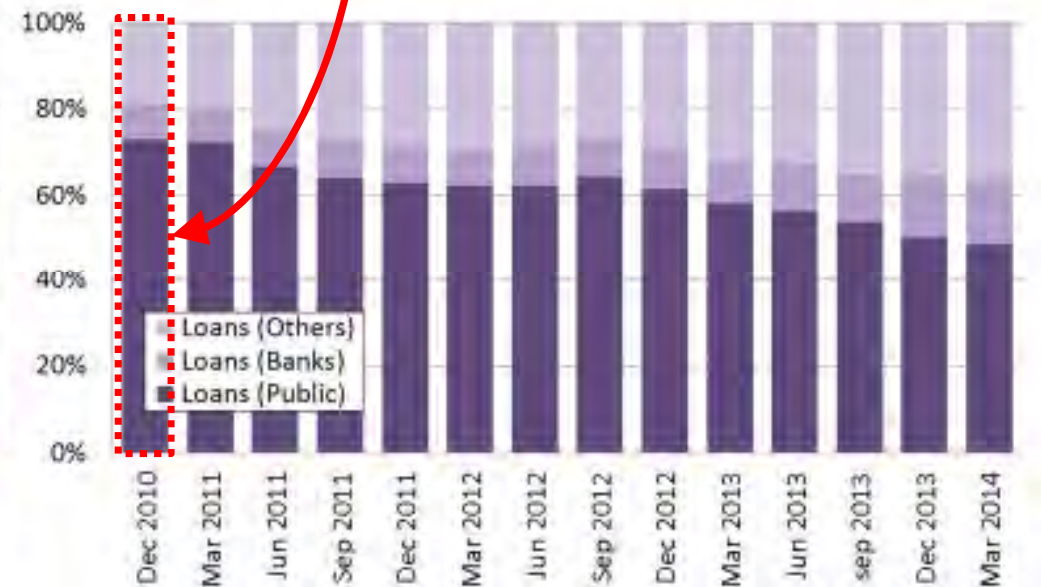
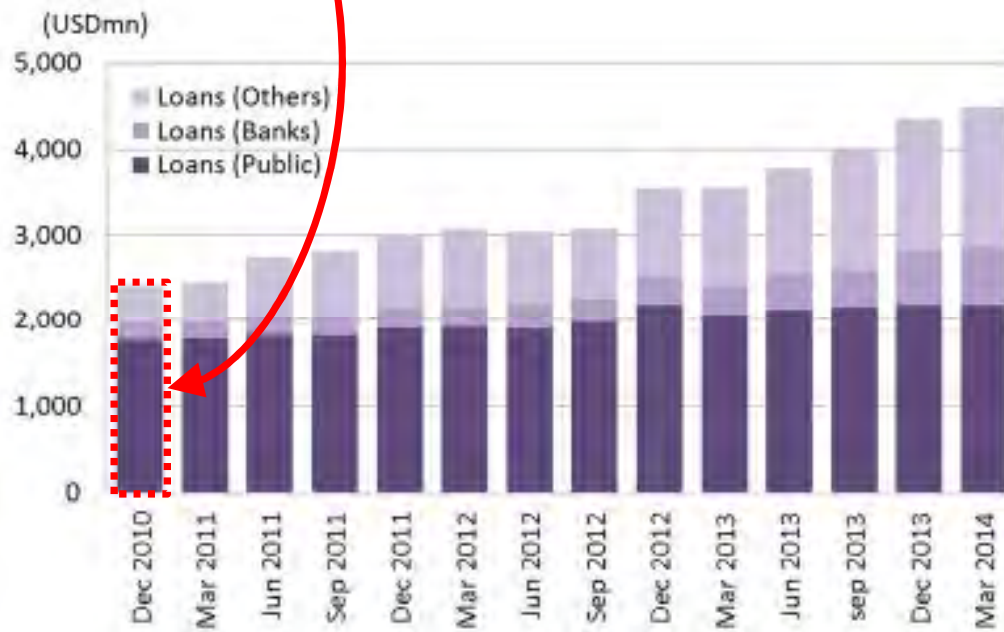
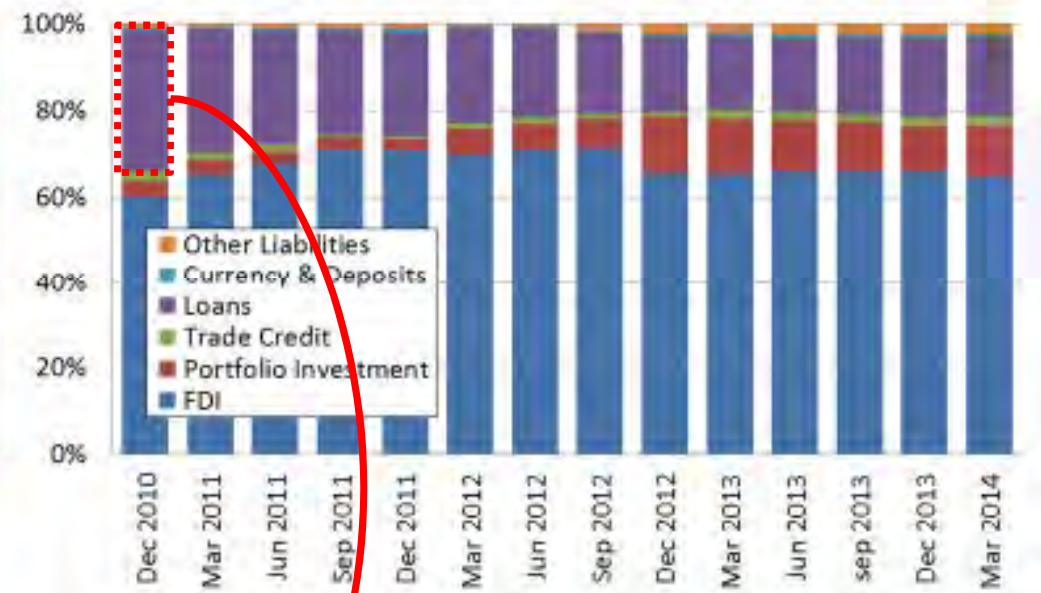
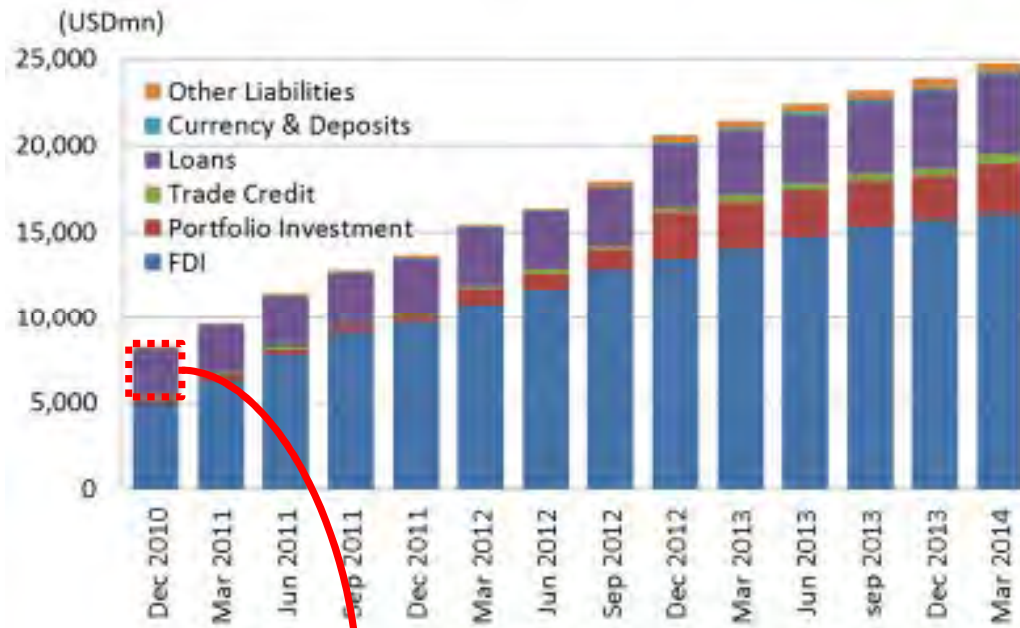
| (As of March 31, 2014)<br>Consolidated                    |  <b>NTT</b> |                        |  |  <b>TEPCO</b> |
|---|--|---|---|--|
|   | Nippon Telegraph and Telephone corporation   | East Japan Railway and 6 companies  | Japan Tobacco   | Tokyo Electric Power Company   |
| Establishment / Listed                                    | 1985 / 1985  | East: 1987 / 1992<br>West&Central: 1987 / 1993  | 1985 / 1994   | 1952 / 2003  |
| Employees<br>(person)                                     | 239,750  | East: 73,511<br>Group total: 173,591  | 51,341  | 35,723   |
| Paid, In Capital<br>(JPY bn)                              | 938  | East: 200<br>Group total*: 460  | 100   | 1,400  |
| Total Asset<br>(JPY bn)                                   | 20,285   | East: 7,428<br>Group total*: 18,481   | 4,611   | 14,801   |
| Total Revenue<br>(JPY bn)                                 | 10,925   | East: 2,704<br>Group total*: 6,432  | 2,400   | 6,631  |
| Market Capitalization<br>(JPY bn)                         | 9,092  | 9,890<br>(East & West & Central Sub, total)   | 8,132   | 770  |
| Ownership<br>(Voting rights base)<br>(red= public sector) | <b>MOF: 35.65%</b><br>Employee: 0.81%  | <u>Privatized 3 companies</u><br>Private: 100.00%<br><br><u>Other 4 companies</u><br><b>JRTT: 100.00%</b> | <b>MOF: 33.35%</b>  | <b>NDF*: 50.10%</b><br>Employee: 1.46%<br><b>Tokyo Metropolis: 1.35%</b>                         |
| Floated stock (%)   | 64.35%   | 100.00%<br>(East & West & Central)  | 66.65%  | 48.55%   |

\* Nuclear Damage Compensation and Decommissioning Facilitation Corporation

# c.f. Structure of Cross Border Financing

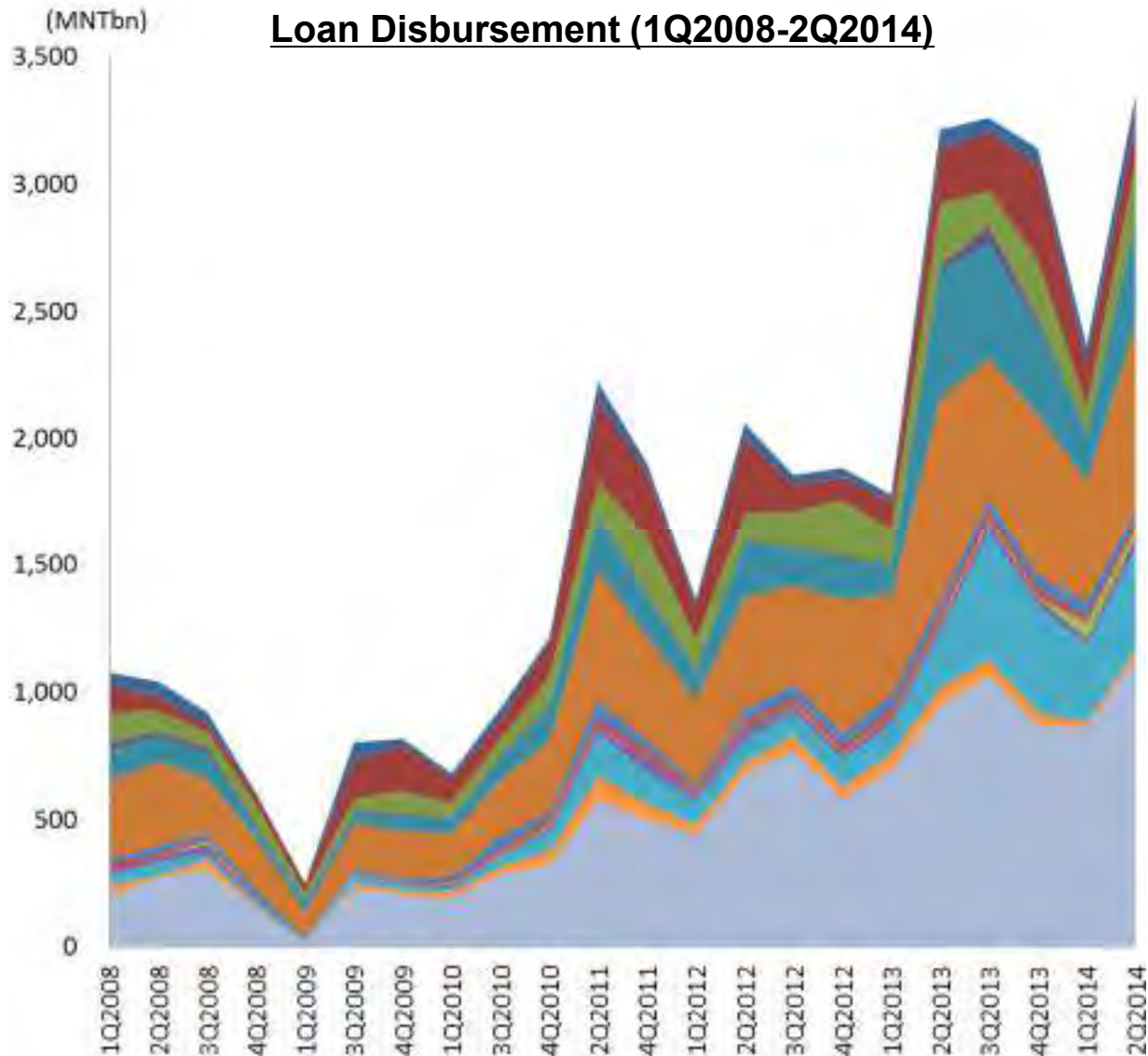
## Recent changes in cross border money flows captured through IIP(\*)

(\*) IIP = International Investment Position  
Source: JICA experts from Mongol Bank

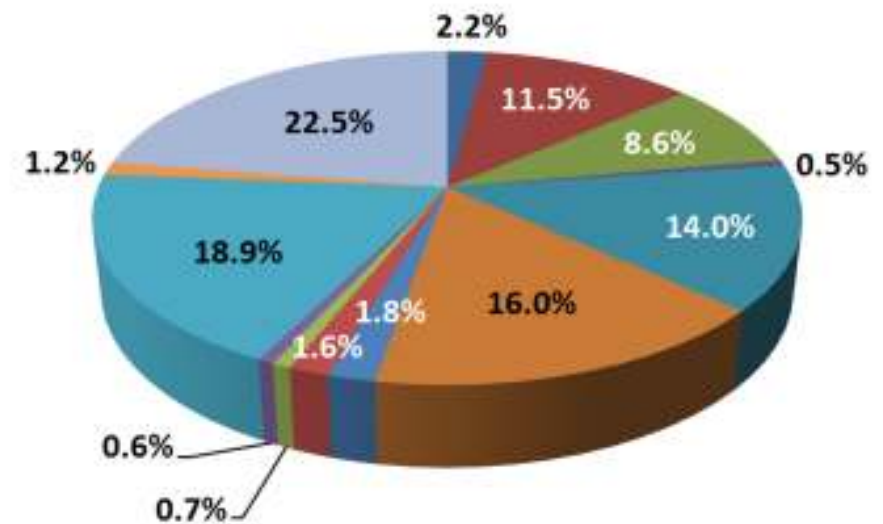


## c.f. Sector Composition of Debt Financing

### Loan disbursement & outstanding by sector



### Sector Composition of Loan Outstanding (2Q2014)



Source: JICA experts from Mongol Bank

For Further Questions/Inquiries...

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## JICA Consultant Team / Corporate Finance Analysis

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Phone: +81-3-6214-4630

# **Project for Capacity Building of Capital Market in Mongolia: Financials for Securities Companies**

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30 April 2015

Daiwa Institute of Research  
Japan Economic Research Institute

## 1a. Securities companies' business

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### 1. Brokerage

Traditional and main source of income for most of securities companies. Branch network and online IT system are keys to success.

### 2. Underwriting

Requires skilled staff. It usually takes years from the time when an underwriter starts talking with a company to its IPO. Underwriting commission rate can be as high as 5%, taking risks of price variation of shares that are bought from the company before selling out to investors.

### 3. Dealing

Securities companies also act as an investor.

### 4. Others

With diversified business, securities companies also collect commissions such as M&A advisory fees, fund management fees, administrative commissions, other financial product related commissions etc.

## 1b. Securities companies' business: Brokerage commission

Brokerage commission is the fee an investor pays to a securities broker for placing buy/sell order.

Example: You place buy order for Sugi Corp, 3,000 shares, at MNT15,000.

|                               |              |
|-------------------------------|--------------|
| Sugi Corp current share price | MNT15,000    |
| Order volume                  | 3,000 shares |
| Brokerage commission rate     | 0.8%         |

Brokerage commission you have to pay to your securities company, in other words your securities company's income is:

$$\text{MNT}15,000 \times 3,000 \text{ shares} \times 0.8\% = \text{MNT}360,000$$

## 1c. Securities companies' business: Underwriting commission

Underwriting commission is the fee that a company pays to securities companies/investment banks for underwriting. Underwriting is that securities companies/investment banks buy new shares from a issuer before an IPO.

Example: Sugi Corp makes an IPO by issuing new shares and three securities companies (Urade Securities, Kaneko Securities, Ozaki Securities) underwrite the shares.

|                              |                   |
|------------------------------|-------------------|
| Sugi Corp IPO price          | MNT15,000         |
| New shares issued            | 30,000,000 shares |
| Underwriting commission rate | 5.0%              |
| Urade Securities' allotment  | 15,000,000 shares |
| Kaneko Securities' allotment | 10,000,000 shares |
| Ozaki Securities' allotment  | 5,000,000 shares  |

Underwriting commission that Sugi Corp has to pay to Urade Securities, in other words, Urade Securities' income is:

$$\text{MNT}15,000 \times 15,000,000 \text{ shares} \times 5.0\% = \text{MNT}11.25\text{m}$$



## 1d. Securities companies' business: Dealing

Dealing is buy/sell activities by a securities company using its own money.

Example: A dealer at Urade Securities bought Sugi Corp's shares last month, then sells all of them this month.

|  |                                |
|--|--------------------------------|
| Sugi Corp's share price on 31 Mar                              | MNT15,000                      |
| Volume at dealer's account                                     | 30,000 shares                  |
| Sugi Corp's share price on 30 Apr                              | MNT 16,000                     |
| Urade Securities' client Mr Z agrees to buy Sugi Corp's shares | at MNT16,000,<br>30,000 shares |

Urade Securities' dealer made profit in this transaction:

$$\text{MNT}16,000 \times 30,000 \text{ shares} - \text{MNT}15,000 \times 30,000 \text{ shares} = \text{MNT}30\text{m}$$

## 2a. Aggregate statements of income for Japanese securities industry

JPY bn

|  | Mar-10 | Mar-11 | Mar-12 | Mar-13 | Mar-14 |
|--|--------|--------|--------|--------|--------|
| <b>Commission received</b>                 | 2,128  | 1,898  | 1,635  | 1,794  | 2,461  |
| <b>Net gain on trading</b>                 | 805    | 540    | 636    | 896    | 1,098  |
| <b>Other revenues</b>                      | 32     | 53     | 33     | 41     | 49     |
| <b>Operating revenues</b>                  | 3,382  | 2,920  | 2,711  | 3,171  | 4,089  |
| <b>Net financial revenues</b>              | 149    | 161    | 167    | 166    | 192    |
| <b>Net operating revenues</b>              | 3,114  | 2,652  | 2,471  | 2,898  | 3,801  |
| <b>Selling, general and admin expenses</b> | 2,774  | 2,618  | 2,286  | 2,317  | 2,628  |
| <b>Operating income</b>                    | 340    | 34     | 185    | 581    | 1,172  |
| <b>Net non-operating income</b>            | -7     | 53     | 33     | 25     | 17     |
| <b>Income before tax</b>                   | 334    | 87     | 218    | 606    | 1,189  |
| <b>Extraordinary items</b>                 | -19    | -198   | -42    | 8      | 26     |
| <b>Income tax</b>                          | 112    | 160    | 202    | 156    | 301    |
| <b>Net income</b>                          | 202    | -271   | -26    | 457    | 914    |

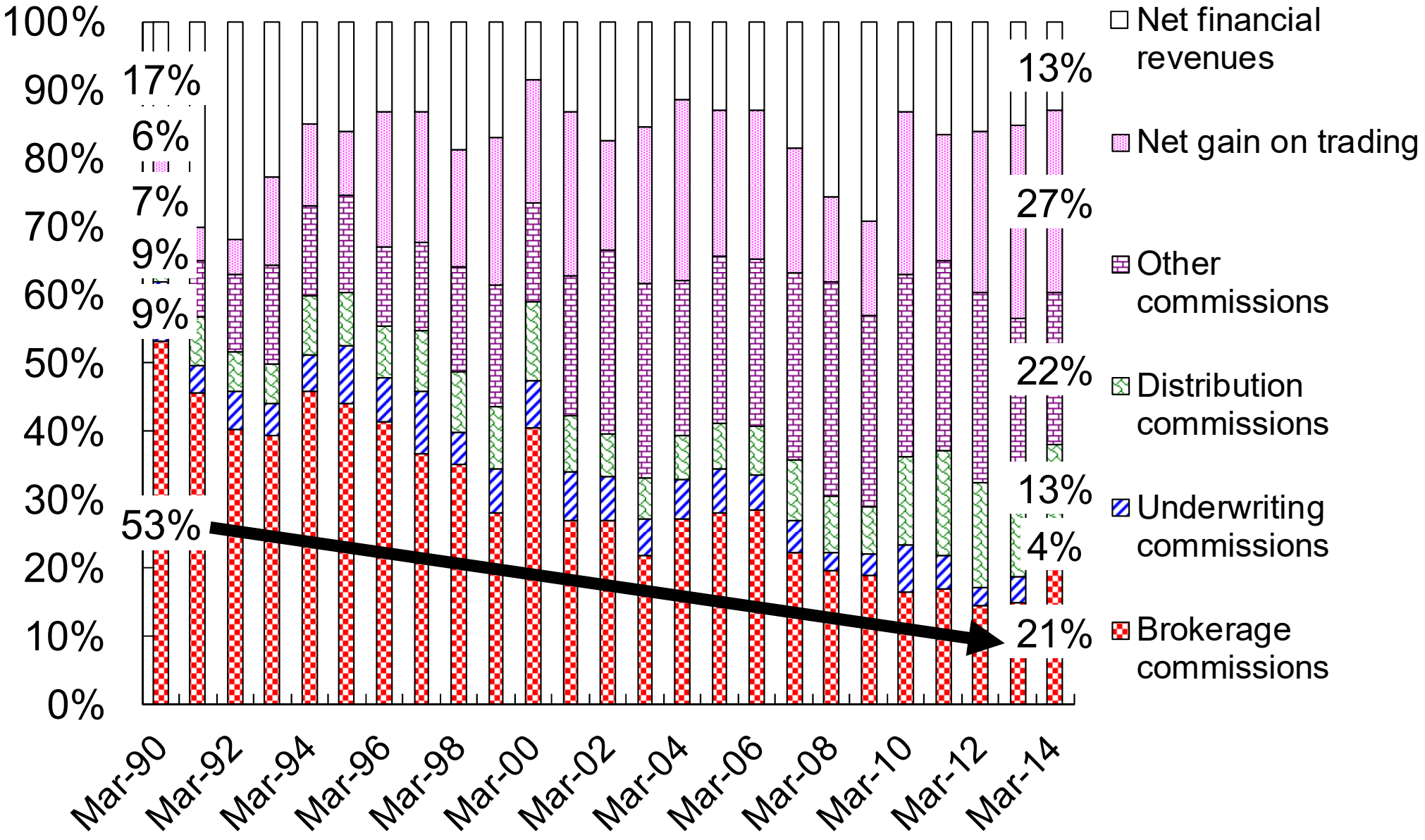
Source: Japan Securities Dealers Association

## 2a. Brief description for securities' companies' statements of income

| Item                                       | Description  |
|--|--|
| <b>Commission received</b>                 | Brokerage commission, underwriting commission etc.   |
| <b>Net gain on trading</b>                 | Dealing  |
| <b>Operating revenues</b>                  | Commission received + Net gain on trading  |
| <b>Net financial revenues</b>              | Dividend income, bond coupon income, margin trade income, securities lending income etc.                         |
| <b>Net operating revenues</b>              | Operating revenues + net financial revenues  |
| <b>Selling, general and admin expenses</b> | Employees' compensation & benefits, occupancy & rental, trading related expense, IT system, office supplies etc. |
| <b>Operating income</b>                    | Profit from operations   |
| <b>Net non-operating income</b>            | Net interest & investment income not included in net financial revenues  |
| <b>Income before tax</b>                   | Profit before corporate tax  |
| <b>Extraordinary items</b>                 | Temporary items such as one-time charge  |
| <b>Income tax</b>                          | Corporate tax  |
| <b>Net income</b>                          | Net profit   |

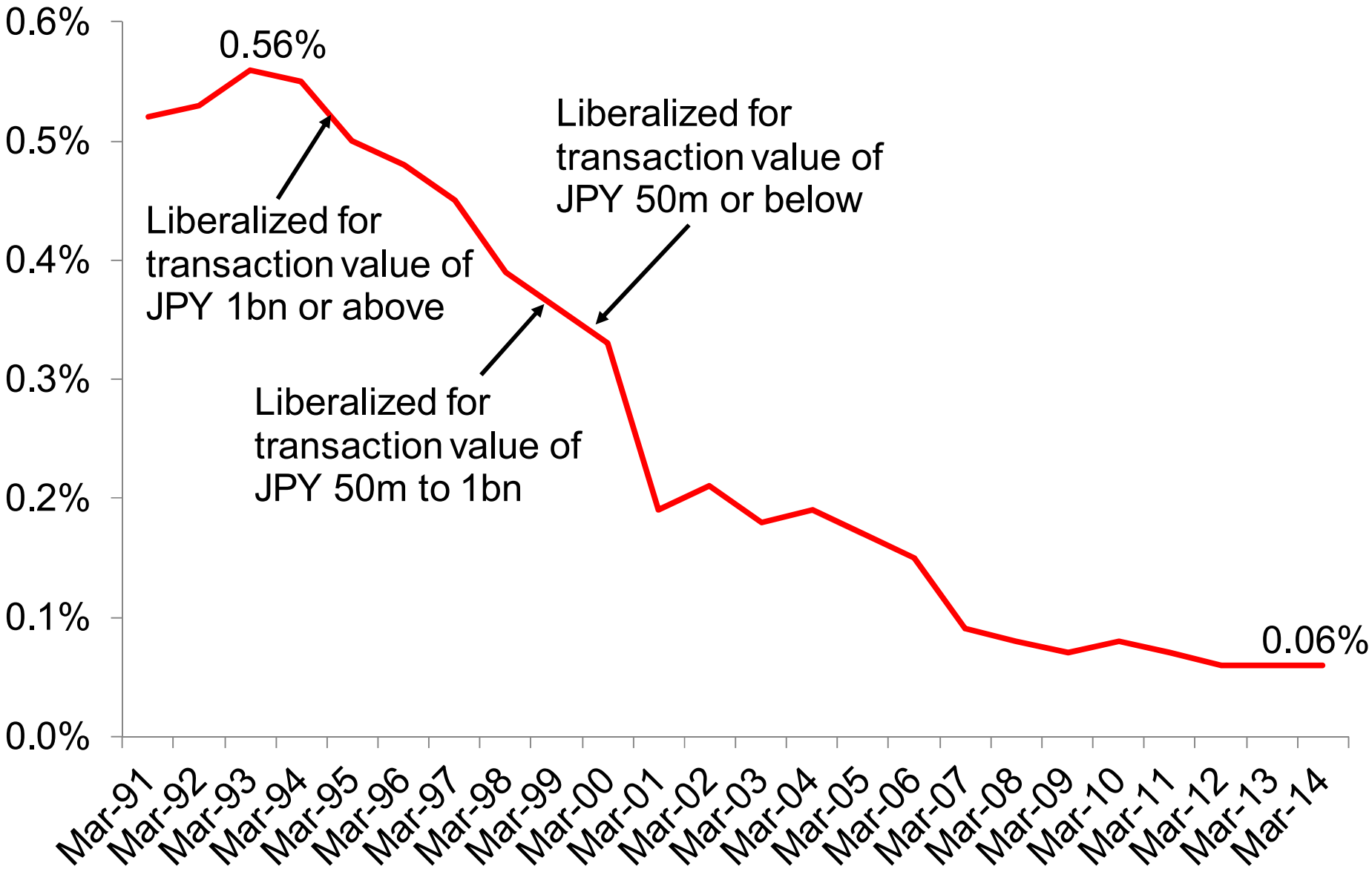
Source: Daiwa Institute of Research

# 2b. Net operating revenue breakdown for Japanese securities industry



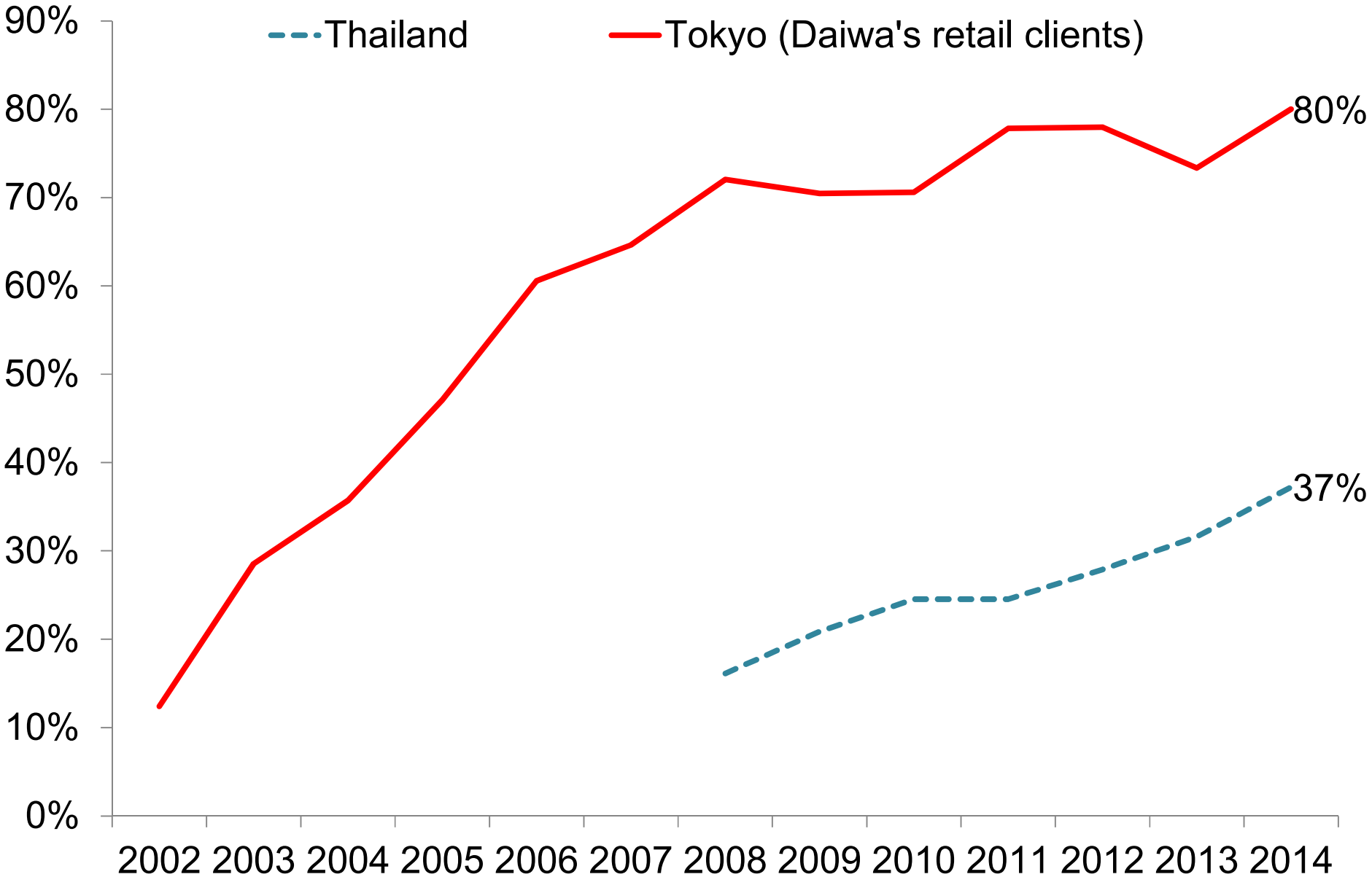
Source: Japan Securities Dealers Association

# 2-c. Declines in brokerage business: Liberalization of brokerage commission



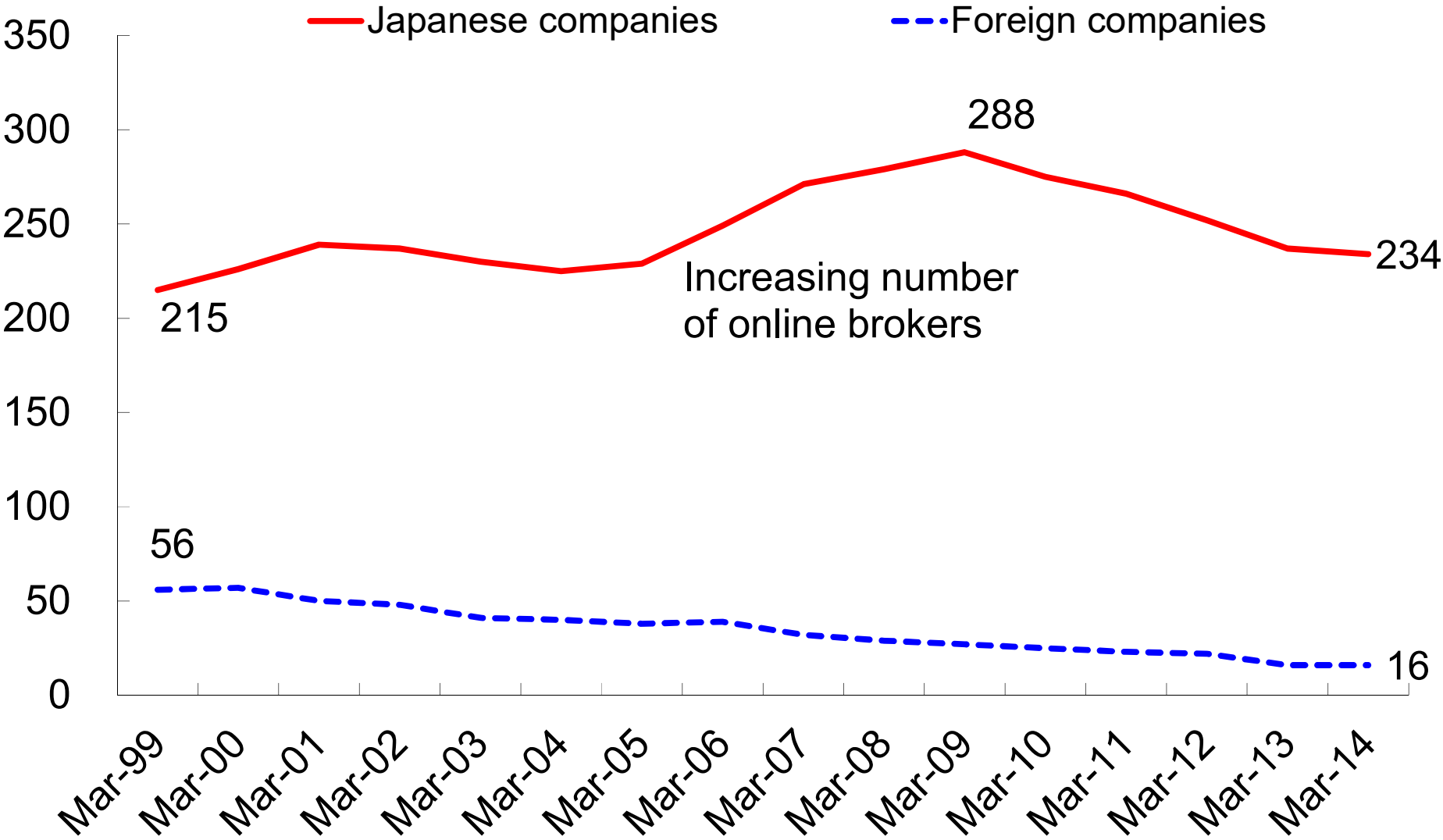
Source: Tokyo Stock Exchange

## 2-d. Lowering brokerage commission rate: Rising % share of online trading



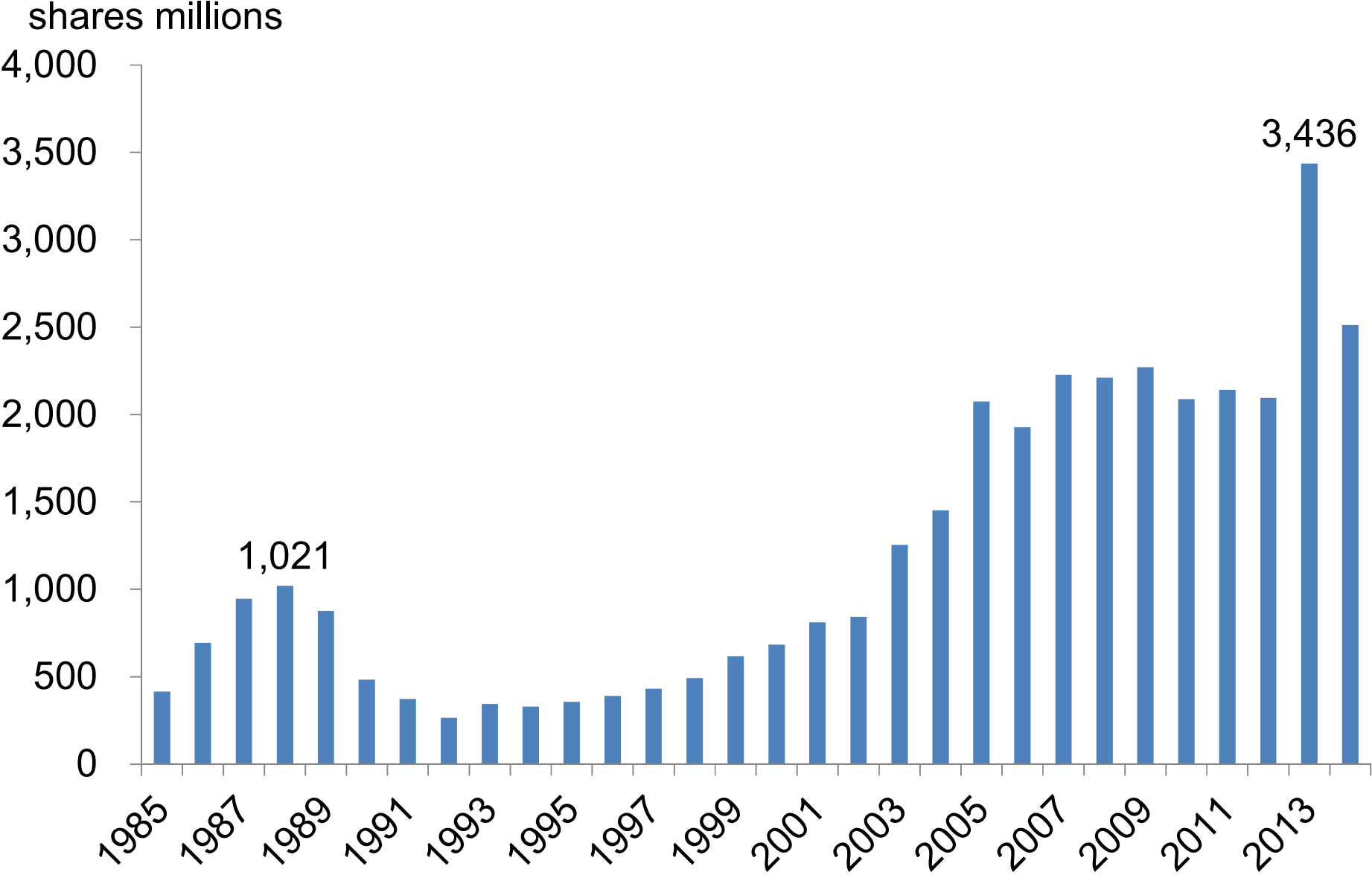
Source: Daiwa Securities Group, Inc., Stock Exchange of Thailand

## 2-e. Online brokers: Trend in number of securities companies in Japan



Source: Japan Securities Dealers Association

**2-f. Lower commission rates: Increased daily avg trading vol at Tokyo Stock Exchange**



Source: Tokyo Stock Exchange

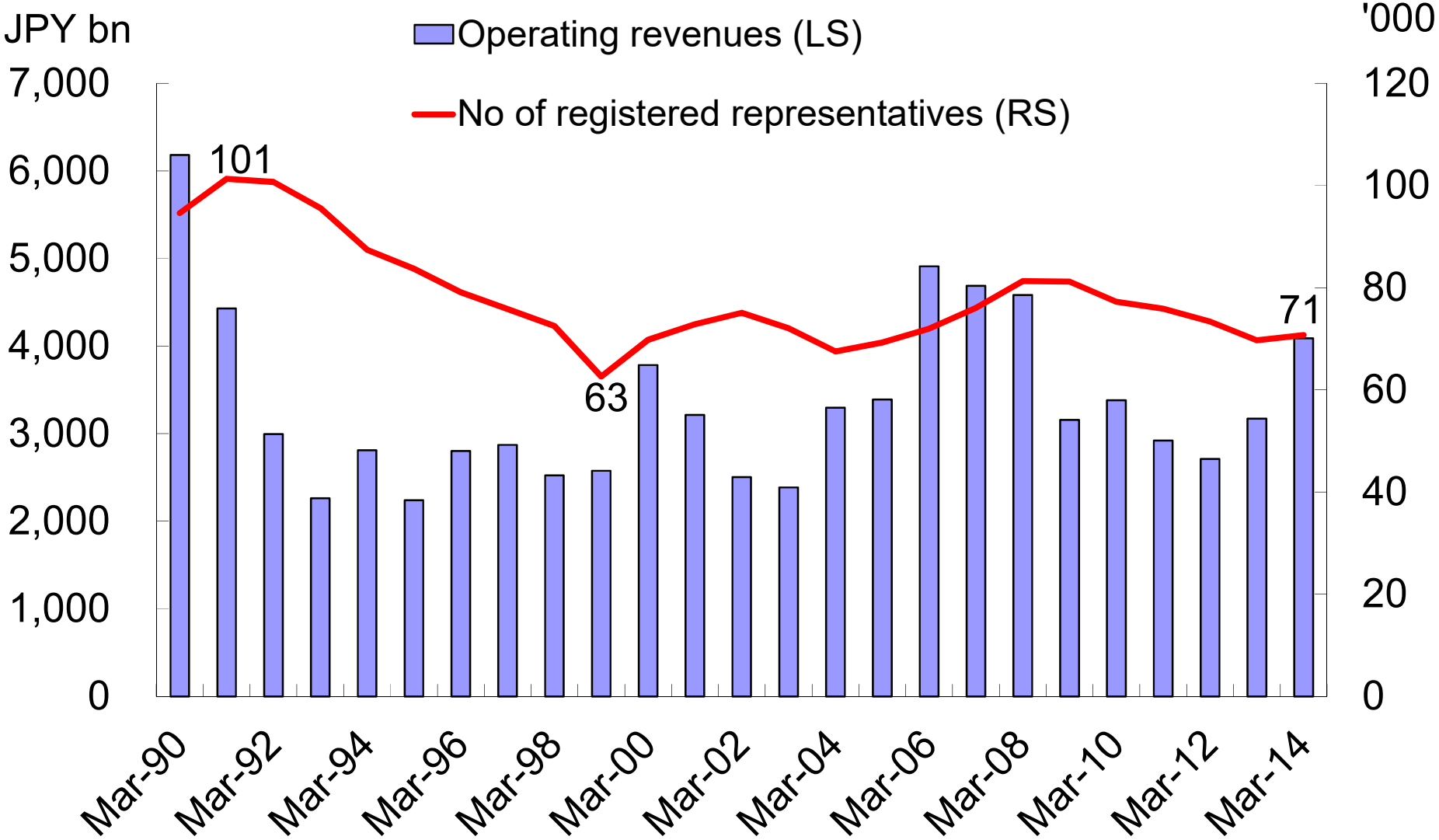


## 2-g. Selling, general and administrative (SGA) expenses for Japanese securities industry



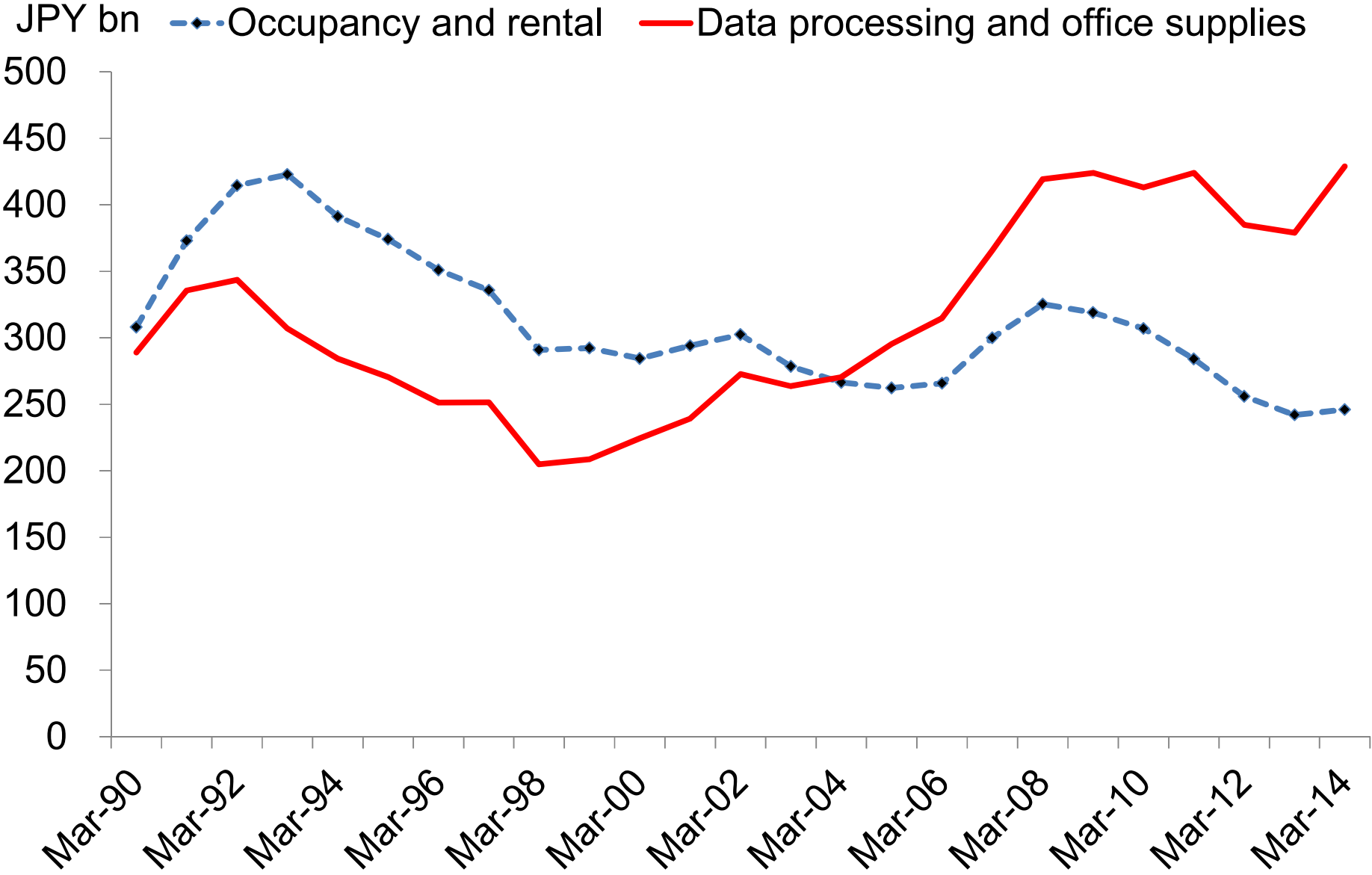
Source: Japan Securities Dealers Association

## 2-h. Largest fixed cost: Number of registered representatives decreased



Source: Japan Securities Dealers Association

## 2-i. SGA: Declining office cost and increasing IT system/OA cost



Source: Japan Securities Dealers Association

### 3-a. Consolidated income statement for Daiwa Securities Group (1)

JPY bn

|  | Mar-08 | Mar-09 | Mar-10 | Mar-11 | Mar-12 | Mar-13 | Mar-14 | Mar-15 |
|--|--------|--------|--------|--------|--------|--------|--------|--------|
| <b>Total operating revenue</b>                   | 825    | 414    | 538    | 403    | 422    | 525    | 643    | 659    |
| <b>Net operating revenue</b>                     | 447    | 200    | 458    | 319    | 336    | 417    | 542    | 532    |
| <b>Total selling, general and admin expenses</b> | 364    | 343    | 363    | 364    | 360    | 333    | 357    | 361    |
| <b>Operating income (loss)</b>                   | 84     | -144   | 95     | -45    | -24    | 84     | 185    | 171    |
| <b>Ordinary income (loss)</b>                    | 90     | -141   | 103    | -33    | -12    | 95     | 197    | 185    |
| <b>Income (loss) before income tax</b>           | 82     | -164   | 97     | -35    | -17    | 92     | 196    | 182    |
| <b>Net income (loss)</b>                         | 46     | -85    | 43     | -37    | -39    | 73     | 169    | 148    |

Source: Daiwa Securities Group, Inc.

### 3-b. Consolidated income statement for Daiwa Securities Group (2)

|  | JPY bn |        |        |        |        |        |        |        |
|--|--------|--------|--------|--------|--------|--------|--------|--------|
|  | Mar-08 | Mar-09 | Mar-10 | Mar-11 | Mar-12 | Mar-13 | Mar-14 | Mar-15 |
| <b>Brokerage commission</b>                  | 84     | 56     | 56     | 51     | 41     | 49     | 90     | 70     |
| <b>Underwriting commission</b>               | 25     | 21     | 54     | 26     | 20     | 27     | 30     | 38     |
| <b>Distribution commission</b>               | 43     | 19     | 33     | 32     | 49     | 45     | 53     | 41     |
| <b>Other commission</b>                      | 143    | 113    | 109    | 110    | 111    | 109    | 130    | 143    |
| <b>Total commission received</b>             | 294    | 209    | 253    | 219    | 221    | 230    | 302    | 291    |
| <b>Net trading income</b>                    | 103    | 41     | 111    | 92     | 79     | 124    | 156    | 157    |
| <b>Net gain (loss) on private equity etc</b> | 19     | -79    | 76     | -17    | 2      | 17     | 17     | 7      |
| <b>Financial revenue</b>                     | 358    | 193    | 55     | 72     | 80     | 93     | 108    | 126    |
| <b>Other operating revenue</b>               | 50     | 51     | 44     | 37     | 40     | 63     | 59     | 78     |
| <b>Total operating revenue</b>               | 825    | 414    | 538    | 403    | 422    | 525    | 643    | 659    |
| <b>Financial expenses</b>                    | 340    | 176    | 48     | 58     | 60     | 70     | 60     | 80     |
| <b>Other operating expenses</b>              | 38     | 38     | 32     | 26     | 27     | 38     | 41     | 47     |
| <b>Net operating revenue</b>                 | 447    | 200    | 458    | 319    | 336    | 417    | 542    | 532    |

Source: Daiwa Securities Group, Inc.

### 3-c. Consolidated income statement for Daiwa Securities Group (3)

|  | JPY bn |        |        |        |        |        |        |        |
|--|--------|--------|--------|--------|--------|--------|--------|--------|
|  | Mar-08 | Mar-09 | Mar-10 | Mar-11 | Mar-12 | Mar-13 | Mar-14 | Mar-15 |
| <b>Trading related expenses</b>                  | 85     | 66     | 62     | 70     | 69     | 67     | 74     | 74     |
| <b>Personal expenses</b>                         | 157    | 142    | 170    | 160    | 158    | 157    | 177    | 182    |
| <b>Real estate expenses</b>                      | 39     | 44     | 44     | 45     | 45     | 38     | 36     | 37     |
| <b>Office cost</b>                               | 30     | 30     | 26     | 27     | 28     | 23     | 25     | 25     |
| <b>Depreciation</b>                              | 28     | 36     | 39     | 39     | 40     | 31     | 27     | 24     |
| <b>Taxes and dues</b>                            | 7      | 7      | 8      | 7      | 7      | 6      | 7      | 7      |
| <b>Others</b>                                    | 18     | 20     | 14     | 15     | 13     | 12     | 12     | 12     |
| <b>Total selling, general and admin expenses</b> | 364    | 343    | 363    | 364    | 360    | 333    | 357    | 361    |

Source: Daiwa Securities Group, Inc.

### 3-d. Consolidated income statement for Daiwa Securities Group (4)

|  | JPY bn |        |        |        |        |        |        |        |
|--|--------|--------|--------|--------|--------|--------|--------|--------|
|  | Mar-08 | Mar-09 | Mar-10 | Mar-11 | Mar-12 | Mar-13 | Mar-14 | Mar-15 |
| <b>Operating income (loss)</b>         | 84     | -144   | 95     | -45    | -24    | 84     | 185    | 171    |
| <b>Non-operating income</b>            | 10     | 8      | 9      | 16     | 13     | 14     | 15     | 16     |
| <b>Non-operating expenses</b>          | 3      | 5      | 2      | 3      | 1      | 3      | 3      | 3      |
| <b>Ordinary income (loss)</b>          | 90     | -141   | 103    | -33    | -12    | 95     | 197    | 185    |
| <b>Extraordinary income</b>            | 4      | 6      | 2      | 9      | 40     | 10     | 10     | 5      |
| <b>Extraordinary loss</b>              | 12     | 29     | 7      | 11     | 44     | 13     | 11     | 8      |
| <b>Income (loss) before income tax</b> | 82     | -164   | 97     | -35    | -17    | 92     | 196    | 182    |
| <b>Income tax</b>                      | 41     | 0      | 50     | 10     | 24     | 12     | 18     | 27     |
| <b>Minority interests</b>              | -5     | -61    | 4      | -7     | -2     | 7      | 8      | 6      |
| <b>Net income (loss)</b>               | 46     | -85    | 43     | -37    | -39    | 73     | 169    | 148    |

Source: Daiwa Securities Group, Inc.

### 3-e. Consolidated balance sheet for Daiwa Securities Group, Mar-15

JPY bn

|  |        |   |        |
|--|--------|---|--------|
| <b>Cash and deposits</b>                 | 2,985  | <b>Trading products</b>                           | 6,014  |
| <b>Short-term investment securities</b>  | 2,629  | <b>Loans payable secured by securities</b>        | 7,553  |
| <b>Trading products</b>                  | 8,304  | <b>Deposits for banking business</b>              | 2,745  |
| <b>Operational investment securities</b> | 119    | <b>Short-term loans payable</b>                   | 1,011  |
| <b>Loans secured by securities</b>       | 6,728  | <b>Commercial papers</b>                          | 388    |
| <b>Current assets</b>                    | 22,190 | <b>Current portion of bonds</b>                   | 264    |
| <b>Property, plant and equipment</b>     | 458    | <b>Current liabilities</b>                        | 19,353 |
| <b>Intangible assets</b>                 | 77     | <b>Bonds payable</b>                              | 1,179  |
| <b>Investments and other assets</b>      | 275    | <b>Long-term loans payable</b>                    | 946    |
| <b>Non-current assets</b>                | 810    | <b>Non-current liabilities</b>                    | 2,209  |
|  |        | <b>Total liabilities</b>                          | 21,566 |
|  |        | <b>Shareholders' equity</b>                       | 1,434  |
| <b>Total assets</b>                      | 23,001 | <b>Total liabilities and shareholders' equity</b> | 23,001 |



## 3-f. Capital adequacy ratio

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### 1. Simple CAR

$\text{CAR} = \text{Shareholders' equity} / \text{Total assets}$

Daiwa Securities Group's CAR is 5.4% as at Mar-15.

### 2. CAR by Financial Instruments and Exchange Act

$\text{CAR} = \text{Capital that are not immobilized} / \text{Risk assets}$

FSA's requirement is a securities company's CAR should be above 140%.

Daiwa Securities Group's CAR is 288.5% as at Mar-15.

### 3. CAR by Basel 3

$\text{CAR} = \text{Total qualifying capital} / \text{Total risk-weighted assets}$

Basel 3's requirement is a financial institution's CAR should be 8% or above.

Daiwa Securities Group's CAR is 22.3% as at Dec-14.

### 3-g. Capital adequacy ratio, Basel 3 basis

|  |                 | JPY bn |        |
|--|-----------------|--------|--------|
|  |                 | Sep-14 | Dec-14 |
| Total Qualifying Capital                                 | (D)=(A)+(B)+(C) | 11,598 | 12,387 |
| Common Equity Tier 1                                     | (A)             | 10,854 | 11,338 |
| Additional Tier 1  | (B)             | 288    | 491    |
| Tier 2 Capital   | (C)             | 455    | 557    |
| Total Risk-Weighted Assets                               | (E)             | 51,721 | 55,478 |
| Credit Risk  |                 | 30,717 | 32,155 |
| Market Risk *1   |                 | 11,723 | 13,570 |
| Operational Risk *1                                      |                 | 9,281  | 9,752  |
| Consolidated Common Equity Tier 1 Capital Adequacy Ratio | (A)/(E)         | 20.9%  | 20.4%  |
| Consolidated Tier 1 Capital Adequacy Ratio               | ((A)+(B))/(E)   | 21.5%  | 21.3%  |
| Consolidated Total Capital Adequacy Ratio *2             | (D)/(E)         | 22.4%  | 22.3%  |

\*1 Market and Operational Risk hereunder is computed by multiplying each risk amount by 12.5 (the Reciprocal of 8%).

\*2 Consolidated Capital Adequacy Ratio hereunder is calculated under the principal of Financial Service Agency Public Notice 130 of the Financial Instruments and the Exchange Act (Article 57-17-1).

# **Project for Capacity Building of Capital Market in Mongolia: Case Study – BDSec's annual financial summary**

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1 May 2015

Daiwa Institute of Research  
Japan Economic Research Institute

## 1. Income statement for BDSec (1)

|                                      | MNT'000   |           |           |
|--------------------------------------|-----------|-----------|-----------|
|                                      | Dec-12    | Dec-13    | Dec-14    |
| <b>Operating revenues</b>            | 5,898,647 | 2,596,428 | 2,299,827 |
| <b>Financial revenues</b>            | 53,781    | 39,715    | 163,693   |
| <b>Net operating revenues</b>        | 5,952,428 | 2,636,143 | 2,463,520 |
| <b>Cost of investment securities</b> | 1,093,568 | 650,221   | 1,259,413 |
| <b>Gross profit</b>                  | 4,858,859 | 1,985,922 | 1,204,107 |
| <b>Operating expense</b>             | 3,108,205 | 1,636,030 | 1,720,019 |
| <b>Non-operating income</b>          | -85,120   | -26,924   | -19,289   |
| <b>Income before tax</b>             | 1,665,534 | 322,969   | -535,201  |
| <b>Income tax</b>                    | 174,140   | 35,086    | -50,479   |
| <b>Net income</b>                    | 1,491,394 | 287,883   | -484,722  |

Source: BDSec

## 2. Income statement for BDSec (2)

|  | MNT'000   |           |           |
|--|-----------|-----------|-----------|
|  | Dec-12    | Dec-13    | Dec-14    |
| <b>Brokerage and trading income</b>    | 5,695,402 | 2,114,899 | 1,789,532 |
| <b>Underwriting income</b>             | 67,114    | 206,833   | -         |
| <b>Investment and financial advice</b> | 15,567    | 124,333   | 369,339   |
| <b>Other income</b>                    | 120,565   | 150,364   | 140,955   |
| <b>Operating revenues</b>              | 5,898,647 | 2,596,428 | 2,299,827 |
| <b>Interest income</b>                 | 35,878    | 36,055    | 157,888   |
| <b>Dividend income</b>                 | 1,059     | 3,197     | 5,805     |
| <b>Others</b>                          | 16,844    | 463       | -         |
| <b>Financial revenues</b>              | 53,781    | 39,715    | 163,693   |
| <b>Operating income</b>                | 5,952,428 | 2,636,143 | 2,463,520 |

Source: BDSec

### 3. Income statement for BDSec (3)

|  | MNT'000   |           |           |
|--|-----------|-----------|-----------|
|  | Dec-12    | Dec-13    | Dec-14    |
| <b>Wages and salaries</b>                      | 395,178   | 505,525   | 649,992   |
| <b>Social securities contributions</b>         | 43,814    | 56,693    | 72,621    |
| <b>Maintenance costs</b>                       | 32,508    | 23,187    | 23,293    |
| <b>Operating costs</b>                         | 80,518    | 76,851    | 113,163   |
| <b>Allowance</b>                               | 25,065    | 133,062   | 89,247    |
| <b>Transportation expense</b>                  | 621       | 4,099     | -         |
| <b>Depreciation</b>                            | 239,184   | 274,650   | 268,784   |
| <b>Advertising expense</b>                     | 62,480    | 22,558    | 37,737    |
| <b>Postage</b>                                 | 10,993    | 25,071    | 23,681    |
| <b>Fuel cost</b>                               | 23,816    | 30,276    | 23,683    |
| <b>Remuneration</b>                            | -         | -         | 14,200    |
| <b>Interest expense</b>                        | -         | 7,459     | 2,707     |
| <b>FRC service fee</b>                         | 2,300     | 2,300     | 2,300     |
| <b>Mongolian Stock Exchange membership fee</b> | 1,000     | 5,000     | 2,500     |
| <b>MSCH&amp;CD service fee</b>                 | 193       | 257       | 328       |
| <b>Regulatory fees</b>                         | 232,139   | 31,364    | 9,853     |
| <b>Mongolian Stock Exchange commission</b>     | 744,356   | 173,051   | 112,113   |
| <b>MSCH&amp;CD commission</b>                  | 665,966   | 121,319   | 63,550    |
| <b>Other expenses</b>                          | 548,076   | 143,308   | 210,268   |
| <b>Operating expenses</b>                      | 3,108,205 | 1,636,030 | 1,720,019 |

## 4. Balance sheet for BDSec

MNT'000

|  | Dec-12    | Dec-13    | Dec-14     |   | Dec-12    | Dec-13    | Dec-14     |
|--|-----------|-----------|------------|---|-----------|-----------|------------|
| <b>Cash and equivalents</b>                  | 661,214   | 857,856   | 5,119,886  | <b>Accounts payable</b>                           | 175,323   | 75,557    | 55,551     |
| <b>Short-term investments</b>                | 3,800,784 | 3,683,799 | 3,892,570  | <b>Salaries payable</b>                           | 18,296    | 17,418    | 21,101     |
| <b>Securities fair value adjustment(+/-)</b> | 619,458   | 445,419   | 433,734    | <b>Taxes payable</b>                              | 9,710     | 12,696    | 40,287     |
| <b>Securities risk protection fund</b>       | -33,000   | -33,000   | -33,000    | <b>Health insurance premium payable</b>           | 7,478     | -         | 605        |
| <b>Trade and other receivable</b>            | 938,104   | 1,290,442 | 1,423,156  | <b>Dividends payable</b>                          | 0         | 660,000   | 678,469    |
| <b>Others</b>                                | -         | -         | 24,486     | <b>Short-term loans</b>                           | -         | -         | 720,000    |
| <b>Current assets</b>                        | 5,986,559 | 6,244,515 | 10,860,832 | <b>Others</b>                                     | 8,411     | 21,485    | 22,642     |
| <b>Non-current assets</b>                    | 3,763,661 | 3,505,293 | 3,866,825  | <b>Current liabilities</b>                        | 219,217   | 787,156   | 1,538,654  |
|  |           |           |            | <b>Non-current liabilities</b>                    | 61,946    | 44,542    | -          |
|  |           |           |            | <b>Total liabilities</b>                          | 281,163   | 831,698   | 1,538,654  |
|  |           |           |            | <b>Shareholders' equity</b>                       | 9,469,057 | 8,918,111 | 13,189,002 |
| <b>Total assets</b>                          | 9,750,220 | 9,749,808 | 14,727,657 | <b>Total liabilities and shareholders' equity</b> | 9,750,220 | 9,749,808 | 14,727,657 |

# Basics & Scheduling

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Project for Capacity Building of Capital Market in Mongolia  
Training Course for Securities Companies (1)

Shinji Ohno  
JICA Consultant Team

## Contents

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- What are the key roles of a securities company as an Underwriter in the IPO process ?
- What is crucial steps and factors when considering IPO scheduling (venue, timeline)?



## Factors for a Successful IPO



2

## Consultation for Pilot IPO & Dual Listing Companies

| Task Item   | Current Status <sup>(*)</sup> | Consulting Needs (Y/N) | Priority (H/M/L) | Comments |
|---|-------------------------------|------------------------|------------------|----------|
| <b>Scheduling</b>                                     |                               |                        |                  |          |
| Identifying an appropriate venue/scheme               |                               |                        |                  |          |
| Preparing timeline                                    |                               |                        |                  |          |
| Designing & implementing ESOP                         |                               |                        |                  |          |
| <b>Valuation</b>                                      |                               |                        |                  |          |
| <b>Accounting System</b>                              |                               |                        |                  |          |
| <b>HR / General Affairs</b>                           |                               |                        |                  |          |
| <b>Capital Policy</b>                                 |                               |                        |                  |          |
| Pre-IPO financing                                     |                               |                        |                  |          |
| Identifying appropriate shareholding structure        |                               |                        |                  |          |
| Identifying measures to change shareholding structure |                               |                        |                  |          |
| Scheduling for altering capital structure             |                               |                        |                  |          |
| <b>Corporate Governance / Compliance</b>              |                               |                        |                  |          |
| <b>Budget Planning</b>                                |                               |                        |                  |          |
| <b>Internal Auditing</b>                              |                               |                        |                  |          |
| <b>Pre-IPO Restructuring</b>                          |                               |                        |                  |          |
| <b>Documentation</b>                                  |                               |                        |                  |          |
| <b>Post IPO Disclosure</b>                            |                               |                        |                  |          |
| <b>IR Activities</b>                                  |                               |                        |                  |          |

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## Role of Underwriter (1)

---

### The Underwriter is

- ✓ the most important *partner* for the Issuer and the principal player in the IPO
- ✓ “*recommender*” of the issuer ⇒ if sent off an immature company to the market, it needs to take certain responsibility (damage reputation)



### Advice on ...

- Listing schedule and Selection of IPO market
- Business Plan and Capital Policy
- Coordinate activities of all parties
- Drafting prospectus and listing application, etc.
- Marketing strategy for listing
- Issue price, size, timing and distribution
- Coordinate road show
- IR Support
- Capital raising strategy, stabilizing stock price
- Provide necessary market information

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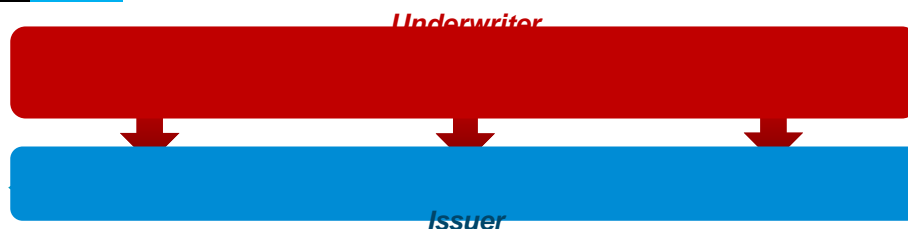
## Role of Underwriter (2)

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### Underwriter Selection – *factors to be considered by the issuer*

- Sufficient track record and expertise supporting past IPOs
  - ✓ Knowledge of industry, business model
  - ✓ Understanding of listing market's restrictions, rules, etc.
  - ✓ Proposal capabilities for IPO scheduling and capital policy
  - ✓ Underwriter's internal resources
- Well underwriting arrangement : cost/price competitiveness, underwriting commitment
- Strong distribution expertise
- Good proposal capabilities for post-IPO : IR, finance, M&A, etc.

The **Underwriter** needs to provide services from the standpoint of both the *Issuer* and the *Investor*



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## c.f. Types of Underwriting

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### 'Firm Commitment' Underwriting

- Issuer sells entire issue to U/W'ers
- U/W'ers then resell them to the public
- U/W'ers make money on the spread btw:
  - the price paid to the issuer and
  - the price received from investors when the shares are sold
- **U/W'ers bear the risk of not being able to sell** the entire issue for more than the cost
- Most common U/W type in US.

#### Firm Commitment as an Option

- Issuer buys a put option from the U/W'er.
- U/W'er gives a call option to investors.
- Issuer's put option becomes real only in the final pricing meeting.

### 'Best Efforts' Underwriting

- U/W'er makes 'best effort' to sell the shares at an agreed offering price
- **Issuer bears the risk of the unsold part**
- IBKs only markets the issue. Prospectus states:
  - Offer price (P)
  - Min # of shares that must be sold ( $Q_{min}$ )
  - Max # of shares that will be sold ( $Q_{max}$ )
- If  $Q_{min}$  is not reached in 90 days (e.g.), investors get their money back from an escrow A/C.
- In US, only **35% of IPOs**, accounting for **13%** of the total money raised.
- **Generally for small firms.**
- Issuers can choose the price itself, otherwise IBKs would force the company to go public at very low price.

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## c.f. Pricing Issue

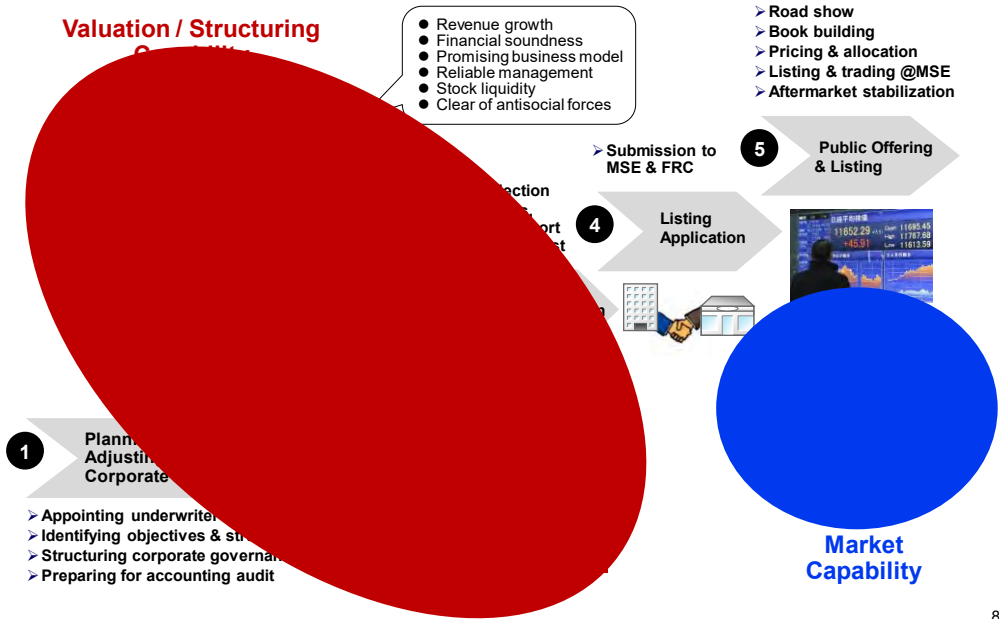
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### Underpricing

- Defined as **'the difference in price between the closing price on the 1<sup>st</sup> day of trading & the offer price'**
- IPO pricing is very difficult, as no current market price is available.
- General practice, in which Underwriters earn reputations through;
  - ✓ Achieving **higher price than the offer price**
  - ✓ **Selling out the shares**
- **Smaller, riskier IPOs underprice to attract investors.**

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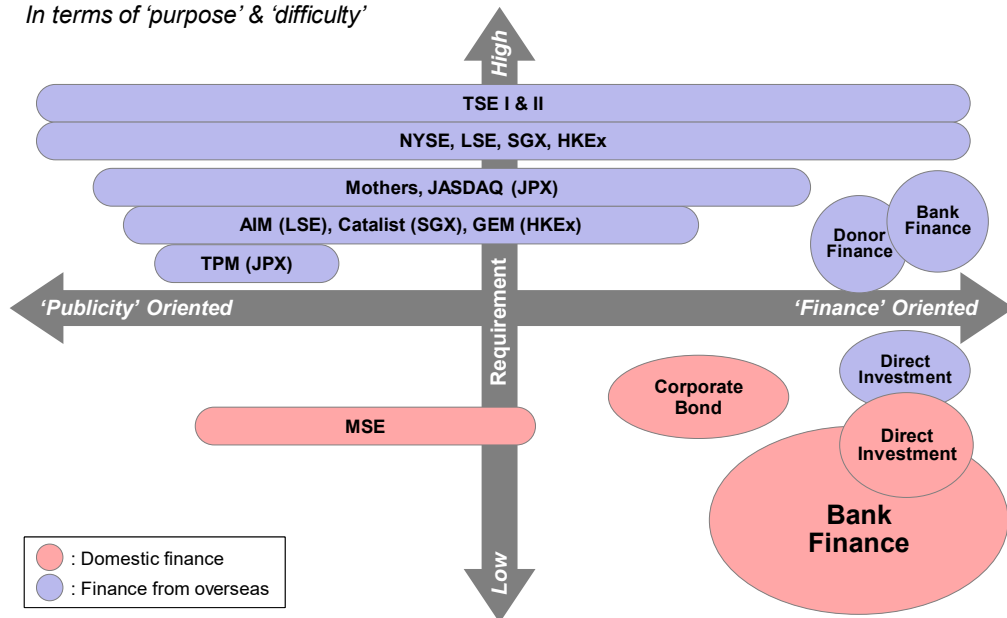
## Typical IPO Process



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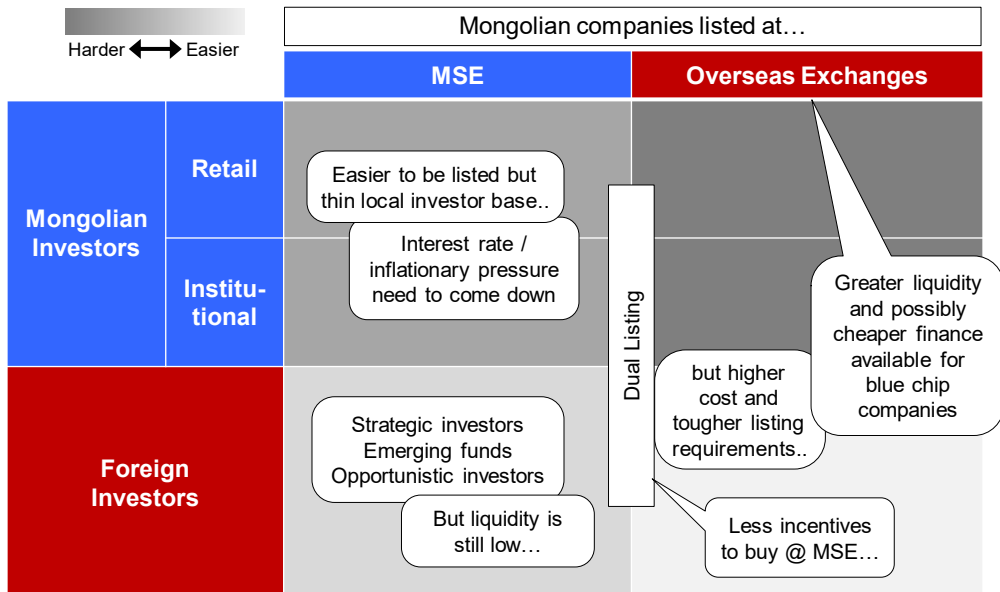
## Consideration of Financing Tools

In terms of 'purpose' & 'difficulty'



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## Consideration of Equity Financing in Mongolia vs Overseas



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## Consideration of Listing Venue

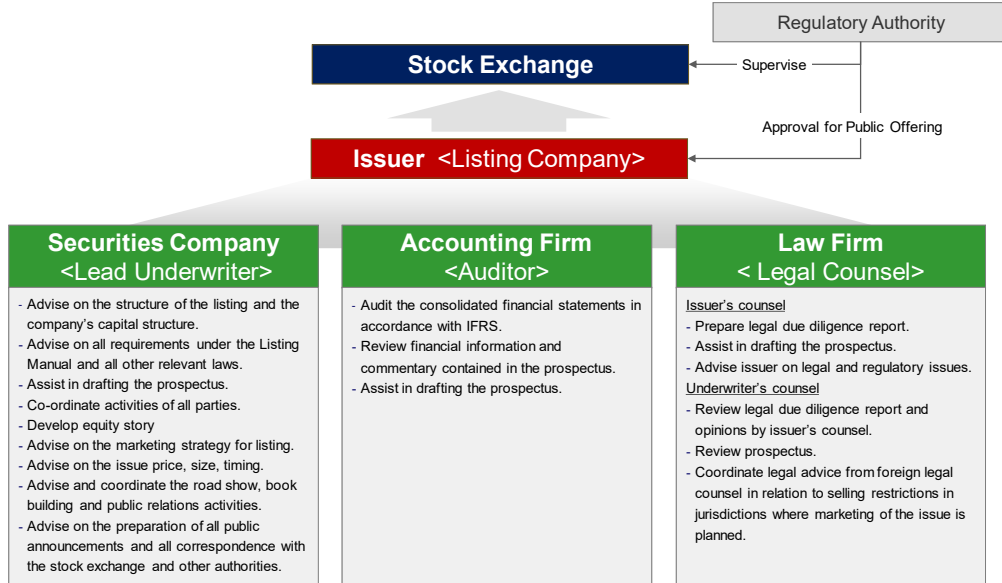
|                             | Mongol Stock Exchange   | Tokyo Stock Exchange  |                | Hong Kong Stock Exchange  |                              | Singapore Exchange  |                      |
|-----------------------------|---|---|----------------|---|------------------------------|---|----------------------|
| Investor base               | Limited local investors and frontier market focused foreign investors, PE funds | Extensive institutional investor base, local high net worth individuals and foreign investors |                | Extensive institutional and private banking investor base, regionally focused to ASEAN equities |                              | Extensive institutional investor base and active local retail investors, domestically focused |                      |
| Total market cap            | USD 0.63 billion  | USD 4,915 billion   |                | USD 3,185 billion   |                              | USD 640 billion   |                      |
| # of listed companies       | 235   | 3,511   |                | 1,866   |                              | 769   |                      |
| Number of IPOs              | ■ 2015: 1<br>■ 2014: 1  | ■ 2015: 85<br>■ 2014: 71  |                | ■ 2015: 124<br>■ 2014: 115  |                              | ■ 2015: 14<br>■ 2014: 30  |                      |
| IPO funds raised            | ■ 2015: USD 2.6 mil<br>■ 2014: USD 37.2 mil                                     | ■ 2015: USD 14.6 bn<br>■ 2014: USD 10.5 bn  |                | ■ 2015: USD 26.1 bn<br>■ 2014: USD 29.7 bn  |                              | ■ 2015: USD 0.4 bn<br>■ 2014: USD 2.4 bn  |                      |
| <b>Listing Requirements</b> | <b>II Classification</b>  | <b>1<sup>st</sup> Section</b>   | <b>Mothers</b> | <b>Main Board</b>   | <b>GEM</b>                   | <b>Main Board</b>   | <b>Catalist</b>      |
| Listing format              | Primary & secondary listing   | Primary & secondary listing   |                | Primary & secondary listing   | Primary listing only         | Primary & secondary listing   | Primary listing only |
| Min # of shareholders       | None  | 2,200   | 200            | 300   | 100                          | 500   | 200                  |
| Free-float ratio            | 15%   | 35%   | 25%            | 25%   | 25%                          | 12-25%  | 15%                  |
| Operating track record      | 2 years   | 3 years   | 1 year         | 3 years   | 2 years                      | 3 years   | None                 |
| Financial requirements      | Min market cap (No financials)  | Either Min profit or Min sales & market cap   |                | Either Min profit & market cap or Min sales & market cap  | Min cash flow and market cap | Either Min profit, Min profit & market cap, or Min sales & market cap                         | None                 |

Sources: HP of MSE, TSE, HKE, SGX

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## Key Parties Involved in IPO Process

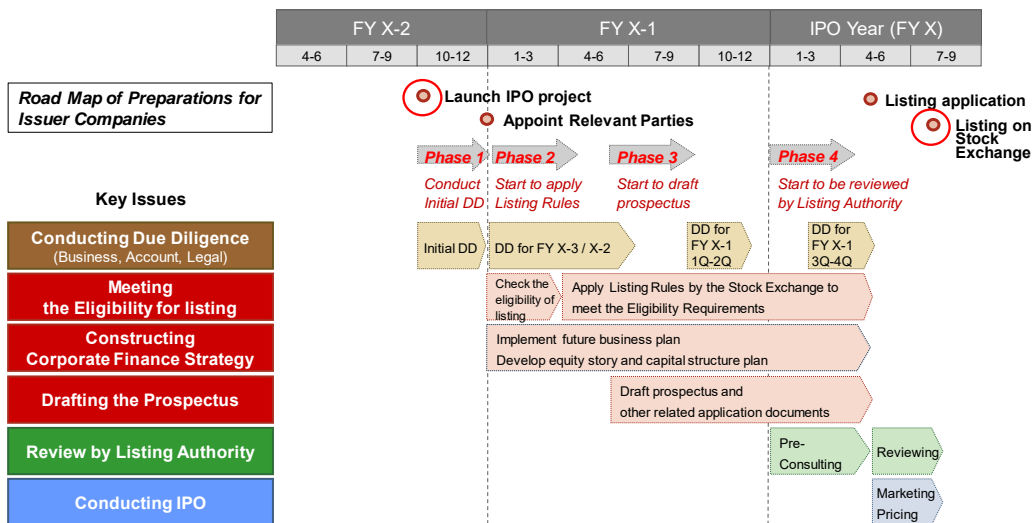
- Appoint a team of advisors having deep experience and a strong grasp of regulatory trends



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## Scheduling IPO Journey (1) – Preparations for the IPO

*This schedule is based on typical IPO process in major foreign markets but subject to change depending on each cases*



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## Scheduling IPO Journey (2) – Consideration of Target Timing

---

Tentatively set Target Timing of IPO from **Internal Factor**

Consider timing of IPO mainly focusing on the following **five view points**

1. Issuer's business target and strategy
2. Timing of satisfying the listing requirements
3. Timing of achieving profitability and growth base expected by the investors
4. Capital policy and strategy
5. Sufficient period of time for establishment of internal management and control system



According to target IPO timing,

**Plan a working schedule for IPO preparation**

and..

**Get ready for the opening of the “IPO windows of opportunity”**

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## Scheduling IPO Journey (3) - Timing the Market

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Decide the Timing of IPO from **External Factor “Windows of Opportunity”**

**Timing is crucial** – Timing of IPO can strongly impact stock performance

- ○ If good timing : Not only provides the issuer with an optimal valuation but will provide its IPO investors with the greatest upside in their investment after the IPO
- × If bad timing : Shares may have to be offered at a lower price or the stock price will drop in the aftermarket
- There are clear “**windows of opportunity**” that open and close for IPO issuers
- Determinants of suitability
  - ✓ General stock market condition
  - ✓ Industry market condition
  - ✓ Frequency and size of all IPO's in the financial cycle



Many factors influence the stock market

- Political environments
- Macro economic conditions (Interest rates, Inflation)
- Micro economic forecast, etc

➡ **Each market/country has its own factors**



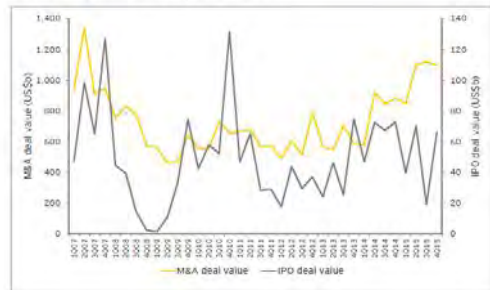
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## Scheduling IPO Journey (4) – Common Mistake

Global IPO and M&A by deal numbers



Global IPO and M&A by deal value



Sources: EY Global IPO Trends

One of the common mistakes of newly listed companies is to *hurry into their IPO journeys before the companies are ready*

The frequent rush to go public is due to ...

- Company's immediate need for capital
- Pressure from its stakeholders (board members, owners, etc.)
- Desire to capitalize on a limited window of opportunity

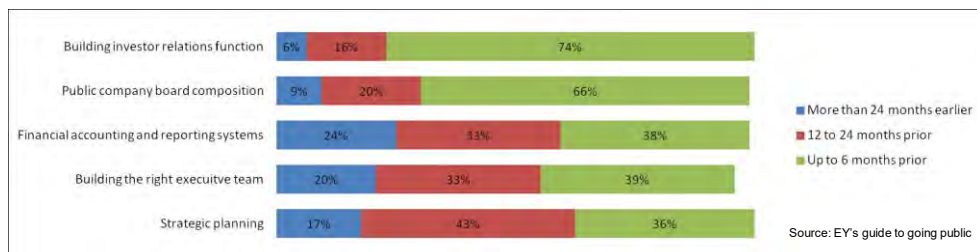


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## Scheduling IPO Journey (5) – Successful Planning

### 1. Prepare early

Begin the IPO readiness process early enough so that the company acts and operates like a public company before the IPO. Don't underestimate the amount of time the IPO journey will take.



### 2. Have an alternative financing strategy

It is imperative to have the flexibility to execute alternative financing strategies, in case the IPO does not happen or needs to be delayed. e.g. PE, bank or bond financing



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# **Thank you !!**

For further questions, comments & suggestions, please contact:

Shinji Ohno / Takayuki Urade / Ryota Sugishita

JICA Consulting Team  
Office (Local): Room #204, FRC



## МОНГОЛЫН ХӨРӨНГИЙН БИРЖИД ҮНЭТ ЦААС БҮРТГҮҮЛЭХ, ҮНЭТ ЦААСНЫ ТАНИЛЦУУЛГАД ТАВИГДАХ ШААРДЛАГА



### Агуулга

---

- Үнэт цаас гаргагчид тавигдах шаардлага
- Бүртгүүлэх ажиллагааны бэлтгэл
- Биржид бүртгүүлэх хүсэлт гаргах
- Хувьцааны бүртгэлийн шалгуур
- Бүртгэлийн шалгуураас чөлөөлөх буюу хөнгөлөх
- Үнэт цаасны танилцуулга /Prospectus/
- Биржид төлөх төлбөр, хөлс



# Үнэт цаас гаргагчид тавигдах шаардлага



- Санхүү эдийн засгийн үзүүлэлт (Борлуулалт, ашиг орлого, хөрөнгийн өгөөж г.м), зах зээлийн үнэлгээ, хувьцааны тархалт зэргийн хувьд журамд заасан шалгуур, шаардлагыг хангасан байх,

- Аудитын үйл ажиллагаа эрхлэх хуулийн этгээдээ дүгнэлт гаргуулсан байх (ҮЦЗЗТХ 10.6)

- Хууль зүйн зөвлөгөө үзүүлэх хуулийн этгээдээр дүгнэлт гаргуулсан байх (ҮЦЗЗТХ 10.6)



- Хөрөнгийн болон бизнесийн үнэлгээ хийлгэсэн байх

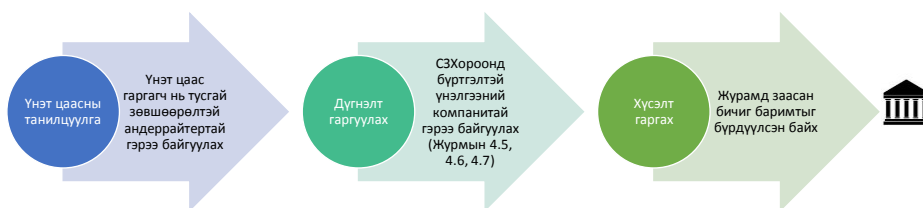
- Андеррайтерийн байгууллагатай гэрээ байгуулсан байх



AUDITED



# Бүртгүүлэх ажиллагааны бэлтгэл



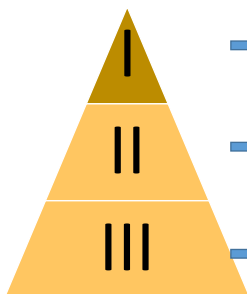
# Биржид бүртгүүлэх хүсэлт гаргах

|  |  |
|--|--|
| <b>Бүрдүүлэх материал</b>  | Өргөдөл (Маягт 1)                                  |
|  | Үнэт цаас гаргагчийн мэдэгдэл (Маягт 3)            |
|  | Андеррайтерийн мэдэгдэл (Маягт 4)                  |
|  | Үнэт цаас гаргах тухай эрх бүхий этгээдийн шийдвэр |
|  | Үнэт цаасны танилцуулга                            |
| Журмын 4.5, 4.6, 4.7-д заасан хууль, үнэлгээ болон аудитын дүгнэлт                 |  |
| Хөндлөнгийн шинжээч, мэргэжилтэн оролцсон бол журмын 4.4-т заасан үнэлэлт, дүгнэлт |  |
| Өргөдөл хүлээн авах, хянах үйлчилгээний хөлс төлсөн баримт                         |  |



## Хувьцааны бүртгэлийн ангилал, шалгуур

### ХУВЬЦААНЫ АНГИЛАЛ



- Нэр хүндтэй, ЗЗҮ өндөртэй, тогтвортой үйл ажиллагаа явуулж, ашиг орлоготой ажилладаг **ТОМООХОН** компаниуд
- ЗЗҮ болон эргэлтийн хөрөнгийн шаардлагыг хангасан **ДУНД** зэргийн компаниуд
- Хувьцаагаа мэргэжлийн хөрөнгө оруулагчдад санал болгон арилжаалдаг, шинэлэг санаа бүхий, эрсдэл өндөртэй **ЖИЖИГ, ДУНД** хэлбэрийн компаниуд



## Хувьцааны бүртгэлийн ангилал шалгуур

|   |                               | I ангилал     | II ангилал    | III ангилал   |
|---|-------------------------------|---------------|---------------|---|
| № | ҮНЭТ ЦААСАНД ТАВИХ ШАЛГУУР    |               |               |   |
| 1 | ЗЗҮ (төгрөг)                  | 5 тэрбум<br>↑ | 1 тэрбум<br>↑ | Компанийн хүсэлтийг харгалзан МХБ-ээс тогтоосон шаардлагыг хангах |
| 2 | Олон нийтэд санал болгох хувь | ≥ 25%         | ≥ 15%         |   |
| 3 | Арилжигдсан хугацаа           | 2 жил         |               |   |



## Хувьцааны бүртгэлийн ангилал шалгуур (үргэлжлэл)

| №  | КОМПАНИД ТАВИХ ШАЛГУУР                     |                 |   |                      |
|----|--|-----------------|---|----------------------|
| 5  | Үйл ажиллагаа явуулсан жил                 | 3 жил ↑         | 2 жил ↑   |                      |
| 6  | Санхүүгийн тайлан                          | 3 жил IFRS/GAAP | 3 жил IFRS/GAAP   |                      |
| 7  | Сүүлийн жилийн БО-ын хэмжээ (төгрөг)       | 5 тэрбум ↑      |   |                      |
| 8  | Сүүлийн жилийн ашгийн хэмжээ (төгрөг)      | 500 сая ↑       |   |                      |
| 9  | Эргэлтийн хөрөнгө                          |                 | Бүртгэгдсэнээс хойш 12 сарын хугацаанд хэрэглэх хангалттай ЭХ |                      |
| 10 | Андеррайтертэй байх                        | +               | +   | +                    |
| 11 | Компанийн засаглалын зарчмыг дагаж, мөрдөх | +               | + /үгүй бол тайлбар/  | + /үгүй бол тайлбар/ |



Татварын болон хугацаа хэтэрсэн их хэмжээний зээлийн өргүйбайх, хэрэв өртэй тохиолдолд өр зээлийн талаарх мэт цаасны танилчилгал элгэрэнг

I ангилал

II ангилал

III ангилал

# Бүртгэлийн шалгуураас чөлөөлөх, хөнгөлөх

## Хөнгөлөлт, чөлөөлөлт

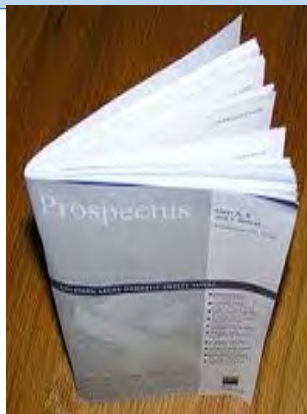
- Бүртгэлийн шалгуураас чөлөөлөх, хөнгөлөх боломжтой:
  - Үнэт цаас гаргагч, түүнд мэргэжлийн үйлчилгээ үзүүлж байгаа зохицуулалттай этгээд нь журмаар тогтоосон хувьцааны болон өрийн хэрэгслийн шалгуураас чөлөөлүүлэх буюу хөнгөлүүлэх тухай үндэслэл бүхий хүсэлтээ Биржид гаргах эрхтэй.
  - Дээрх асуудлыг Биржийн Гүйцэтгэх захирлын тушаалаар шийдвэрлэнэ. Ингэхдээ тухайн үнэт цаас гаргагчийн хувьд, эсхүл тухайн үнэт цаасны хувьд хугацаа тогтоож тодорхой нөхцөл хангахыг үүрэг болгож болно.
- Төлбөр, хураамжийн хөнгөлөлт, чөлөөлөлт эдлүүлэх боломжтой:
  - Анх удаа бүртгүүлэх бол жилийн үйлчилгээний хөлс төлөхөөс чөлөөлнө.
  - I ангилалд нэмж үнэт цаас гаргах, Бүртгэлийн ангилал өсөх, бодитоор буюу шүүд хөрөнгө татаагүй тохиролдолд гэх мэт хэд хэдэн тохиолдолд Бүртгүүлэх үйлчилгээний хөлсийг 20% хүртэл хөнгөлнө.
  - ЗГ болон орон нутгийн үнэт цаасны хураамжийн хэмжээг гэрээгээр уян хатан байдлаар зохицуулах боломжтой.



# Үнэт цаасны танилцуулга

Үнэт цаасны танилцуулга нь хөрөнгө оруулалтын шийдвэрт нөлөөлөх чухал баримт бичиг юм.

1. Үнэт цаас гаргагчын тухай мэдээлэл
2. Үнэт цаасны тухай мэдээлэл
3. Үнэт цаас гаргах ажиллагаанд оролцсон этгээдүүдийн мэдээлэл



# Үнэт цаасны танилцуулга

Үнэт цаасны танилцуулга нь 3 хэсгээс бүрдэнэ.

## Үнэт цаас гаргагчийн тухай:

- Үнэт цаас гаргагчийн оноосон нэр, хаяг, үйл ажиллагаа;
- Улсын бүртгэлийн болон регистрийн дугаар, бүртгэсэн он, сар, өдөр;
- Бүтэц, зохион байгуулалт, эрх бүхий албан тушаалтны талаарх мэдээлэл, тэдгээрийн өмчлөл дэх хувьцааны тоо, хувь хэмжээ;
- Хувь нийлүүлсэн хөрөнгийн хэмжээ, өмнө зарласан болон гаргасан, эргүүлэн худалдан авсан үнэт цаасны тоо, төрөл, нэрлэсэн үнэ болон өөрийн хөрөнгийн хэмжээ, биет болон биет бус хөрөнгийн талаарх мэдээлэл;
- Санхүүгийн тайлан, үүний талаар аудитын байгууллагаас гаргасан дүгнэлт;
- Хувь нийлүүлсэн хөрөнгийн тав болон түүнээс дээш хувьтай тэнцэх хэмжээний үнийн дүн бүхий үүрэг хүлээсэн гэрээ, хэлцэл, тэдгээрийн хэрэгжилтийн тухай;
- Холбогдох этгээдийн тухай
- Нөлөө бүхий хувьцаа эзэмшигчдийн талаарх мэдээлэл
- Хөрөнгө өр төлбөр санхүүгийн талаарх
- Дунд хугацааны бизнес төлөвлөгөө, санхүүгийн эрсдэл, ногдол ашгийн бодлогын талаар

## Үнэт цаасны тухай

- Нийтэд санал болгох үнэт цаасны төрөл тоо, хэлбэр, нэрлэсэн үнэ, нийтэд санал болгох болон арилжих нөхцөл, өрийн хэрэгслийн хувьд хугацаа, үндсэн төлбөр, хүү төлөх нөхцөл, журам;
- Үнэт цаасаар гэрчлэгдэх эрх, үүрэг;
- Хувьцаанд хөрвөх үнэт цаас бол тухайн үнэт цаасыг хувьцаанд хөрвүүлэх нөхцөл, журам;
- Өрийн хэрэгслийн хувьд эргэн төлөгдөх баталгаа, барьцаа эд хөрөнгийн бүртгэлтэй холбоотой мэдээлэл

## Үнэт цаас гаргах ажиллагаанд оролцсон этгээдийн тухай

- Тухайн үнэт цаасыг нийтэд санал болгох ажиллагаанд хамтран оролцож байгаа зохицуулалттай этгээд болон бусад мэргэжлийн үйлчилгээ үзүүлж байгаа этгээдийн тухай
- Тэдгээртэй байгуулсан гэрээгээр хүлээсэн эрх, үүрэг, хариуцлагын тухай мэдээлэл



## Үнэт цаасны танилцуулгад тавигдах шаардлага

МХБ нь үнэт цаасны танилцуулгад тусгагдсан мэдээлэлд үндэслэн хөрөнгө оруулалтын зарцуулалтыг хянана.

- Танилцуулгын эхний хуудсанд хөрөнгө оруулагчидад зориулсан анхааруулгыг бичсэн байна. /журмын 6.6.1/
- Үнэт цаас гаргагчийн ТУЗ-ийн дарга, Гүйцэтгэх захирал, ерөнхий нягтлан бодогч, андеррайтерийн Гүйцэтгэх захирал нар гарын үсэг зурж, тэмдэг дарж баталгаажуулсан байх
- Үнэт цаасны танилцуулгын бүх хуудсыг нэг бүрчлэн дугаарлаж, үнэт цаас гаргагчийн Гүйцэтгэх захирал, андеррайтерийн Гүйцэтгэх захирал гарын үсэг зурж баталгаажуулах
- 400-с илүүгүй хуудастай үдэж хавтасласан, товъёог хийсэн байх



# Биржид төлөх төлбөр, хөлс

|   | I ангилал  | II ангилал  | III ангилал  |
|---|--|---|--|
| <b>Өргөдлийг хүлээн авч хянах үйлчилгээний хөлс</b> | Шинээр болон нэмж үнэт цаас бүртгүүлэх<br>2,000,000  | 2,000,000   | 2,000,000  |
| <b>Үнэт цаасыг бүртгэх үйлчилгээний хөлс</b>        | <b>Хувьцаа</b> /хувьцааны нийт арилжаалсан<br>10,000,000 төгрөгөөс багагүй, 100,000,000  | 5,000,000 төгрөгөөс багагүй, 50,000,000                 | 1,000,000 төгрөгөөс багагүй,<br>10,000,000 төгрөгөөс ихгүй |
| <b>Жилийн үйлчилгээний хөлс</b>                     | <b>Жилийн үйлчилгээний хөлс</b> /компанийн зах зээлийн үнэлгээний 0.005%/<br>1,200,000 төгрөгөөс багагүй, 24,000,000 төгрөгөөс ихгүй | 1,200,000 төгрөгөөс багагүй, 24,000,000 төгрөгөөс ихгүй | 500,000 төгрөгөөс багагүй,<br>10,000,000 төгрөгөөс ихгүй   |



## АНХААРАЛ ХАНДУУЛСАНД БАЯРЛАЛАА





# Capital Policy

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Project for Capacity Building of Capital Market in Mongolia  
Training Course for Securities Companies (1)

Takayuki Urade  
Capital Market Specialist  
JICA Consultant Team

## Contents

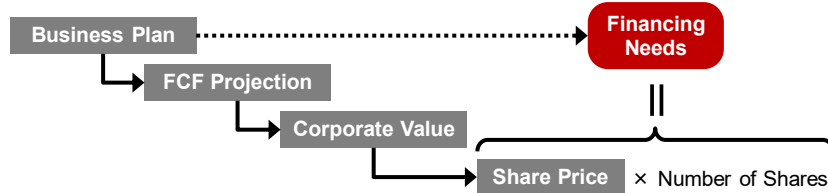
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- What is 'Capital Policy'?
- Why is 'Capital Policy' Necessary?
- How to Apply Capital Policy?
- Tools for Capital Policy
- Strategic Considerations
- Legal / Accounting Considerations
- Cases of Failure
- Case Study

## What is 'Capital Policy'?

### Definition

- Plan to achieve a particular ownership structure by identifying how many shares will be allocated to whom at what price, based on;



- Rolling process: Need to keep updating by feeding relevant variables (e.g. biz models, other financial sources).



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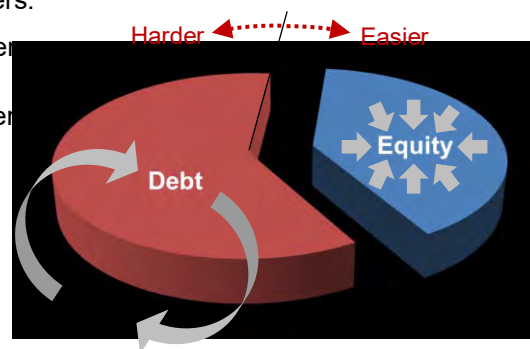
## Why is 'Capital Policy' Necessary? (1)

*Harder than the business itself...*

Mistakes in capital policy at an earlier stage are not easy to correct...

('.')

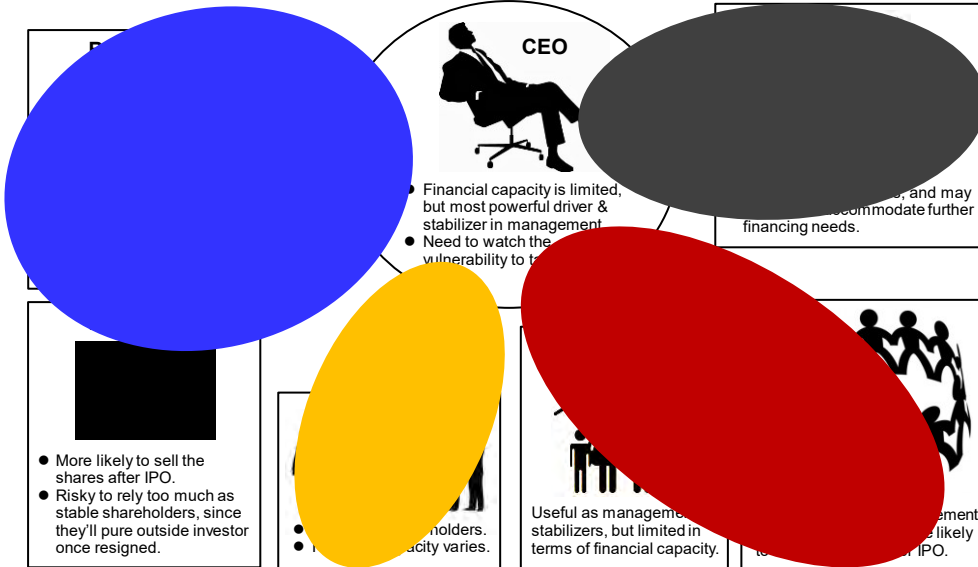
- Debt = 'Outside' capital  
Equity = 'Own' capital  
→ Difficult to kick out existing owners.
- Greater cost of moving shares under increasing corporate value.  
→ Once diluted, not easy to recover the founder's ownership share.



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## Why is 'Capital Policy' Necessary? (2)

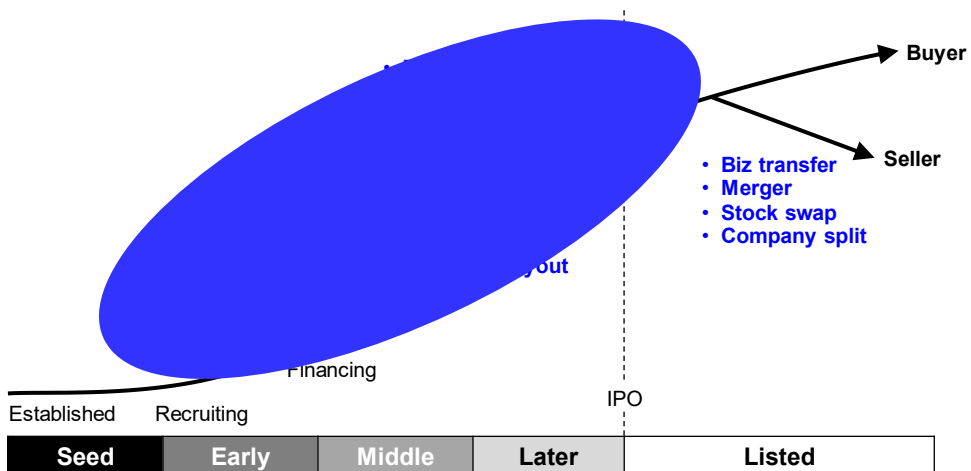
Stakeholders with varying motivation, capacity & constraints



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## Why is 'Capital Policy' Necessary? (3)

Capital policy needs to be designed in the context of 'business lifecycle'.

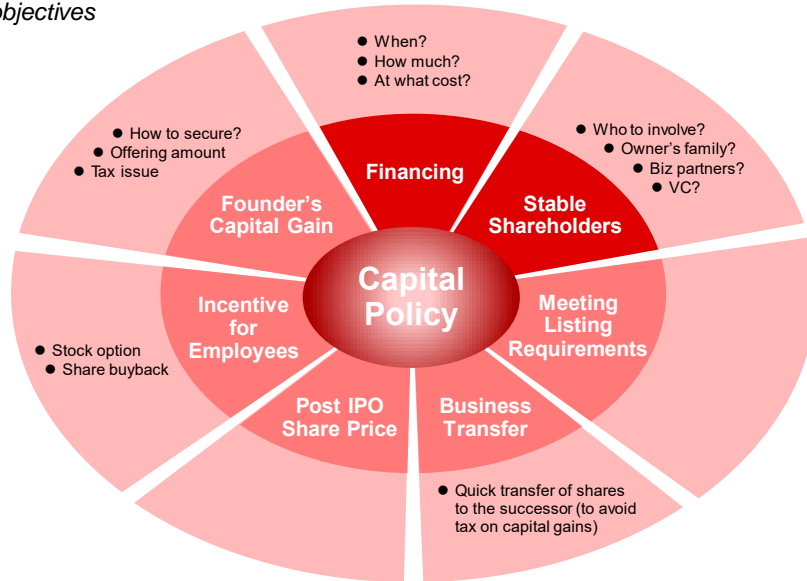


Note: Above events do not necessarily take place in this order.  
Source: JICA Consulting Team from 磯崎哲也『起業のファイナンス』（日本実業出版社、2010年）(Japanese only)

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## Why is 'Capital Policy' Necessary? (4)

Major objectives



Source: JICA Consulting Team, from 石崎由紀人『ベンチャー企業を上場成功に導く資本政策立案マニュアル(第2版)』(中央経済社、2014) (Japanese only)

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## How to Apply Capital Policy? (1): PDCA Cycle

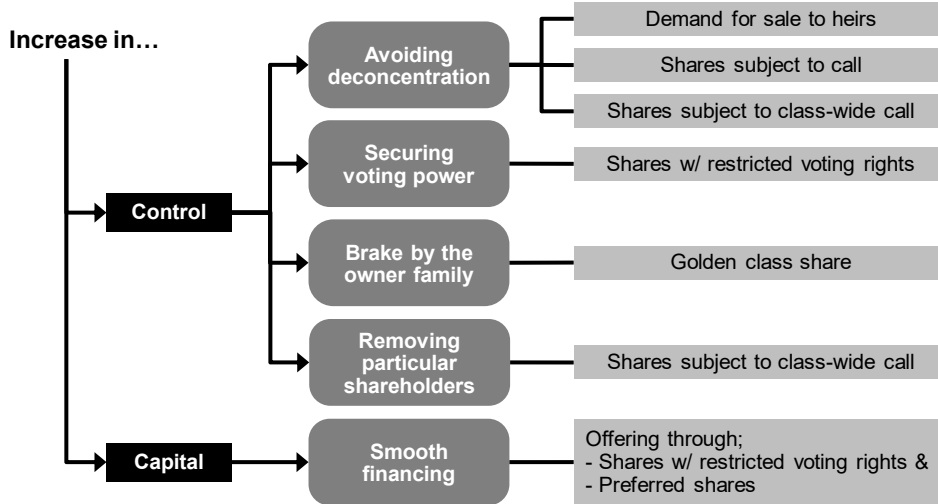
Capital policy needs to be adjusted to the environmental changes on a real-time basis...



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## How to Apply Capital Policy? (2): Decision Process (A)

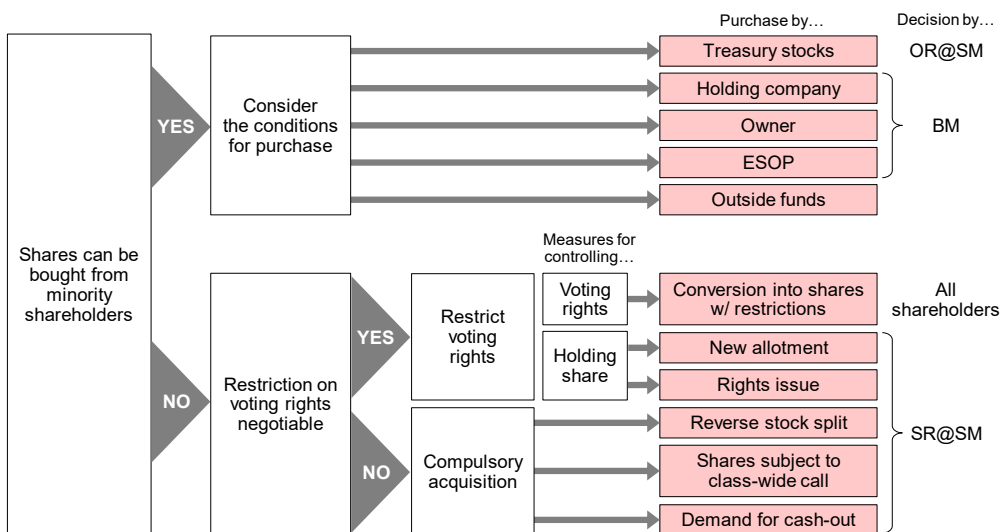
Identifying necessary measures by 'purpose'



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## How to Apply Capital Policy? (3): Decision Process (B)

Identifying necessary measures by 'external constraints'



Source: JICA Consulting Team

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## Tools for Capital Policy (1)

### Measures for transforming the capital structure

| Measure                         | Detail | Purpose                         |                      |                      |           |                | Decision by...<br>(in the case of unlisted companies)  |
|---------------------------------|--------|---------------------------------|----------------------|----------------------|-----------|----------------|--|
|                                 |        | Altering shareholding structure | Increase # of shares | Decrease # of shares | Financing | Incentive Plan |  |
| Share transfer                  |        | ○                               |                      |                      |           |                | Board meeting (BM), unless specified in the article of incorporation (AI)  |
| 3 <sup>rd</sup> party allotment |        | ○                               | ○                    |                      | ○         |                | Share subscription: Special resolution (SR) @ shareholder meeting (SM), while the decision can be deputed to BM<br>Allotment: BM, unless specified otherwise in AI   |
| Warrant bond                    |        | ○                               | ○                    |                      | ○         |                | SR@SM, while the decision on subscription details can be deputed to BM   |
| Shareholder allotment           |        |                                 | ○                    |                      | ○         |                | SR@SM, while the decision can be deputed to BM   |
| Rights issue                    |        | ○                               | ○                    |                      | ○         | ○              | SR@SM, while the decision on subscription details can be deputed to BM   |
| Stock split, free allotment     |        |                                 | ○                    |                      |           |                | BM   |
| Share buyback                   |        | ○                               |                      |                      | ×         |                | From all shareholders: Ordinary resolution (OR)@SM<br>From particular shareholders: SR@SM<br>From subsidiaries: BM<br>From the market or through tender offer: OR@SM |
| Retirement of treasury stocks   |        | ○                               |                      | ○                    |           |                | Same as new allotment  |
| Disposal of treasury stocks     |        | ○                               |                      |                      | ○         |                | BM   |
| Capital reduction               |        | △                               |                      | △                    |           |                | SR@SM  |
| Reverse stock split             |        |                                 |                      | ○                    |           |                | SR@SM  |
| Class shares                    |        | ○                               |                      |                      | ○         |                | SR@SM & SR@Class SM  |

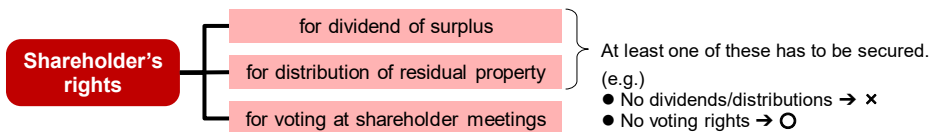
Source: JICA Consulting Team from 一般社団法人 日本経営調査士協会 (編著), 『これですべてがわかるIPOの実務 (第2版)』 (中央経済社, 2014) (Japanese only)

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## Tools for Capital Policy (2)

### Class Shares: rights & obligations specified by type

| # | Type  | Details  |
|---|---|--|
| 1 | <b>Dividend of surplus</b>                                  | Altering dividend rate (preferred / subordinated stocks)   |
| 2 | <b>Distribution of residual property</b>                    | Altering shares in distributing residual property at liquidation   |
| 3 | <b>Shares w/ restricted voting right</b>                    | Excluding particular resolution matter(s) that can be voted  |
| 4 | <b>Shares w/ restriction on transfer</b>                    | Requiring issuer's approval for transferring   |
| 5 | <b>Shares w/ put option</b>                                 | Holder has an option to ask the issuer to buy the shares   |
| 6 | <b>Shares subject to call</b>                               | Issuer has an option to buy the shares under particular conditions                                       |
| 7 | <b>Shares subject to class-wide call</b>                    | Issuer has an option to buy all the shares class-wide, under the resolution of the shareholders' meeting |
| 8 | <b>Shares w/ veto right (Golden Shares)</b>                 | Allowing veto right to the holders for particular matters  |
| 9 | <b>Shares w/ the right to vote for directors / auditors</b> | Allowing the holders the voting right to select the directors / auditors                                 |

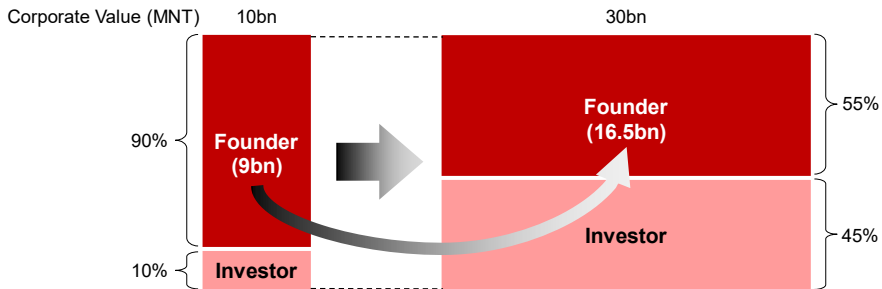


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## Strategic Considerations

### Optimizing Shareholding Structure: Key Issues

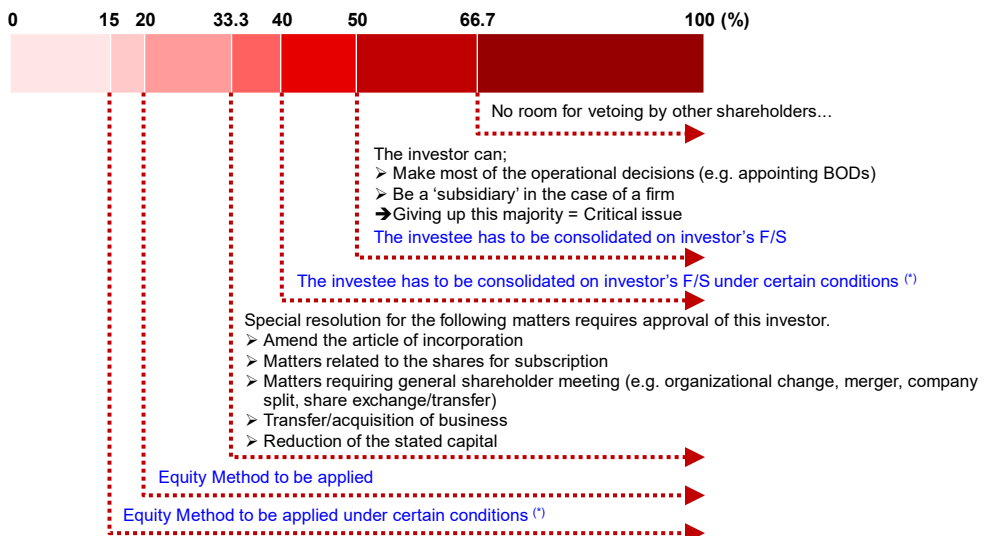
- 1. Financing:** Can necessary amount be financed (thru appropriate valuation & share price)?
- 2. Shareholding structure:** Stable enough even after listing?
  - Appropriate level of stock options?
  - Risk of scattered ownership
  - Strategic investors: Capable of increasing the corporate value?
- 3. Capital gains:** Enough to compensate the efforts by the founder & investors?
- 4. Listing criteria:** Are they cleared?
- 5. Other factors:** Capital market structure, market of corporate managers...



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## Legal / Accounting Considerations

### Under Japanese Commercial Code, Companies Act & accounting rules









(\*) e.g. BODs sent from the investor, contractual influence on decision making.  
Source: JICA Consulting Team

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## Cases of Failure

### Obstacles to successful capital policy

|   |   |   |
|---|---|---|
|  | Imbalance between financing amount & ownership share  | Greater than expected dilution as a result of too much financing compared to the actual needs.  |
|  | Inappropriate valuation/pricing for pre-IPO financing | Too high valuation compared to what strategic investors can afford to pay in, also making future financing harder.  |
|  | Loose forecast for business planning                  | Lower than forecasted profit level, resulting in lower post IPO share price. Not only enough capital gains cannot be realized, but also may not be able to meet the listing requirement (if any on market cap). |
|  | Failure in identifying stable shareholders            | Too large shareholding by VC, scaring away the potential underwriters. Founding members' unexpected resignation after the share price becomes too high, making it difficult to find the buyer(s).               |
|  | Unexpected taxation on share transfer                 | Too low price for 3 <sup>rd</sup> party allotment compared to the valuation required by tax law, resulting in unexpected taxation.  |
|  | Bad timing for business transfer                      | Too late share transfer from the founder to the successor, resulting in higher than expected share price, which makes it difficult for the successor to acquire the shares.                                     |

Source: JICA Consulting Team, from 石崎由紀人『ベンチャー企業を上場成功に導く資本政策立案マニュアル(第2版)』(中央経済社、2014) (Japanese only)

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## Case Study

### Start-up company going public in 5yrs...

|   | Jan 2011      |       | Dec 2011   |             |                            |          | Mar 2014    |       |                            | Dec 2016       |       |  |
|---|---------------|-------|--|-------------|----------------------------|----------|-------------|-------|----------------------------|----------------|-------|--|
|   | Establishment |       | Third party allotment (#1)   |             | Third party allotment (#2) |          | IPO         |       |                            |                |       |  |
|   | # of shares   | %     | Increase   | # of shares | %                          | Increase | # of shares | %     | Increase                   | # of shares    | %     |  |
| CEO                                     | 16,000        | 80.0  |  | 16,000      | 53.2                       |          | 16,000      | 48.3  |                            | 16,000         | 43.5  |  |
| Employee                                | 4,000         | 20.0  |  | 4,000       | 13.3                       |          | 4,000       | 12.1  |                            | 4,000          | 10.9  |  |
| Internal holdings                       | 20,000        | 100.0 |  | 20,000      | 66.4                       |          | 20,000      | 60.4  |                            | 20,000         | 54.3  |  |
| VC                                      |               |       | 10,100   | 10,100      | 33.6                       | 1,000    | 11,100      | 33.5  |                            | 11,100         | 30.2  |  |
| Biz partner (1)                         |               |       |  |             |                            | 1,000    | 1,000       | 3.0   |                            | 1,000          | 2.7   |  |
| Biz partner (2)                         |               |       |  |             |                            | 1,000    | 1,000       | 3.0   |                            | 1,000          | 2.7   |  |
| Others                                  |               |       | Additional investment under 'anti-dilution' clause @investment A/G |             |                            |          |             |       | 3,700                      | 3,700          | 10.1  |  |
| Total                                   | 20,000        | 100.0 | 10,100   | 30,100      | 100.0                      | 3,000    | 33,100      | 100.0 | 3,700                      | 36,800         | 100.0 |  |
| Per share (MNT)                         | 500           |       | 10,000   |             |                            | 60,000   |             |       | 250,000                    |                |       |  |
| Financed amount (MNTmn)                 | 10            |       | 101  |             |                            | 180      |             |       | 925                        |                |       |  |
| Corporate value @post financing (MNTmn) | 10            |       | 301  |             |                            | 1,986    |             |       | 9,200                      |                |       |  |
|   |               |       |  |             |                            |          |             |       | Amount for public offering | Market cap@IPO |       |  |

Financing needs (#1) for:  
- Hiring more staff  
- Expanding production line, etc.

Financing needs (#2)

CEO's share comes down to less than half, but still the company has more than 60%

The company is assumed to have (MNT200mn) of pre-financing value. (i.e. the corporate value has increased by 20x.)

Source: JICA Consulting Team, from 石崎由紀人『ベンチャー企業を上場成功に導く資本政策立案マニュアル(第2版)』(中央経済社、2014) (Japanese only)

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# Thank you!

For further questions, comments & suggestions, please contact:

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## **Project for Capacity Building of Capital Market in Mongolia**

# **How to Approach Potential Clients**

23 May 2016

Ryota Sugishita  
JICA Consultant, Daiwa Institute of Research

### 1. Know your business - What is brokerage?

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Q1. How can securities companies make money?

Your company's business performance highly depends on brokerage.

Q2. How can you earn brokerage commission?

- A) Just sit and wait in your office chair.
- B) Proactively contact clients.

Which do you think is better?

## 1. Know your business - How can brokerage business be conducted

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### A) Just sit and wait in your office chair.

- ✓ Hope it works. You may be able to earn enough in the bull market.
- ✓ But it is not sustainable. Perhaps you can not even cover your personnel cost if you just sit and wait.



### B) Proactively contact clients.

- ✓ Tough job. You may be ignored when you contact.
- ✓ But your performance may improve dramatically if you can find good clients.



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## 1. Know your business - What is your role?

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You are a financial advisor for your clients.

- ✓ You do not just execute buy/sell orders for your clients. Your role is to contribute to your clients' financial asset management.

So, you are advised to:

- know your clients' financial asset profiles;
- classify your clients by type;
- advise your clients individually.

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## 1. Know your business - Client profiles

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An example of client profile sheet

|                                 |   |  |
|---------------------------------|---|--|
| Your experiences in investments | <input type="checkbox"/> Mongolian stocks<br><input type="checkbox"/> Mongolian government bonds<br><input type="checkbox"/> Mongolian corporate bonds  | <input type="checkbox"/> Overseas stocks<br><input type="checkbox"/> Overseas bonds<br><input type="checkbox"/> Mutual funds<br><input type="checkbox"/> Other products<br><input type="checkbox"/> Online trading |
| Your investment plan            | <input type="checkbox"/> Mongolian stocks<br><input type="checkbox"/> Mongolian government bonds<br><input type="checkbox"/> Mongolian corporate bonds  | <input type="checkbox"/> Overseas stocks<br><input type="checkbox"/> Overseas bonds<br><input type="checkbox"/> Mutual funds<br><input type="checkbox"/> Others  |
| How did you know our company    | <input type="checkbox"/> Introduced by someone<br><input type="checkbox"/> Called by our staff<br><input type="checkbox"/> Saw our website  | <input type="checkbox"/> Received an e-mail from us<br><input type="checkbox"/> Saw advertisement on TV  |
| Investment strategy             | <input type="checkbox"/> Long-term<br><input type="checkbox"/> Mid-term<br><input type="checkbox"/> Short-term  | <input type="checkbox"/> Higher capital gains<br><input type="checkbox"/> Stable dividend income<br><input type="checkbox"/> Others  |
| Your assets                     | Your annual income:<br><input type="checkbox"/> MNT 10m or below<br><input type="checkbox"/> MNT 10-50m<br><input type="checkbox"/> MNT 50-100m<br><input type="checkbox"/> MNT 100m or above | Your financial assets:<br><input type="checkbox"/> MNT 10m or below<br><input type="checkbox"/> MNT 10-50m<br><input type="checkbox"/> MNT 50-100m<br><input type="checkbox"/> MNT 100m or above                   |

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## 2. How to reach out clients - Retail clients

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### 1) Phone calls - for potential clients that have not opened an account with your company yet

You should make as many phone calls as possible to potential clients to:

- i. increase number of your clients;
- ii. support your brokerage business especially when you are in the bearish market.



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## 2. How to reach out clients - Retail clients

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### 1) Phone calls - for clients with an account

You should sometimes call your existing clients in order to:

- i. know how your clients feel their financial assets;
- ii. provide new information that possibly encourages your clients to make new investment decisions;
- iii. keep in touch with your clients.

You may be reluctant to call a client when the client's financial asset is devalued. However you should keep relationships with your clients in the difficult times.

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## 2. How to reach out clients - Retail clients

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### 1) Phone calls - for clients with an account - cont.

Example 1: One of your clients Mr Sugi bought APU shares six months ago. Prices for APU were up 30% so far.

Example 2: Mr Sugi bought APU shares last year. Share prices keep falling, down 30% till to-date.

Are you going to keep quiet not contacting Sugi? Or are you going to contact to persuade him for an investment decision?

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## 2. How to reach out clients - Retail clients

### 2) E-mails

If you know clients' e-mail addresses, you can maintain your relationships with your clients. For instance, you can send:

- i. daily/weekly/monthly market comments
- ii. company/industry news
- iii. economic data updates
- iv. your recommendation list
- v. new product information (e.g. IPO)

You should still make phone calls, in addition to sending e-mails.

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## 2. How to reach out clients - Retail clients

### 2) E-mails - cont.

Market report by Daiwa Securities

**Market Review for 3rd Week of May**

**Japanese stock strategy memo**

- TOPIX up 1.76% vs. last Friday on yen depreciation, higher commodity prices
- Financials outperformed sharply and materials, capital goods underperformed sharply; consumer goods, transportation & utilities, technology underperformed with return reversal effect notable; high-tech, low-P/E, low-P/B, low-priced stocks outperformed

**Market Outlook:** In the third week of May, the April FOMC minutes suggested a gradual rate hike in June, which the yen-sensitive TOPIX gained 1.76% from last Friday to 2,245.45, reflecting higher commodity prices and favorable economic data. Top performers included consumer goods, transportation & utilities, and health care, while the worst performers included capital goods, transportation, information & communications, electric power & gas, and food.

**16 May: TOPIX rebounded.** The index rebounded lower in the wake of overnight weakness on Wall Street, but it then posted up, reflecting yen depreciation vs. the dollar and gains across all prices. Expectations for government stimulus led to broader range of stocks higher.

**17 May: TOPIX closed up.** A broad range of stocks, particularly auto and other export-oriented companies, rebounded sharply from their declines amid the external environment, such as yen depreciation and higher commodity prices.

**18 May: TOPIX closed higher.** Financials advanced as higher-than-expected Q2 data for auto have led to raise expectations for additional monetary easing by the BOJ.

**19 May: TOPIX ended weak.** Japanese stocks, particularly foreign demand-driven firms, showed signs of weakness. Consumer goods, machinery, metals and semi-conductors, however, the index then fell back as markets reacted to news in China. Stock markets had spent previous night reduce prices.

**20 May: TOPIX rebounded.** The index rebounded lower in the wake of a sell-off in US shares. That said, it then gained ground, reflecting expectations for the Q2 finance minister's meeting and growth government measures. Stocks that advanced were repair/renew programs gained ground.

**Conclusion:** Financials underperformed early on and capital goods and materials did so markedly. Consumer goods were notable underperformers, and transportation & utilities had been the also underperformers. By midweek, top performers were electric cars, engineering/tech, food/beverage, system equipment, and sports & leisure activity. Among the worst performers were department stores, auto tires, apparel, health pharmaceuticals, and steel stocks. By Friday, high-tech, underweight (low-P/E, low-P/B), and low-priced stocks outperformed amid a strong return reversal effect.

Macro economy report by Daiwa Securities

**Outlook for domestic economy (update, May)**

**Economy remains in a soft patch**

- Indicatory, non-GDP sensitive sectors consistently under the discounts. Stocks on return price rise, but no clear additional catalyst in sight.
- The recovery in GDP sensitive sectors continues with the discounts. Stocks on return price rise, but no clear additional catalyst in sight.
- Oil will fall the next 3-4 months to hit the government's goal through JET's international supply.
- May report not sufficient to raise and could see an increase since the price and policy will move from it onwards.
- This report is written on the preliminary, annual GDP data. Our growth estimate has changed +0.2% for FY2016 and +0.7% for FY2017.

| Indicator                                   | 2015  |       | 2016  |       | 2017  |       | 2018  | 2019  | 2020  | 2021  |
|---|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|   | Q1    | Q2    | Q1    | Q2    | Q1    | Q2    |       |       |       |       |
| GDP (annual % change)                       | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| Core CPI (annual % change)                  | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| Core PPI (annual % change)                  | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| Unemployment rate                           | 2.6   | 2.6   | 2.6   | 2.6   | 2.6   | 2.6   | 2.6   | 2.6   | 2.6   | 2.6   |
| Household consumption (annual % change)     | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| Government consumption (annual % change)    | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| Investment (annual % change)                | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| Exports (annual % change)                   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| Imports (annual % change)                   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| Trade balance (annual % change)             | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| Current account (annual % change)           | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| Government budget balance (annual % change) | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| Government debt (annual % change)           | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| Government debt to GDP ratio                | 233.2 | 233.2 | 233.2 | 233.2 | 233.2 | 233.2 | 233.2 | 233.2 | 233.2 | 233.2 |

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## 2. How to reach out clients - Retail clients

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### 3) Visits

You are sometimes advised to visit your clients. Face-to-face communication is more valuable.

- ✓ If you receive a visit by one of your clients to your office, that is a good chance to strengthen relationship with the client. It may provide you with opportunity to persuade him/her to make a new investment decision.
- ✓ If you do not receive clients' visits, you may have to consider if you should visit them to introduce yourselves and inform them your advice on investments.

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## 2. How to reach out clients - Retail clients

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### 4) Website

Website is increasingly important for your business. We expect it will be common for Mongolian brokers to provide an online trading platform.

In the online trading market, website design is one of key points for success. A simple but visually appealing website design may attract more investors.

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## 2. How to reach out clients - Retail clients

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When you communicate with your clients:

- ✓ Do you think you can sell something you do not know?
- ✓ When you call your clients or potential clients, you need to be ready for telling your recommendations.
- ✓ For recommending to your clients, you have to fully understand what you are going to talk about.
- ✓ Sometimes your client know better than you about a company you recommend.
- ✓ You are a professional. You need to learn every day.

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## 3. How to reach out clients - Foreign investors

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Although foreign investors are inactive in the Mongolian stock market in recent years, they are your potential big clients.

1) Institutional or retail?

- ✓ Foreign investors can be both institutional and retail.
- ✓ Mongolian securities brokers may have a bigger chance to talk to foreign institutional investors, given that it is usually hard to reach foreign retail investors, unless you have a partnership with an overseas securities company with retail clients that are interested in the Mongolian stocks.

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### 3. How to reach out clients - Foreign investors

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#### 2) What are foreign institutional investors like?

- ✓ Foreign institutional investors are professional investors with wide knowledge in finance, macro economy and industries.
- ✓ They are sometimes demanding. Unless most of their minimum requirements are cleared, they will not invest.
- ✓ Their requirements include size of a stock, profitability of the company, liquidity, reliability in financial statements, corporate governance etc.

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### 3. How to reach out clients - Foreign investors

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#### 2) What are foreign institutional investors like? - cont.

- ✓ They may be not familiar with Mongolia in the beginning. But they can learn quickly, by reaching out variety of information and in-depth research about Mongolian companies.
- ✓ They also want to contact listed companies directly. You may be sometimes requested to set up a conference call or a meeting with a listed company.
- ✓ You need to continue studying to deal with foreign institutional investors.

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### 3. How to reach out clients - Foreign investors

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#### 3) What are typical services for foreign institutional investors?

##### i. Sending e-mails regularly

Institutional investors can access to multiple number of brokers. You are not the only one. You better contact them frequently to appeal that you are the best partner.

##### ii. Conference call with local companies

They may not be able to visit Mongolia often. They appreciate if you can set up a conference call with a company, especially with management.

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### 3. How to reach out clients - Foreign investors

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#### 3) What are typical services for foreign institutional investors? - cont.

##### iii. Research trip to Mongolia

Foreign institutional investors may sometimes ask you to arrange a research trip to Mongolia. If you can arrange good meetings, that should be helpful for the them.

##### iv. Investment conference

Another possibility is to host a investment conference, either in Ulaanbaatar or overseas. If you can invite major entrepreneurs, policy makers and professionals, that is a good opportunity for foreign institutional investors to learn about Mongolia's market outlook.

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### 3. How to reach out clients - Foreign investors

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#### 3) What are typical services for foreign institutional investors? - cont.

Oyu Tolgoi site visit for investors, Oct14      Conference Notice by Daiwa Securities



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### 4. Educating fresh graduates - Japan's typical case

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- ✓ In Japan, major companies including securities companies recruit fresh graduates every year.
- ✓ Only a part of fresh graduates have learned financials. Almost all of the fresh graduates do not know anything about the securities industry.
- ✓ Japanese securities companies spend months to educate the fresh graduates.

Training fresh graduates at Daiwa Securities



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#### 4. Educating fresh graduates - Japan's typical case

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What fresh graduates learn after employed in April:

i. Studying for securities representative's license

For the first 3 months, new employees learn basics for securities business and are ordered to pass the exam for a securities representative license by June.

ii. Understanding financial products

In June, they are sent to a branch to learn retail sales. They study financial products such as major stocks, mutual funds, bonds etc. so that they can explain to potential clients.

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#### 4. Educating fresh graduates - Japan's case

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What fresh graduates learn after employed in April:

iii. Learning how to communicate with a client

- ✓ Before contacting retail investors, new employees practice how they should talk to clients. Role-playing is often used, assuming a senior staff is a retail client and he/she is a sales staff talking to the client.
- ✓ The senior staff purposely ask tough questions to the new staff. Not only knowledge of financial products, but also how sales staff should talk and behave is also monitored.

iv. Calling as many clients as possible every day

In Japan, new staff are often ordered to call as many as possible.

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# Баярлалаа!

Та бүхэн асуулт асуух, өөрийн санал, зөвлөмжөө илгээхийг хүсвэл  
доорх хаягаар хандаарай.

**Ryota Sugishita**

Жайка Зөвлөхийн Баг  
Офис (орон нутгийн): өрөө #204, FRC



## **Project for Capacity Building of Capital Market in Mongolia**

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# **Lecture on Investor Education**

23 May 2016

Akifumi Nakanishi  
JICA Consultant, Daiwa Institute of Research

### **Contents of the lecture**

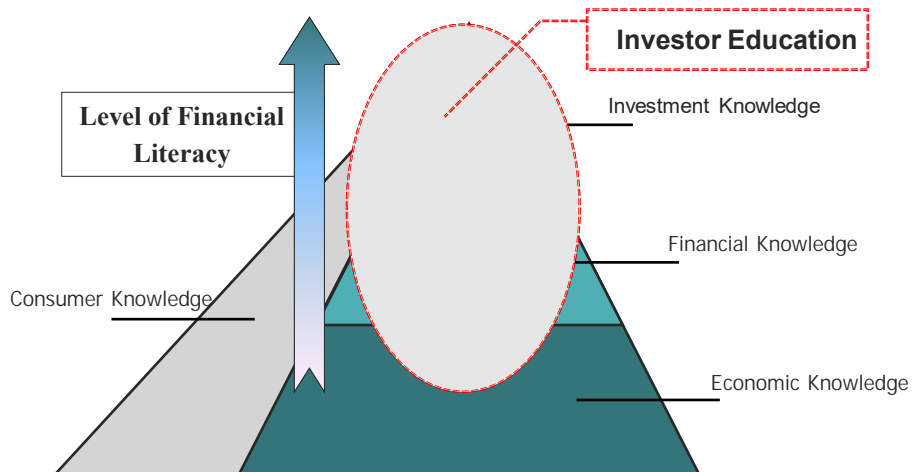
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1. Investor Education (IE): Why important?
2. Various channels for IE
3. Actual contents and menus for IE
4. Basic knowledge: Valuation tools
5. Q&A

## 1-1. Investor Education - Concept

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- ◆ Improving financial literacy requires multiple level of understandings
- ◆ Investor education covers advanced knowledge of finance and investment



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## 1-2. Investor Education and Financial Literacy – Importance

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- ◆ Improving financial literacy will help develop public awareness which is a very important factor and step towards market oriented economy.
- ◆ Why important in Mongolia?
  - Prerequisite for a stable and credible financial market
  - Promote investment hence stimulating economic growth
  - Increase awareness leads to widening the investor base
  - Diminish all kinds of anxiety towards capital market and gain confidence.

3



### 1-3. Relevant Institutions – Roles and Objectives

#### ◆ Securities companies are most responsible to educate investors

| Group                                   | Institution                             | Role and Objectives   | Legal Enforcement | Target Stakeholders                                |
|---|---|---|-------------------|--|
| Financial Authority                     | Ministry of Finance                     | Decide on the issuance schedule and provide public announcement       | ○ mandatory       | public, financial institutions                     |
|   | Central Bank                            | Conduct monetary operation via bond intervention, financial education | ○ mandatory       | bankers, financial institutions                    |
|   | Securities Exchange Commission          | Supervise and monitor via rules and regulation, financial education   | ○ mandatory       | brokers, dealers, financial professions, investors |
| Financial Institutions / Intermediaries | Stock Exchange                          | Control stock market operation,                                       | △ certain extent  | market participants, investors                     |
|   | Commercial Banks                        | Provide macro-economic and market information,                        | △ certain extent  | investors  |
|   | Securities House / Asset Management     | Provide information on financial services and instruments, seminars   | △ certain extent  | investors  |
| Associations                            | Securities' Dealers, Banking, CPAs etc. | Provide updated market information and benchmarks                     | △ certain extent  | market participants, investors                     |
| Educational Institutions                | Universities, Higher education          | Provide relevant academic knowledge and educational materials         | × voluntary       | students, educators, potential investors           |

### 1-4. Specific actions ① Financial authorities

#### ◆ Efforts in providing information at real time basis

- Establish framework of timely disclosures of relevant information.
- Consult necessary market data to financial institutions.
- Announce any policy changes and amendments to the public.

#### ◆ Activities for improving public awareness

- Utilize financial institutions, market participants and medium equally to reach the public.
- Establish investor protection scheme.
- Conduct social networking programs.

## 1-5. Specific actions ② Securities companies & financial institutions

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### ◆ Efforts in updating information and data

- Gather relevant data and market information on daily basis.
- Inquire necessary details to the financial authorities.
- Provide any changes and amendments to the clients.

### ◆ Activities for information dissemination

- Inform the public using all kinds of medium such as newspapers, magazine, television programs, banners, post letters, internet website, mobile gadgets, etc.
- Socialization activities via seminars and events at regular basis.

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## 2-1. Various Channels for Investor Education

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- ◆ Investor education can be delivered through various channels as an extension of the ordinary activities done by the securities companies
  - ✓ Direct contact: sales and marketing activities such as at the branch, customer's property, as well as via post mails, emails, phones, faxes, text messages, etc..
  - ✓ Publication and reports: information dissemination activities such as the market data (indices, forex, trade stats, etc.) macroeconomic reports, industry outlooks, instruments, etc..
  - ✓ Socialization events: socialization activities targeting the existing and potential investors via seminars, workshop, lectures, webinars, "investor day", etc..
  - ✓ Media: advertisement and promotion activities via media such as the television, radio, newspapers, magazines, websites, SNS (YouTube, Facebook, Twitter, etc.) , etc..

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## 2-4. Various Channels for IE (3): Socialization events

- ✓ Seminars and workshop type events will definitely help investors to understand the current market situation, investment opportunities and investable products.
- ✓ Such event will also allow securities companies to widen the networks on potential investors as well as promote products to the clients.



Seminars and Webinars by Daiwa Securities Group

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## 2-5. Various Channels for IE (4): Media sources

- ✓ Media sources is also a very powerful channel to reach potential investors and promote sales and marketing.
- ✓ One may differentiate which type of media to be utilized depending on the targeted audience (i.e. by gender, age, location, nationality, etc.).



Daiwa TV programs and Twitter sites

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### 3-1. Actual Contents of Investor Education

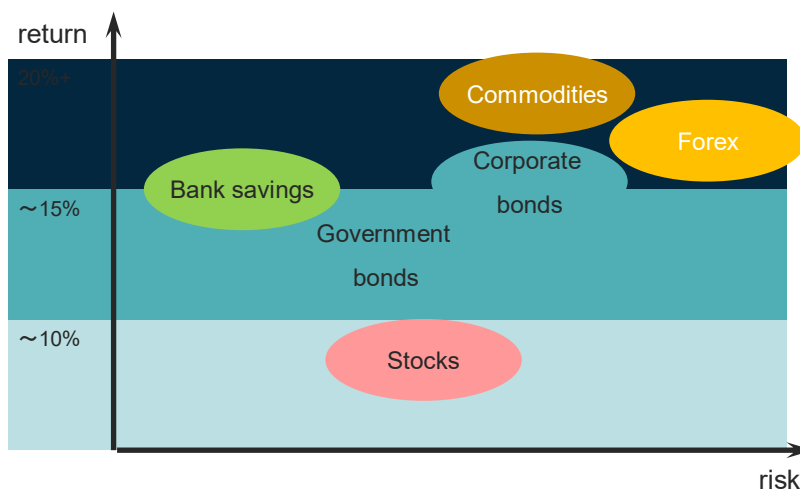
- ◆ Investor education can be delivered depending on the investors' investment needs and level of financial literacy
- ◆ Prepare necessary materials to maintain and assure the quality disseminated

| Investment needs               | Product types<br>(currently available in Mongolia) |
|--------------------------------|--|
| First time investment          | Stocks   |
| Retirement Plans               | Government bonds/corporate bonds                   |
| Short-term / Long-term horizon | Foreign Currencies                                 |
| Asset Management               | Commodities  |
| Diversification                | Foreign products                                   |
| Inheritance Plans              |  |

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### 3-2. Probable Menu for investment opportunities (current Mongolia)

- ◆ Essential to understand the probable returns and risks on each instruments
- ◆ Introduce options of products depending on the investors' preference on investment and risk taking level



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### 3-3. Probable Menu for investment opportunities (current Mongolia)

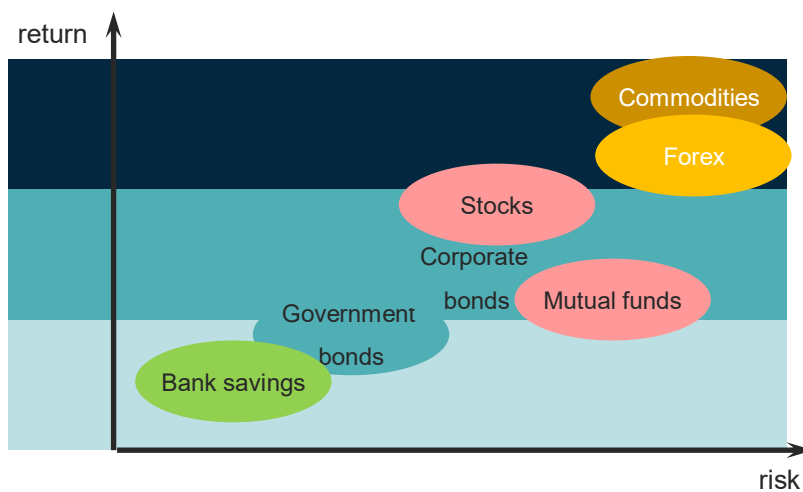
- ◆ Bank savings is the most attractive opportunity and favored in current Mongolia
- ◆ Government bonds have also attracted certain amount of investors due to high yield compared to other investable products

| Product                             | Annual return | Risk   |
|-------------------------------------|---------------|--------|
| 1-year max. bank deposit rate       | 18.00%        | Low    |
| Weighted avg bank deposit rate      | 13.30%        | Low    |
| 12-week Government securities yield | 13.19%        | Lowest |
| 1-year return for a stock           | ?             | High   |
| Annual USD/MNT depreciation         | 5-10%         | High   |

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### 3-4. Probable Menu for investment opportunities (other markets)

- ◆ Recommended to understand probable returns and risks in other markets
- ◆ It is also helpful to access to other countries' institutions who are initiating the investor educations with various kinds of references and resources



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### 3-5. Underlying Risks for Investments

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- ◆ Ability to explain the risks behind the investment activities is very important

| Types of Risks                      | Description  |
|-------------------------------------|--|
| Political / Legislative Risk        | Risk occur when changes in the government ruling parties and associated policies and legislative matters realized.                                       |
| Inflation Risk                      | The chance that the value of an asset or income will be deflated (inflated) as inflation rate shrinks (widens).  |
| Foreign Currency Exchange rate Risk | Risk that arises from the possible fluctuations in the prices between local and foreign currency exchanges.  |
| Interest Rate Risk                  | Possibility of a fixed-rate debt instrument will decline in value as a result of a rise in interest rates.   |
| Credit Risk                         | Possibility that a particular debtors will no be able to pay the interest rate payments and/or principals.   |
| Market Risk /Systematic Risk        | Risk that cannot be avoided such as the natural disasters, economic recessions, changes in the natural resource prices, terrorist attacks.               |
| Liquidity Risk                      | Risk that an investor may not be able to buy (sell) the securities product when desired due to insufficient quantities and/or opportunities are limited. |

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### 3-6. Example of Educating Investors (1): First time investors

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1) For first time investors

- ✓ If a new client of yours does not have any experience in investments, first of all you have to explain differences between saving and investing.

#### Example

- Unlike bank deposits, you may lose your money when you invest in stocks.
- Even when a bank goes bankrupt, your deposit, to a certain extent, will be secured by Deposit Insurance Corporation of Mongolia. The money you invest in stocks is not insured. A share price decline means the value of your stocks falls.
- But you may earn more from your investment than your saving.

17

### 3-7. Example of Educating Investors (2): Experienced investors

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2) For non first-time investors

- ✓ If your client understands the differences between saving and investing, now you can promote a certain product to your client, by your own idea.

#### Government bonds

- Under the current interest rate environment, it is very difficult to promote stocks.
- The government bond is perhaps the first choice for many of your clients.
- You need to appeal what kind of advantages a client of yours can take from government bond investment.

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### 3-8. Example of Educating Investors (3): Experienced investors

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2) For non first-time investors - cont.

#### Stocks

- How can you promote stocks under the current difficult situation?
- Bottom fishing is a phrase that is often used in the downcycle.
- What indicators can be implications for a turnaround of share prices?

19



#### 4-1. Basic Knowledge: Valuation

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- ✓ Before an investor makes investment decisions, he/she measures if the price of a stock is overpriced (expensive) or undervalued (cheap) by calculating valuation.
- ✓ Most commonly used valuation is the price-earnings ratio (P/E ratio).
- ✓ P/E ratio is simple and easy to use. It is applicable if a company is profitable. Institutional investors and analysts mostly uses the P/E ratio.
- ✓ Another well-known valuation is the price-book ratio (P/B ratio). P/B ratio is often used in the downturn of the market. Theoretically you can say the stock is oversold if its P/B ratio falls below x1.0.
- ✓ Dividend yield is often used for long-term investors, especially when interests rates are low.

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#### 4-2. Basic Knowledge: Price-earning ratio (P/E ratio)

---

- ✓ When you calculate P/E ratio for a stock, you should use an estimate EPS for the current year or the next year, not previous year's actual EPS.
- ✓ In Mongolia, it appears to be quite difficult to estimate EPS of a listed company due to poor disclosure. What you can do could be, at best, looking at the past earnings and making a bold estimate.
- ✓ Interviewing listed companies is also a part of your job, although most of them may refuse to comment. You need to get to know listed companies' information to be familiar with them. Your better knowledge on listed companies will contribute to investor education.

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### 4-3. Price-earning ratio (P/E ratio)

---

- ✓ P/E ratio cannot be applied if a company reports a loss.
- ✓ Mining companies' earnings momentum is quite dynamic. Is P/E ratio good enough to value mining companies' valuation?
- ✓ In the exploration stage, mining companies do not have revenue, thus they are loss-making companies. When a loss-making mining company in the exploration stage makes an IPO, what valuation should we use?
- ✓ Perhaps you need a bold long-term estimate for the company's financials, based on probable reserves, company's long-term exploration and production plan as well as price forecast of mining products.

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### 4-4. Basic knowledge (1): Price-earning ratio (P/E ratio)

---

Price - earnings ratio = share price / EPS (earnings per share)

EPS = Net income / total number of shares outstanding (period average)

| Sugi Corp's FY2015 earnings forecast: |                 |
|---------------------------------------|-----------------|
| Revenues                              | MNT 100 million |
| Expenditures                          | MNT 70 million  |
| Income before tax                     | MNT 30 million  |
| Net income                            | MNT 20 million  |
| Total number of shares: 100,000       |                 |

Sugi Corp's EPS forecast for FY 2015  
= MNT 20 million / 100,000 shares  
= MNT **200**

(1) When Sugi Corp's share price is MNT 4,000  
P/E ratio = MNT 4,000 / MNT 200 = **20x**

(2) When Sugi Corp's share price is MNT 2,000  
P/E ratio = MNT 2,000 / MNT 200 = **10x**

- ✓ P/E ratio compares the current share price with its earnings.
- ✓ **Whether the company's share price is trading at a premium or a discount is judged** from the comparison with the P/E ratio of companies in the similar sector, or a historical range of its P/E ratios.
- ✓ P/E ratio trends may vary amongst sectors or the economic trends of the country and timing.

Source: Daiwa Institute of Research

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## 4-5. Basic knowledge (2): Price-book ratio (P/B ratio)

Price - book ratio = share price / BPS (book value per share)

BPS = shareholders' equity (net assets) / total number of shares outstanding

| Sugi Corp's FY2015 financial forecast |                       |
|---------------------------------------|-----------------------|
| Total assets                          | MNT500 million        |
| Liabilities                           | MNT300 million        |
| <b>Shareholders' equity</b>           | <b>MNT200 million</b> |
| Total number of shares: 100,000       |                       |

BPS = MNT 200 million / 100,000 shares  
= MNT **2,000**

(1) When the share price is MNT 4,000  
P/B ratio = MNT 4,000 / MNT 2,000 = **2x**

(2) When the share price is MNT 2,000  
P/B ratio = MNT 2,000 / MNT 2,000 = **1x**

- ✓ P/B ratio is a ratio that is often used in a down cycle to judge downside potential of the a stock.
- ✓ When the P/B ratio is 1x or below 1x, it suggests that the price may be undervalued.

Source: Daiwa Institute of Research

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## 4-6. Basic knowledge (3): Dividend yield

Dividend yield (%) = dividend per share / share price x 100

| Sugi Corp's FY2015 dividend forecast |          |
|--------------------------------------|----------|
| Dividend per share                   | MNT150   |
| Share price                          | MNT4,000 |

(1) Dividend yield for Sugi Corp  
= MNT150 / MNT4,000 = **3.75%**

| Urade Trading's FY2015 dividend forecast |          |
|--|----------|
| Dividend per share                       | MNT100   |
| Share price                              | MNT2,000 |

(2) Dividend yield for Urade Trading  
= MNT100 / MNT2,000 = **5.00%**

-> Investors can receive more dividends from Urade Trading when investing the same amount of money.

- ✓ Generally, dividend yields of companies in a growing stage are lower, some even pay no dividends (for example Microsoft did not pay any dividends until FY2003).
- ✓ On the other hand, there are cases where institutional investors claim more dividends against companies that profit growth become moderate or those have too much cash.

Source: Daiwa Institute of Research

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# Баярлалаа!

Та бүхэн асуулт асуух, өөрийн санал, зөвлөмжөө илгээхийг хүсвэл  
доорх хаягаар хандаарай.

**Akifumi Nakanishi**

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## **Project for Capacity Building of Capital Market in Mongolia**

# **Ethics for Securities Representatives**

23 May 2016

Ryota Sugishita  
JICA Consultant, Daiwa Institute of Research

### 1. Ethics – Minimum standards for securities representatives

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- ✓ If you are licensed as a securities representative, you are requested to be a reliable professional.
- ✓ Nothing else is more important than trust and reputation. Without investors' trust, stock market never develops. If your reputation is bad, you cannot make a deal.
- ✓ In fact, investors stay away from the market if an event that loses investors' trust happens (e.g. placing an order without client's approval, investment fraud etc.).
- ✓ In recent years, a code of ethics for securities companies' representatives is set in major markets.
- ✓ A code of ethics is expected to:
  - improve investors' trust;
  - avoid legal and reputation risks of your company;
  - result in selecting new entrants upon licensing.

## 1. Ethics – Minimum standards for securities representatives - cont.

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- ✓ International Organization of Securities Commissions (IOSCO) released *Model Code of Ethics*<sup>1</sup> in Jun06.
- ✓ IOSCO recommends 6 ethical principles:

- i. Integrity and truthfulness
- ii. Promise keeping
- iii. Loyalty - Managing and fully disclosing conflicts of interest
- iv. Fairness to the customer
- v. Doing no harm to the customer or the profession
- vi. Maintaining confidentiality

<sup>1</sup> <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD217.pdf>

## 1. Ethics – Minimum standards for securities representatives - cont.

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- ✓ In Japan, Japan Securities Dealers Association (JSDA) set *Model Code of Ethics* in Sep07.
- ✓ JSDA's *Model Code of Ethics* consists of 9 principles:

- i. Standards of conduct and compliance with laws
- ii. Managing conflicts of interest
- iii. Confidentiality of information
- iv. Social responsibility
- v. Maximizing your client's interests
- vi. Loyal and fair treatment
- vii. Neutral advice to clients
- viii. Higher ethical behavior
- ix. Healthy development of capital markets

## 2-i. Model code of ethics - Standards of Conduct and Compliance with Laws

---

- ✓ You have to be an ethical person.
- ✓ For building trust and good reputation with your clients, you have to understand laws, rules and regulations for capital markets.
- ✓ Not only acting with integrity in compliance with laws, rules and regulations, you also need to behave ethically even in a space where the current legal framework does not cover.

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## 2-ii. Model code of ethics - Managing conflicts of interest

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- ✓ If you have an incentive to serve one interest at the expense of another interest, that is a conflict of interest.
- ✓ Conflicts of interest can sometimes be seen. You have to be fair in managing conflicts of interest.

### Example 1

- Your company is licensed for brokerage and underwriting.
- You begin to think that Sugi Corp's current share price is overvalued, and want to advise your clients to sell Sugi Corp shares.
- Then you are informed that a colleague of yours is discussing with Sugi Corp for SPO.

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## 2-ii. Model code of ethics - Managing conflicts of interest - cont.

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- ✓ You have to recognize that you can sometimes access privileged or confidential information. You should avoid making a deal, using your privileged or confidential information.
- ✓ You should not pass it if you know privileged or confidential information.

### Example 2

- You are an underwriter and are close to Urade Mining's CEO.
- You heard from the CEO that the company would obtain an exclusive license to develop one of Mongolia's strategic mining deposits.
- This information is not publicly announced yet.

7

## 2-iii. Model code of ethics - Confidentiality of information

---

- ✓ Information that you have obtained from your clients, listed companies and others should be mostly kept confidential.

### Example 3

- Mr Ohno is one of your clients.
- One day someone you do not know calls you and requests to provide Mr Ohno's address, mobile phone number, e-mail address and other personal information with him.

8



### 2-iii. Model code of ethics - Confidentiality of information - cont.

---

- ✓ Information on your clients' financial assets cannot be disclosed to anyone.
- ✓ Trade information is also confidential.

#### Example 4

- Mr Nakanishi is an active client of yours.
- Every day he places an buy/sell order.
- Another client of yours wants to know which stock Mr Nakanishi trades how many.

9

### 2-iv. Model code of ethics - Social responsibility

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- ✓ You are a business person, at the same time a good citizen, contributing to social stability.
- ✓ Be careful of dealing with anti social forces.

10

## 2-v. Model code of ethics - Maximizing your client's interests

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- ✓ You should always make a diligent and professional effort.
- ✓ You need to get to know your client's financial assets, experiences, knowledge as well as his/her investment goals so that you can advise to maximize his/her interests.

11

## 2-vi. Model code of ethics - Loyal and fair treatment

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- ✓ You should show loyalty towards your clients.
- ✓ When you make a trade on behalf of your clients, top priority should be given to your clients' interests.
- ✓ You should be fair to all of your clients. Information that you have obtained is for all of your clients, not only for your important clients.

### Example 5

- Mr Kaneko is your biggest client.
- To serve Mr Kaneko better, you provide updated information on Sugi Corp only with Mr Kaneko.
- Days later, after Sugi Corp's share prices rose substantially, you started to inform other clients about Sugi Corp.

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## 2-vi. Model code of ethics - Loyal and fair treatment

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- ✓ Performance of your client's investment is a result of his/her decision. This is a basic principle for investment.
- ✓ You have to explain to your clients so that they can clearly understand their personal responsibility.

### Example 6

- Mr Ohno is your company's biggest client. Without Mr Ohno's orders, your company will make a loss.
- Mr Ohno bought shares, based on your recommendation, but share prices keep falling and he had to sell all of the shares.
- Mr Ohno requests you to compensate his loss, otherwise he says he will switch to a different broker.

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## 2-vi. Model code of ethics - Loyal and fair treatment - cont.

---

- ✓ However, it may be your fault if a client feels forced to trade.

### Example 7

- Mr Sugi is a 85-year old man and he has not invested in the stock market in the past.
- You heard that Mr Sugi had a lot of cash in his bank account.
- You visited Mr Sugi and talked non-stop about your recommendation. Mr Sugi did not want to be bothered any further and placed an order.

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## 2-vii. Model code of ethics - Fair advice to clients

---

- ✓ You must be a fair investment advisor.
- ✓ You cannot be biased when you advise your clients.
- ✓ Your advice has to be based on a high level of professional knowledge for capital markets.
- ✓ You should distinguish facts from opinions.
- ✓ Be careful of advising based on insider information.

### Example 8

- The policy lending rate fell to 10.5% in May from 12.0%.
- You think the policy rate will be further cut to 9.0%.
- When you talked to a client over the phone, you said “the policy rate will be down to 7.0% in July.”

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## 2-viii. Model code of ethics - Higher ethical behavior

---

- ✓ You are always requested to behave ethically.
- ✓ In an event that is not written in any of laws, rules and regulations for capital markets, you also have to judge from your code of ethics and act accordingly.
- ✓ If you happen to know information that can materially impact on share prices, you should keep the information carefully.

### Example 9

- Urade Mining’s CEO is a good friend of yours.
- A week before Urade Mining releases its financial results for 2015, you heard from him that Urade Mining’s net profit was much higher than expected.
- You are sure of a substantial upside for its share price.

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- ✓ Your daily work contributes to capital market development.
- ✓ Fairness and integrity are critical for health development of capital markets.
- ✓ Beware of losing trust. Unfair disclosure, manipulation of share prices and other misconduct could dampen healthy capital market development.

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## Баярлалаа!

Та бүхэн асуулт асуух, өөрийн санал, зөвлөмжөө илгээхийг хүсвэл доорх хаягаар хандаарай.

**Ryota Sugishita**

Жайка Зөвлөхийн Баг  
Офис (орон нутгийн): өрөө #204, FRC

# Project for Capacity Building of Capital Market in Mongolia: IPO & Dual Listing Seminar Costs & Benefits of IPO

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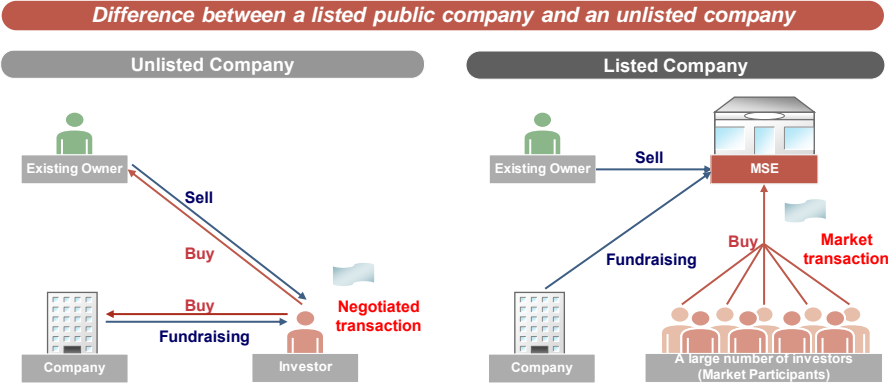
June 23, 2015

Daiwa Institute of Research  
Japan Economic Research Institute

## What is IPO (Initial Public Offering)?

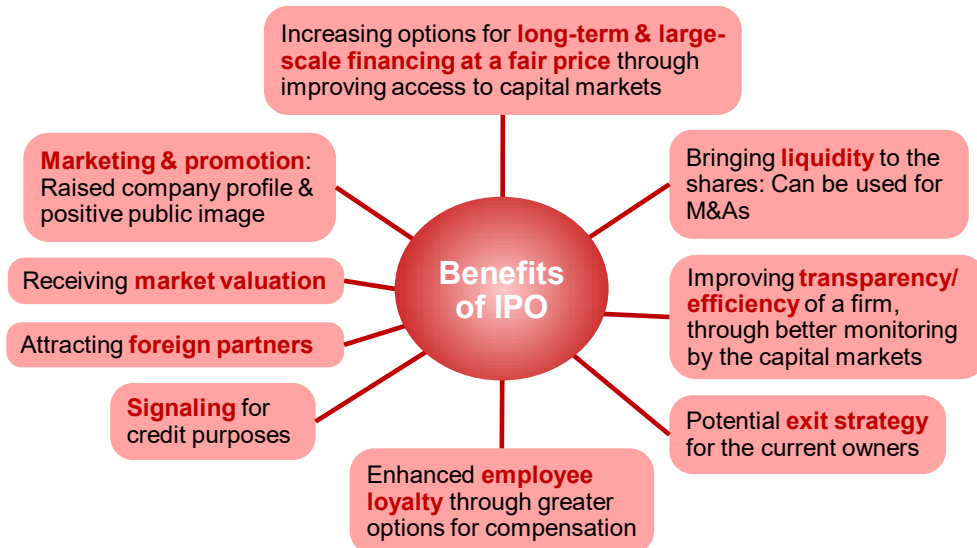
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*A company lists for the first time on a stock exchange and conducts a public offering*



## Benefits of IPO

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3

## Why Do Firms Go Public?: Theories

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### Life Cycle Theories

- **Zingales (1995)**: For a potential acquirer, **public targets are easier to spot** than private ones. Entrepreneurs can facilitate the acquisition of their company for a **higher value after IPO**.
- **Black & Gilson (1998)**: In VC-backed companies, entrepreneurs often **regain control of the company** from the VC.
- **Chemmanur & Fulghieri (1999)**:
  - Allows greater **dispersion of ownership**. Pre-IPO angel investors & VCs hold undiversified portfolios, therefore, are not willing to pay as high a price as diversified market investors.
  - As a firm grows & faces profitable investment opportunities, the costs of going public become worth incurring.
  - Public trading can itself add value to the firm as it inspires **confidence from investors, customers, suppliers & employees**.

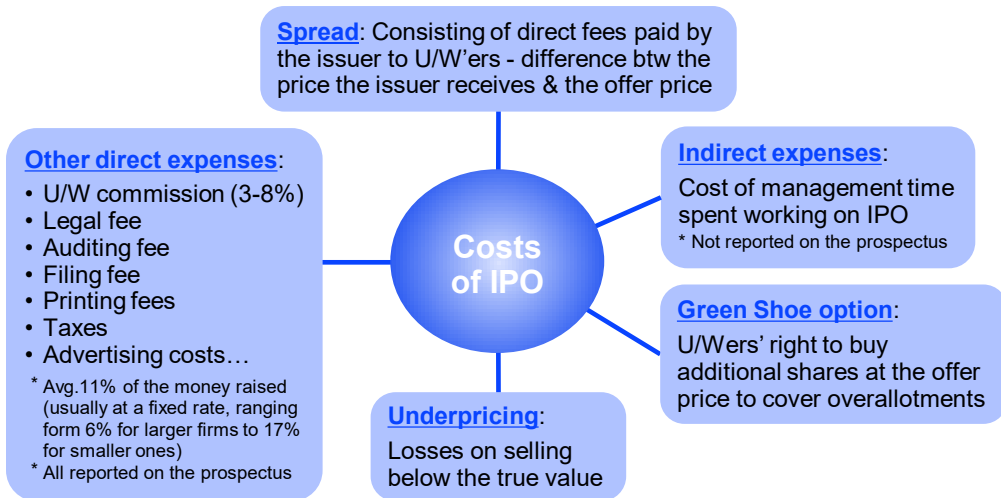
### Market-Timing Theories

- **Schultz (2000)**: **Markets provide valuable info** to entrepreneurs. Higher stock prices of companies in the same industry signal higher growth opportunities.
- **Welch & Ritter (2002)**: Semi-rational theory w/o asymmetric info to explain increased IPO volume following bull markets. Entrepreneur's sense of value derives more from their operations perspective & underlying business fundamentals than from public markets.

4

## Costs of IPO

According to the practices in US, total IPO costs are a big portion of the issue proceeds (avg. 15-30%), which can be divided into the followings.



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## Concerns Related to IPO



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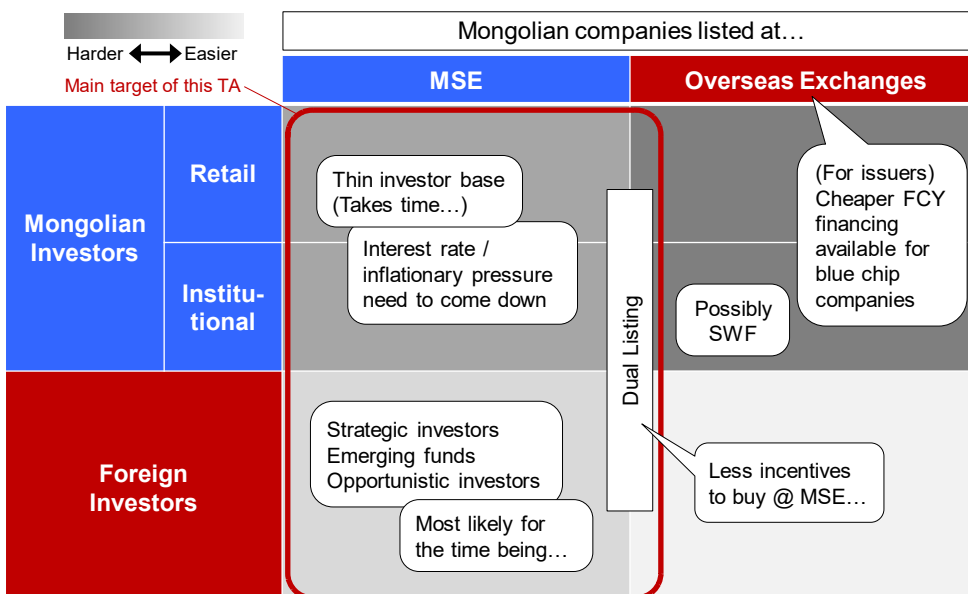


## Private Placement vs. Public Offering

| Private Placement  | Public Offering   |
|--|---|
| <ul style="list-style-type: none"> <li>➤ Securities are sold to <b>a few investors</b> rather than to the public (e.g. VCs).</li> <li>➤ Shares are <b>not registered</b>, so sales must be to <b>'accredited' (high net worth) investors</b>.                             <ul style="list-style-type: none"> <li>- Send out <b>'offering memorandum'</b> with 20-30 pages of data &amp; info, prepared by securities lawyers.</li> <li>- Buyers certify that they meet net worth/income requirements &amp; they will not sell to unqualified investors.</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>➤ Securities are offered to the <b>public</b></li> <li>➤ Shares must be <b>registered</b> with the authority (e.g. SEC@US).</li> <li>➤ <b>Large-scale financing at a fair price</b> becomes available</li> </ul> |

7

## Equity Financing in Mongolian Context



8

## Underwriting: Types

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| 'Firm Commitment' Underwriting  | 'Best Efforts' Underwriting  |
|---|--|
| <ul style="list-style-type: none"><li>➤ Issuer sells entire issue to U/W'ers</li><li>➤ U/W'ers then resell them to the public</li><li>➤ U/W'ers make money on the spread btw:<ul style="list-style-type: none"><li>- the price paid to the issuer and</li><li>- the price received from investors when the shares are sold</li></ul></li><li>➤ <b>U/W'ers bear the risk of not being able to sell</b> the entire issue for more than the cost</li><li>➤ Most common U/W type in US.</li></ul> <p><u>Firm Commitment as an Option</u></p> <ul style="list-style-type: none"><li>➤ Issuer buys a put option from the U/W'er.</li><li>➤ U/W'er gives a call option to investors.</li><li>➤ Issuer's put option becomes real only in the final pricing meeting.</li></ul> | <ul style="list-style-type: none"><li>➤ U/W'er makes 'best effort' to sell the shares at an agreed offering price</li><li>➤ <b>Issuer bears the risk of the unsold part</b></li><li>➤ IBKs only markets the issue. Prospectus states:<ul style="list-style-type: none"><li>- Offer price (P)</li><li>- Min # of shares that must be sold (<math>Q_{min}</math>)</li><li>- Max # of shares that will be sold (<math>Q_{max}</math>)</li></ul></li><li>➤ If <math>Q_{min}</math> is not reached in 90 days (e.g.), investors get their money back from an escrow A/C.</li><li>➤ In US, only <b>35% of IPOs</b>, accounting for <b>13%</b> of the total money raised.</li><li>➤ <b>Generally for small firms.</b></li><li>➤ Issuers can choose the price itself, otherwise IBKs would force the company to go public at very low price.</li></ul> |

9

## Underwriting: Underwriters

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### Services

- **Formulating method to issue securities**
- **Pricing** the securities
- **Selling** the securities
- **Price stabilization** in the aftermarket (by lead U/W'er)
- **Over-Allotment Option** or '**Green Shoe**' Provision:
  - Option granted to an U/W'er for a period of **15-45 (usually 30) days** after the issue date to purchase additional shares. (Typically, **up to 15%** of the shares being sold.)
  - = Call option issued by the firm to IBK.

### Profits

- Commission from the spread between the issue price (P) investors pay & the amount paid to the firm (P(1-C)).

10

### Underpricing

- Defined as ‘**the difference in price btw the closing price on the 1<sup>st</sup> day of trading & the offer price**’
- IPO pricing is very difficult, as no current market price is available.
- General practice, in which U/W'ers earn reputations through;
  - ✓ Achieving **higher price than the offer price**
  - ✓ **Selling out the shares**
- **Smaller, riskier IPOs underprice to attract investors.**

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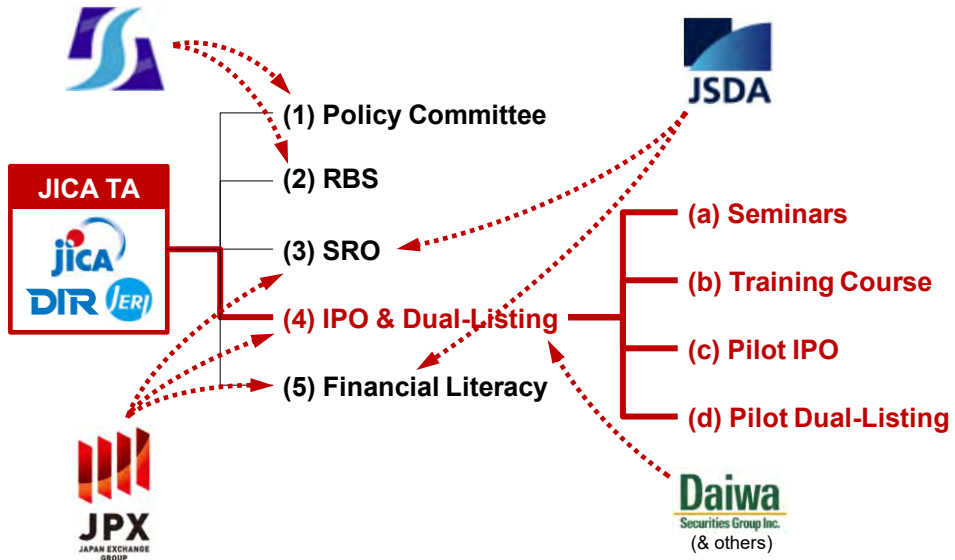
### Factors for a successful IPO

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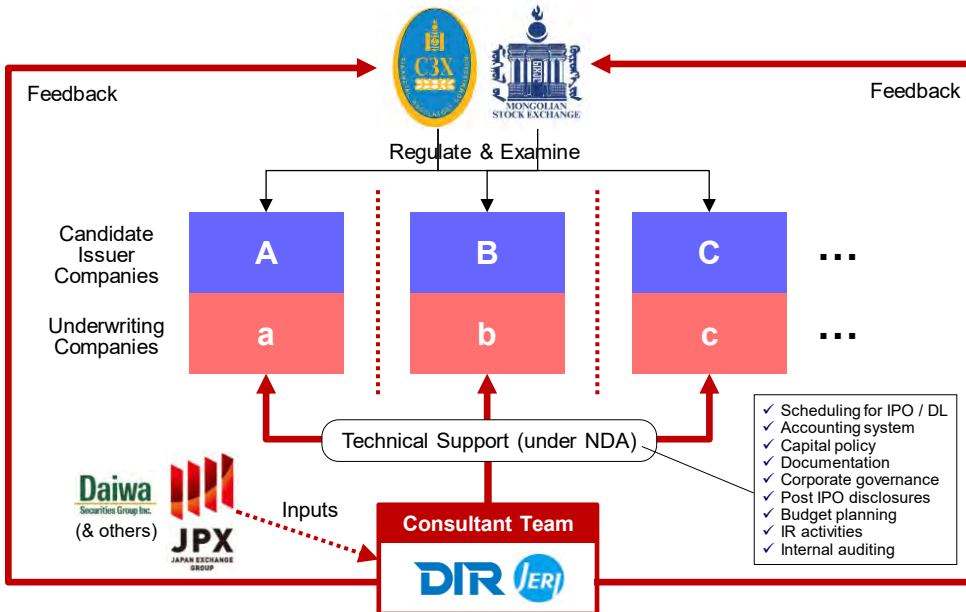
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Support Under JICA TA: Consulting Framework



13

(4)-(c),(d) Pilot IPO & Dual-Listing



14

CONFIDENTIAL

PASSION  
FOR THE  
BEST

# Dual Listing: Benefits & Introduction of Asian Major Stock Exchanges

---

Discussion Material

June 2015

**Daiwa Capital Markets Hong Kong Limited**

Investment Banking Department

**Daiwa**  
Capital Markets

# What is a Dual Listing and Why?

A dual listing is a situation in which the securities of a given company are listed on more than one exchange.

A dual listing sometimes occurs when a company begins to establish an international presence by operating facilities in foreign nations. When this occurs, it is sometimes advantageous to be listed on international exchanges as well as domestic exchanges.

Assuming that the company meets the listing qualifications related to the exchange, there is usually no problem in arranging for shares/depository receipts of the company's stock to be traded on those markets.

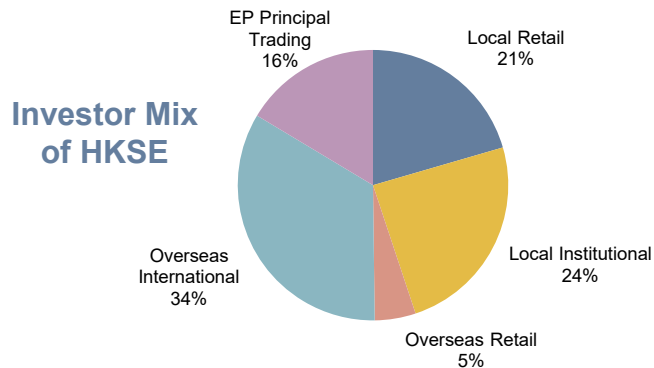
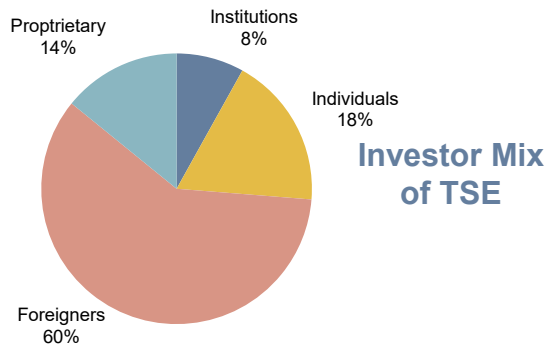
With a dual listing approach, a company can choose to list on more than one exchange simultaneously. Alternatively, a company can choose to list on one exchange followed by a secondary listing on another exchange. Subject to the listing examination that the company go through, this does not necessarily mean that the listings are not equal.

Typically, the reasoning behind a dual listing is to provide investors with more options in trading the shares/depository receipts which in turn can increase the liquidity of the company.

# Merits of Dual Listing

## Expanding Investor Base

- Dual listing might provide easier access to the investors base in that market. For example, high quality retail investors and high net worth individuals through TSE, HKSE, SGX and mainland Chinese investors (Qualified Domestic Institutional Investors) through the HKSE
- Getting listed in another exchange would also bring additional financing opportunities by conducting follow-ons in the secondary listed exchange



## Improving Foreign Investors' Awareness

- The company's name can be spread to foreigners such as global investors and potential business partners through marketing activities including press conference
- Newspaper advertising will be prepared for the marketing and can introduce the company's name to local residents as well as global investors



## **Section 1**




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# **Dual Listing: Overview of Asian Major Stock Exchanges**






# Listing Venue Comparison

## Overview of TSE, SGX and HKSE

|   | <br>JPX<br>JAPAN EXCHANGE GROUP  | <br>SGX<br>SINGAPORE EXCHANGE  | <br>HKEX<br>香港交易所   |
|---|---|---|--|
| <b>Total market cap</b>                     | <ul style="list-style-type: none"> <li>USD 4,378bn</li> </ul>   | <ul style="list-style-type: none"> <li>USD 753bn</li> </ul>   | <ul style="list-style-type: none"> <li>USD 3,233bn</li> </ul>  |
| <b>Total fund raised through IPO</b>        | <ul style="list-style-type: none"> <li>2014: USD 10.5bn</li> <li>2013: USD 9.5bn</li> <li>2012: USD 12.2bn</li> </ul>   | <ul style="list-style-type: none"> <li>2014: USD2.4bn</li> <li>2013: USD5.4bn</li> <li>2012: USD3.0bn</li> </ul>  | <ul style="list-style-type: none"> <li>2014: USD29.7bn</li> <li>2013: USD21.7bn</li> <li>2012: USD11.5bn</li> </ul>  |
| <b>No. of issuer</b>                        | <ul style="list-style-type: none"> <li>3,470</li> </ul>   | <ul style="list-style-type: none"> <li>775</li> </ul>   | <ul style="list-style-type: none"> <li>1,752</li> </ul>  |
| <b>Turnover</b>                             | <ul style="list-style-type: none"> <li>USD 5,444bn (2014)</li> </ul>  | <ul style="list-style-type: none"> <li>USD209bn (2014)</li> </ul>   | <ul style="list-style-type: none"> <li>USD1,521bn (2014)</li> </ul>  |
| <b>Issuers average historical P/E ratio</b> | <ul style="list-style-type: none"> <li>Nikkei 225 18.3x</li> </ul>  | <ul style="list-style-type: none"> <li>Straits Times Index: 13.4x</li> </ul>  | <ul style="list-style-type: none"> <li>Hang Seng Index: 10.6x</li> </ul>   |
| <b>Investor base</b>                        | <ul style="list-style-type: none"> <li>Extensive institutional investor base and very active participation from local high net worth individuals as well as foreign investors</li> </ul>                            | <ul style="list-style-type: none"> <li>Extensive institutional and private banking investor base. Investors are regionally focused on ASEAN equities</li> </ul>   | <ul style="list-style-type: none"> <li>Extensive institutional investor base and very active participation from local retail investors. Investors are domestic focused looking for businesses that have a strong China play</li> </ul> |
| <b>Listing preparation time</b>             | <ul style="list-style-type: none"> <li>c. 12 months</li> </ul>  | <ul style="list-style-type: none"> <li>6.5 - 8 months</li> </ul>  | <ul style="list-style-type: none"> <li>6 - 9 months</li> </ul>   |
| <b>Listing cost</b>                         | <ul style="list-style-type: none"> <li>Moderate listing cost applies</li> </ul>   | <ul style="list-style-type: none"> <li>Moderate listing cost applies</li> </ul>   | <ul style="list-style-type: none"> <li>Moderate listing cost applies</li> </ul>  |
| <b>Ongoing cost</b>                         | <ul style="list-style-type: none"> <li>Moderate ongoing cost; mainly in relation to disclosure and corporate governance requirements</li> <li>Litigation against the issuer or its directors is uncommon</li> </ul> | <ul style="list-style-type: none"> <li>Moderate ongoing cost; mainly in relation to disclosure and corporate governance requirements</li> <li>Litigation against the issuer or its directors is uncommon</li> </ul> | <ul style="list-style-type: none"> <li>Moderate ongoing cost; mainly in relation to disclosure and corporate governance requirements</li> <li>Litigation against the issuer or its directors is uncommon</li> </ul>                    |

# Listing Venue Comparison

## Overview of TSE, SGX and HKSE (Cont'd)

|                                    | <br>JPX<br>JAPAN EXCHANGE GROUP   | <br>SGX<br>SINGAPORE EXCHANGE  | <br>HKEX<br>香港交易所  |
|------------------------------------|--|---|---|
| <b>Board</b>                       | <ul style="list-style-type: none"> <li>First Section</li> </ul>  | <ul style="list-style-type: none"> <li>Main board</li> </ul>  | <ul style="list-style-type: none"> <li>Main board</li> </ul>  |
| <b>Track record</b>                | <ul style="list-style-type: none"> <li>2 years audited accounts</li> </ul>   | <ul style="list-style-type: none"> <li>3 years audited accounts</li> </ul>  | <ul style="list-style-type: none"> <li>3 years audited accounts</li> </ul>  |
| <b>Financial reporting</b>         | <ul style="list-style-type: none"> <li>Japanese GAAP, US GAAP<sup>1</sup>, IFRS or other GAAP<sup>2</sup> permitted by Japan's Financial Services Agency</li> </ul>  | <ul style="list-style-type: none"> <li>FRS, IFRS or US GAAP</li> </ul>  | <ul style="list-style-type: none"> <li>China GAAP, IFRS and HK GAAP</li> </ul>  |
| <b>Minimum # of shareholders</b>   | <ul style="list-style-type: none"> <li>2,200</li> </ul>  | <ul style="list-style-type: none"> <li>500</li> </ul>   | <ul style="list-style-type: none"> <li>300</li> </ul>   |
| <b>Financial requirements</b>      | <p>Expected aggregate market capitalization must be at least JPY 25bn. In addition, the company must meet at least one of the following requirements:</p> <ul style="list-style-type: none"> <li>(1) The total amount of profits in the last 2 years must be at least JPY 500m</li> <li>(2) The company's total market capitalization must be at least JPY 50bn, with sales of JPY 10bn or more in the most recent year</li> </ul> | <p>Fulfilling one of the following requirements:</p> <ul style="list-style-type: none"> <li>(1) Minimum consolidated pre-tax profit of at least SGD30m for the latest financial year and operating track record of at least 3 years</li> <li>(2) Profitable in the latest financial year, with an operating track record of at least 3 years and a market capitalization of at least SGD150m</li> <li>(3) Operating revenue (actual or pro forma) in the latest completed financial year and a market capitalization of at least SGD300m</li> </ul> | <p>Fulfilling one of the following requirements:</p> <ul style="list-style-type: none"> <li>(1) Profits of HKD50m in the last 3 years (with HKD20m in the most recent year and an aggregate of HKD30m in the two preceding years)</li> <li>(2) Market cap at least HKD4bn; revenue of HKD500m for the most recent audited financial year</li> <li>(3) Market cap at least HKD2 billion; revenue of HKD500m for the most recent audited financial year; Positive cashflow from operating activities of HKD100m in aggregation for the 3 precedent years</li> </ul> |
| <b>Lock-up requirements</b>        | <ul style="list-style-type: none"> <li>N.A.</li> </ul>   | <ul style="list-style-type: none"> <li>6 – 12 months for controlling shareholders (&gt;15%)</li> </ul>  | <ul style="list-style-type: none"> <li>Controlling shareholders (&gt;30%) not to dispose of any shares within 6 months of listing, and to maintain as the controlling shareholding in the following 6 months</li> </ul>   |
| <b>Post-IPO equity fundraising</b> | <ul style="list-style-type: none"> <li>6 months constraint according to market practice</li> </ul>   | <ul style="list-style-type: none"> <li>Capital raising of up to 50% allowed under general mandate; shareholders' approval required above that</li> </ul>  | <ul style="list-style-type: none"> <li>Capital raising of up to 20% allowed under general mandate, which is normally obtained through the annual general meeting; shareholders' approval required for more than 20%</li> </ul>  |

# Listing on the TSE

## Key Listing Requirements

### ✓ Financial Requirements

- New applicants must fulfill one of the following three financial requirements:
  - I. The total amount of profits in the last 2 years must be at least JPY 500m
  - II. The company's total market capitalization must be at least JPY 50bn, with sales of JPY 10bn or more in the most recent year

### ✓ Operating history

- A foreign company is required to have continuously carried out its business for three full fiscal years before the date of its listing application, as evidenced by setting up a board of directors (or an analogous institution)

### ✓ Auditor's opinion / financial statements

- There must be no false statements in any of the year-end financial statements for the last 2 years or in any quarterly financial statements for a quarterly accounting period ending in the current year
- A CPA must have opined that the financial statements represented the company's financial position "fairly," on "unqualified terms" or "fairly" albeit on "qualified terms" in an audit report attached to the financial statements for the next-to-last full business year
- A CPA must have opined that the financial statements represented the company's financial position "fairly," on "unqualified terms" or "represented valid information" in an audit report attached to the financial statements for the most recent full business year and the quarterly financial statements for the current business year

### ✓ Corporate Governance

- The company must have an internal control system under J-SOX provisions for a board member to adequately execute his or her duties and for the company to effectively conduct its business activity, which is appropriately secured and operated
  - I. Basic approach to corporate governance and information about its capital structure, corporate attributes etc.
  - II. The company's business management function, as regards its management decision, execution and supervision and other matters pertaining to corporate governance system, and the reasons for selecting this organization and system
  - III. The implementation status of any measures to protect the interests of shareholders and other stakeholders
  - IV. The company's basic approach to, and implementation status of, its internal control system, including matters concerning the development of the corporate structure for eliminating anti-social forces and
  - V. Other matters deemed necessary by the TSE

### ✓ Minimum Public Float

- At least 20,000 trading units of tradable shares (i.e., not held by insiders or large shareholders)
- Ratio of tradable shares to listed shares of at least 35%

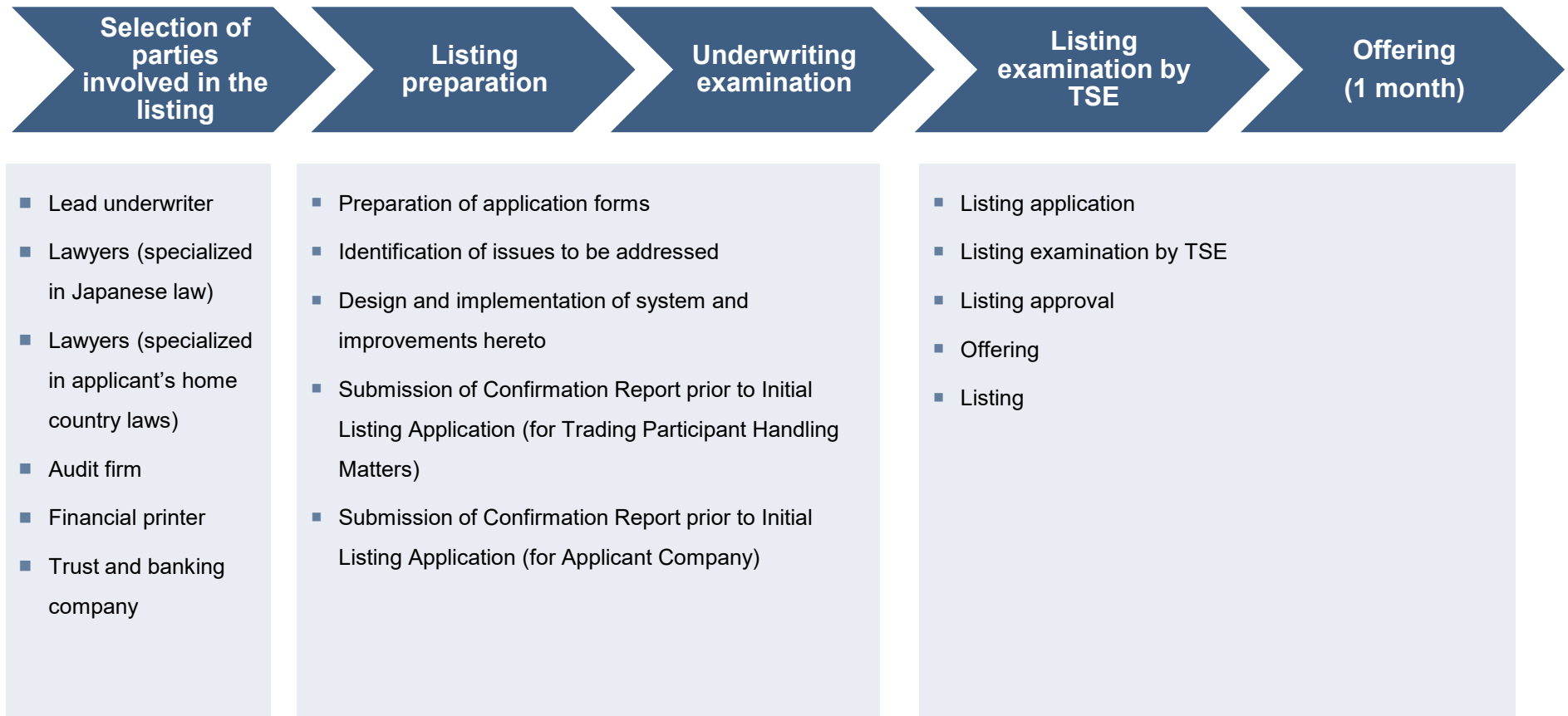
### ✓ Connected Transaction

- Listing Rules requires that The company and its related companies must not be making transactions with interested persons, related companies or other entities under conditions clearly advantageous and/or disadvantageous to the applicant company

- It is advisable for a contemplating issuer to consider these requirements carefully prior to preparing its listing on the TSE
- Daiwa is happy to discuss further with you to design the most appropriate approach to solve potential issues

# Listing on the TSE

## Overview of the Listing Process



# Listing on the HKSE

## Key Listing Requirements

### ✓ Financial Requirements

- A trading record of not less than 3 financial years
- New applicants must fulfill one of the following three financial requirements:
  - I. **Profit Test:** Profits of HKD50 million in the last 3 years (with HKD20 million in the most recent year and an aggregate of HKD30 million in the two preceding years)
  - II. **Market Cap/Revenue Test:** Market cap of at least HKD4 billion at the time of listing; and Revenue of at least HKD500 million for the most recent audited financial year
  - III. **Market Cap/Revenue/Cashflow Test:** Market cap of at least HKD2 billion at the time of listing; Revenue of at least HKD500 million for the most recent financial year; and Cashflow from operating activities of at least HKD100 million in aggregate for the 3 preceding financial years

### ✓ Corporate Governance

- Board comprises of at least 3 independent non-executive director (“INED”)
- Audit committee with at least 3 members, with a majority of INEDs (at least one INED with appropriate professional qualifications/accounting/financial management expertise)

### ✓ Connected Transaction

- Listing Rules requires that the interest of shareholders as a whole are taken into account by a listed issuer when entering into any connected transactions
- If size of any connected transaction is above a certain threshold, waivers from the stock exchange will be required

### ✓ Management & Ownership Continuity

- Management continuity for at least the 3 preceding years; and
- Ownership continuity and control for at least the most recent audited financial year

### ✓ Competition with Controlling Shareholder

- Listing Rules requires that, before listing, competition between the issuer and its controlling shareholders’ other business should be minimized through proper segregation of business
- All existing competition should be eliminated and future competition will not be permitted
- The issuer should be able to demonstrate: (i) Management independence; (ii) Financial independence; and (iii) Operational independence

### ✓ Minimum Public Float

- At least 25% of the total issued share capital (minimum of HKD50 million) must at all times be held by the public
- For issuers with an market cap of over HKD10 billion at the time of listing, the public float can be lowered to a percentage between 15% and 25%
- A minimum of 300 shareholders

### ✓ Lock-up Period

- The issuer’s controlling shareholder (and any pre-IPO investor) shall not: (i) dispose of shares in the period of 6 months from the listing date; and (ii) cease to be a controlling shareholder in the period of another 6 months on the date on which the period referred to above expires

- It is advisable for a contemplating issuer to consider these requirements carefully prior to preparing its listing on the HKSE
- Daiwa is happy to discuss further with you to design the most appropriate approach to solve potential issues

# Listing on the HKSE

## Overview of the Listing Process

### Preparation

- Appoint sponsor(s) and other intermediaries (submit sponsor engagement letter to SEHK at least 2 months before A1 submission)
- Draw up timetable
- Perform all due diligence
- Complete prospectus for publication upon A1
- Complete audited annual reports for the last 3 financial years
- Identify conflict issues with parent group and connected transactions
- Clearly delineate business from the parent group
- Complete internal control report and remedy material deficiencies
- Finalize legal opinions
- Resolve compliance issues (if any)
- Complete verification
- Parent group to submit spinoff proposal to SEHK for approval (3 months before A1)
- Parent group to publish spinoff announcement at A1
- Prepare other listing application documents (“A1 filings”)
- Appoint directors and other committee members

### SEHK Approval

- File A1 application
- Publish Application Proof of prospectus upon A1 on HKEx website (from 1 April 2014 onwards)
- Response to comments from SEHK
- Update financial reports (if applicable)
- Listing hearing
- Shareholder approval of parent group may be required

### Marketing & Pricing

- Prepare marketing materials
- Syndicate research analysts prepare research reports
- Secure cornerstone investors
- Pre-marketing roadshow
- Global roadshow
- Issue prospectus and commence Hong Kong public offering
- Pricing and allocation
- Receive listing approval
- Commence trading

# Listing on the SGX

## Key Listing Requirements

| SGX Mainboard Primary Listing    |  |                     |                         |  |
|----------------------------------|--|---------------------|-------------------------|--|
|                                  | Alternative 1  | Alternative 2       | Alternative 3           |  |
| <b>Quantitative Requirements</b> | Pre-tax profit   | SGD30M in latest FY | Profitable in latest FY | Operating revenue in latest completed FY |
|                                  | Operating track record   | 3 years             | 3 years                 | 1 year or Nil for REIT/BT                |
|                                  | Market Cap   | Nil                 | SGD150M                 | SGD300M                                  |
| <b>Shareholder Spread</b>        | Companies with market cap <SGD300M – 25% public float<br>Companies with market cap ≥SGD300M– 12-20% public float<br>At least 500 public shareholders   |                     |                         |  |
| <b>Independent Directors</b>     | Foreign company must have at least 2 Singapore resident independent directors  |                     |                         |  |
| <b>Moratorium</b>                | <ul style="list-style-type: none"> <li>➢ After IPO, promoters to retain 100% for 1<sup>st</sup> 6 months</li> <li>➢ Pre-IPO investors &gt;5% shareholding to retain profit portion for 6 months</li> </ul>   |                     |                         |  |
| SGX Mainboard Secondary Listing  |  |                     |                         |  |
| <b>Shareholder Spread</b>        | At least 500 shareholders worldwide, or<br>At least 500 shareholders in Singapore or 1,000 shareholders worldwide where there is no established framework and arrangement to facilitate the movement of shares between SGX and the primary home exchange |                     |                         |  |
| <b>Accounting Standard</b>       | Restatement to SFRS or IFRS or US GAAP   |                     |                         |  |
| <b>Prospectus Requirement</b>    | Required. Subject to the Securities and Futures Act (Chapter 289) of Singapore   |                     |                         |  |

# Listing on the SGX

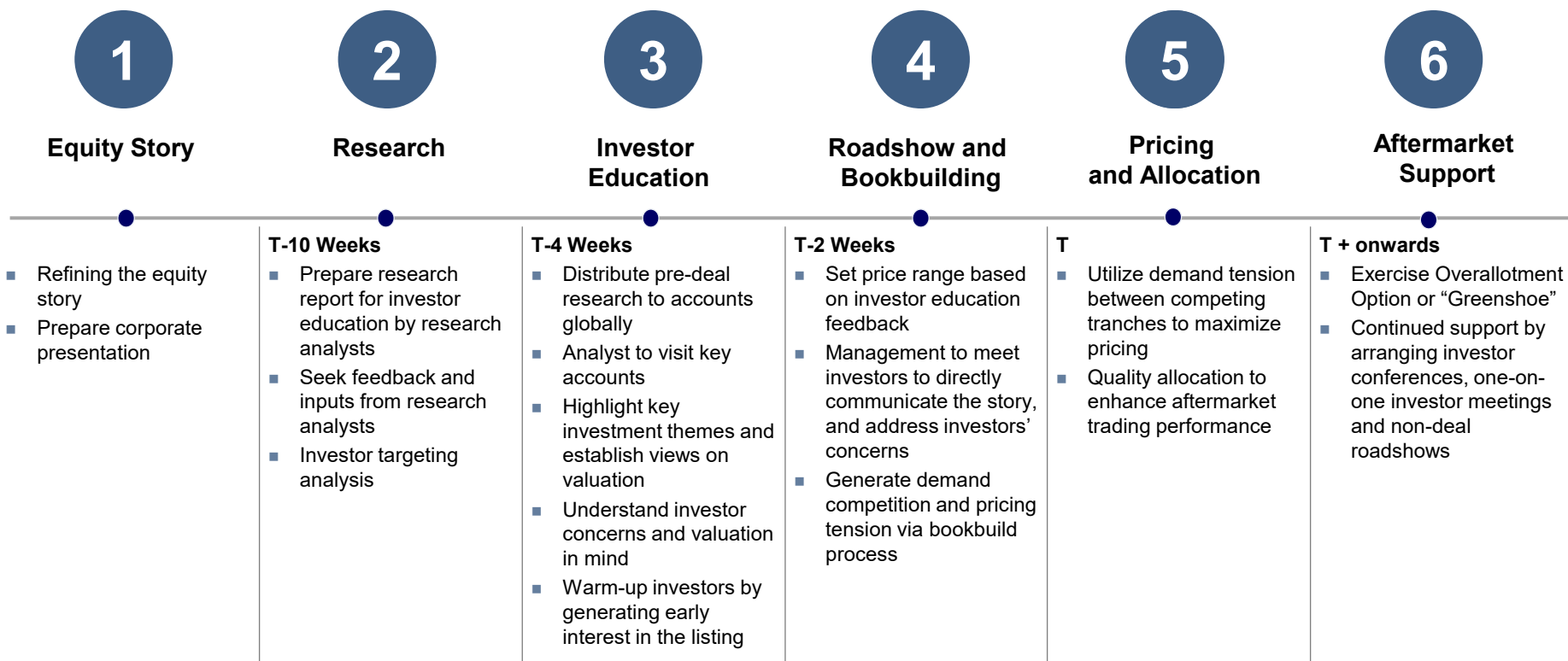
## Primary Listing Timetable

| Submission Preparation  | SGX & MAS Review   | Public Comments                  | Registration   | Trading Commences  |
|---|--|----------------------------------|--|--|
| <p>Preparation of SGX listing application and submission documents</p> <p>Pre-meetings with Singapore listing authorities</p> | <p>Submit listing application &amp; prospectus to SGX</p> <p>Submit prospectus to MAS for pre-lodgment review</p> <p>SGX reviews listing application for compliance with listings requirements and indicates eligibility to list</p> | <p>Lodge prospectus with MAS</p> | <p>Launch offer</p> <p>Submit replacement or supplementary prospectus to MAS and SGX concurrently (if any)</p> | <p>Issuer makes pre-quotation disclosure (if any)</p> <p>SGX lists issuer's securities and commences secondary trading</p> |

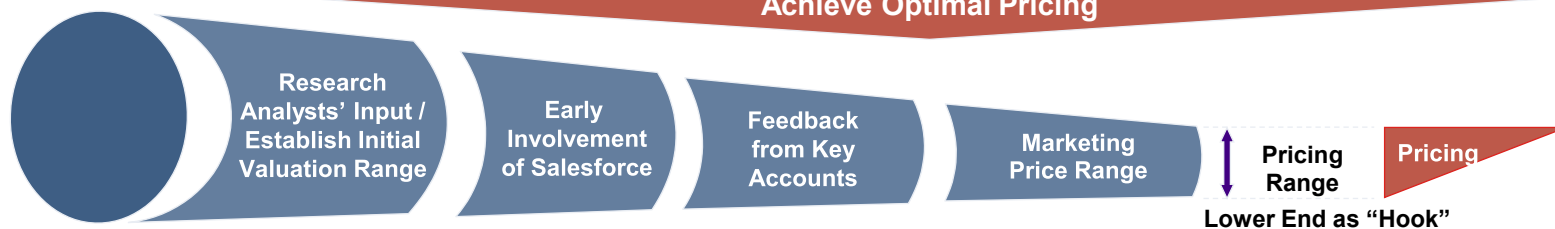


# Overview of the Listing Process

## Marketing Strategy



### Achieve Optimal Pricing






# Overview of the Listing Process

## Management Roadshow and Bookbuilding

- A well-executed, focused roadshow and bookbuilding process is critical to achieving the optimal valuation for the issuer. The management roadshow should focus on delivering a compelling equity and mitigating investor concerns to maximize demand tension

### Indicative Management Roadshow Itinerary – Maximizing the Investment Tension

|        | Locations   | Duration   | Targets  |
|--------|---|------------|--|
| Asia   | <ul style="list-style-type: none"> <li>Hong Kong, Singapore, Tokyo</li> </ul>                          | 3 – 5 days | <ul style="list-style-type: none"> <li>“Local” investors who understands the industry dynamic</li> <li>Substantial holders of comparables</li> </ul> |
| Europe | <ul style="list-style-type: none"> <li>Edinburgh, Frankfurt, Geneva, London, Paris, Zurich</li> </ul>  | 3 – 4 days | <ul style="list-style-type: none"> <li>Top sectorfunds</li> <li>HNW private banking accounts</li> <li>Government pension funds</li> </ul>            |
| U.S.   | <ul style="list-style-type: none"> <li>New York, Boston, Los Angeles San Francisco</li> </ul>          | 2 – 3 days | <ul style="list-style-type: none"> <li>Global institutional investors</li> <li>Top sector focusedfunds</li> </ul>                                    |



#### Preparatory Phase...

#### ...On the Road...

#### ...Building up the Book

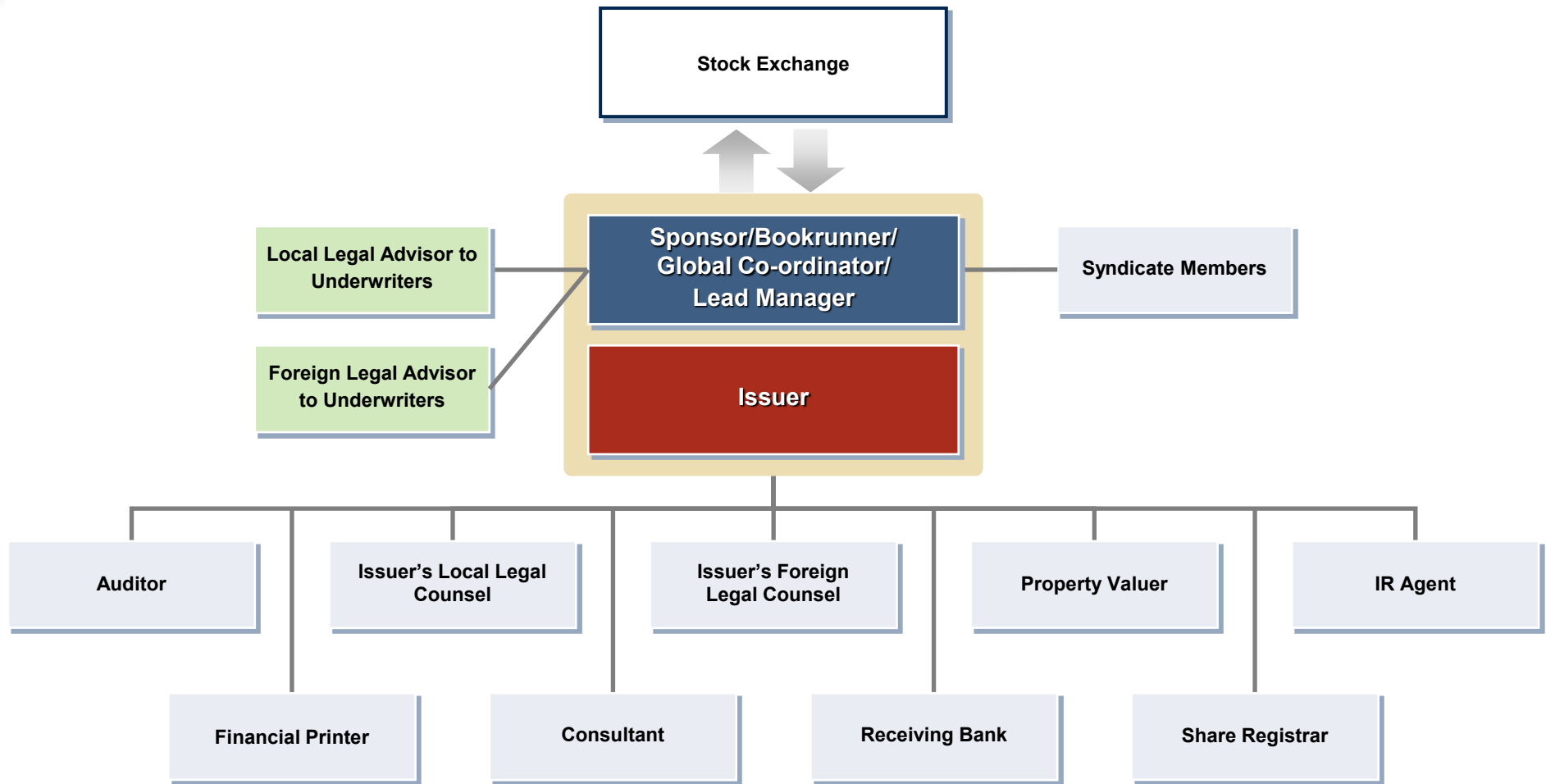
- Format:** One-on-one meetings, group luncheons, breakfast meetings, and press conference
- Investors:** ~ 100 – 150 investor meetings
- Teams:** Two management teams for international roadshow
- Objectives:** 1) Educate investors on equity story; 2) Build demand momentum and perceived scarcity of shares; and 3) Achieve optimal pricing and over-subscription levels for the offering

- Daiwa will assist the issuer in preparing the roadshow presentation which will be used to showcase the issuer's equity story, highlighting the investment merits and addressing key investor concerns
- Daiwa will coordinate all logistical matters

- A typical roadshow will consist of meeting close to 100-150 investors
- Daiwa will provide daily updates to the issuer's regarding the status of bookbuilding as well as briefing management ahead of investor meetings

- While management team is on the road marketing the issue, investors will register their interest and price sensitivity to Daiwa via our global sales force
- Daiwa ECM team will compile a book of demand and present it to the issuer at the end of the roadshow period

# Working Parties for Listing



# Role of Each Party

|  |  |
|--|--|
| <p><b>Sponsor</b></p>  | <ul style="list-style-type: none"> <li>• Administrative responsibilities</li> <li>• Assistance in drafting the prospectus with legal advisers</li> <li>• Negotiation of the prospectus with the regulator or exchange</li> </ul>   |
| <p><b>Bookrunner<br/>Global Coordinator<br/>Lead Manager</b></p> | <ul style="list-style-type: none"> <li>• Global roadshow arrangements</li> <li>• Coordinating between various parties involved in the transaction</li> <li>• Maintaining the list of orders placed by institutional investors in the listing process and deciding on the allocations of stock</li> <li>• Marketing, selling and branding for the issuer</li> </ul>                                       |
| <p><b>Issuer's Legal Adviser</b></p>                             | <ul style="list-style-type: none"> <li>• Lead role in drafting the prospectus</li> <li>• Conducts due diligence into the affairs of the issuer</li> <li>• Advises on listing rules</li> <li>• Negotiation of various agreements entered into by the issuer with banks and other parties</li> <li>• Issues legal opinions and disclosure letter if necessary</li> </ul>                                   |
| <p><b>Underwriter's<br/>Legal Adviser</b></p>                    | <ul style="list-style-type: none"> <li>• Drafts the underwriting and other agreements, as well as guidelines for pre-deal research</li> <li>• Communicating with listing authority or regulator</li> </ul>   |
| <p><b>Auditor</b></p>  | <ul style="list-style-type: none"> <li>• Draw up audited accounts according to the generally agreed accounting principles required by the regulator for the relevant period</li> <li>• Provide the issuer and underwriters with comfort letters in which they will source, cross-check or re-compute all financial information included in the prospectus with the company's existing records</li> </ul> |
| <p><b>Receiving Bank</b></p>                                     | <ul style="list-style-type: none"> <li>• Often one or more large commercial banks</li> <li>• Appointed to manage the application process by the public for the retail offering</li> </ul>  |

# Role of Each Party

|                                    |   |
|------------------------------------|---|
| <b>Internal Control Consultant</b> | <ul style="list-style-type: none"><li>• Provide guidelines to internal control, including corporate governance, segregation of duties, retention of records, review and analysis of results versus organization goals/plans, IT controls, etc.</li></ul>  |
| <b>Property Valuer</b>             | <ul style="list-style-type: none"><li>• Carry out independent valuation of property assets, with the reports included in the prospectus</li></ul>   |
| <b>Share Registrar</b>             | <ul style="list-style-type: none"><li>• Maintain a record of the public shareholders in the company to establish authenticity of ownership, ensure the accurate payment of dividends</li><li>• Process and ballot applications from retail investors and to dispatch share certificates to applicants allocated shares in the listing process</li></ul>                 |
| <b>IR Agency</b>                   | <ul style="list-style-type: none"><li>• Develop issuer's image and promote its investment case to the wider world, which may include creation/update of website</li><li>• Handling the logistics during the roadshow, including air travel, booking hotels and conference rooms, arranging luncheon presentations, inter-city limousine transportations, etc.</li></ul> |
| <b>Financial Printer</b>           | <ul style="list-style-type: none"><li>• A third party to handle the typesetting and input multiple detailed overnight amendments</li><li>• Distribute printouts to what will become an increasingly large number of recipients</li></ul>  |
| <b>Depository Banks</b>            | <ul style="list-style-type: none"><li>• Issues and redeems certificates (depository receipts – DRs)</li><li>• Ensures payments through a custodian of dividends to the owners of the certificates</li></ul>   |

# Key Considerations for Listing Candidates' Dual Listing

- Based on Daiwa's extensive dual listing deal execution experience, we summarized key considerations for listing candidates as below, subject to the specific situations that different companies are facing:

## Key Considerations for Dual Listing

- Due to different requirements of the exchange to be listed, it calls for companies' extra commitment to execute with more documentation requirements

### 1 Waiver Application

- Waivers could be applied when there is difference in regulation between Mongolia and respective exchanges

### 2 Accounting Standard

- The accounting standard of listing applicant generally ought to be shifted to GAAP accepted by respective markets

### 3 Continuous Disclosure

- Annual report, interim report and other documents (quarterly reports, if applicable) required by various stock exchanges need to be disclosed in English and/or other languages

### 4 Due Diligence

- Due diligence is required to be conducted within a short time frame, to subsidiaries and related parties as well

### 5 Hong Kong Deposit Receipt

- Due to certain restrictions, there are cases where a listing candidate can only get listed in Asian exchanged through issuing DRs

## **Section 2**

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### **Dual Listing Case Studies**

# Tosei Corp. – US\$26.8mm SGX Secondary Listing

July 2013  
Real Estate

**T O S E I**

Tosei Corporation

SGX Secondary Listing  
& Follow-on

USD 26.8 mm

Sole Bookrunner  
Sole Placing Agent

First listing of Japanese real estate company on the SGX

Highly successful marketing strategy – book was fully covered on the 1st day of bookbuilding

Top-end priced (4.05% discount to TSE share price)

Precision investor targeting – Most investors met during roadshow placed order

## Transaction Summary

|                          |   |
|--------------------------|---|
| <b>Issuer</b>            | <ul style="list-style-type: none"> <li>Tosei Corporation</li> </ul>   |
| <b>Description</b>       | <ul style="list-style-type: none"> <li>Diversified real estate business in Japan, engaged in property revitalization, development, rental, management and alternative investment</li> </ul>   |
| <b>Ticker</b>            | <ul style="list-style-type: none"> <li>SGX: S2D.SP / TSE: 8923.JP</li> </ul>  |
| <b>Transaction</b>       | <ul style="list-style-type: none"> <li>Listing by way of introduction on the SGX (Mar 2013)</li> <li>Follow-on offering on the SGX (Jul 2013)</li> </ul>  |
| <b>Offering dates</b>    | <ul style="list-style-type: none"> <li>Trade: July 22, 2013; Listing: July 26, 2013</li> </ul>  |
| <b>Share type</b>        | <ul style="list-style-type: none"> <li>72.2% primary shares</li> <li>27.8% secondary shares from CEO</li> </ul>   |
| <b>Tranche split</b>     | <ul style="list-style-type: none"> <li>100.0% international placing</li> </ul>  |
| <b>Distribution</b>      | <ul style="list-style-type: none"> <li>Reg. S</li> </ul>  |
| <b>Offer price range</b> | <ul style="list-style-type: none"> <li>4.0% - 8.0% discount to the TSE stock price</li> </ul>   |
| <b>Offer price:</b>      | <ul style="list-style-type: none"> <li>SGD9.4 per share (4.05% discount to the TSE)</li> </ul>  |
| <b>Offer size:</b>       | <ul style="list-style-type: none"> <li>US\$26.8mm (7.5% of enlarged share capital)</li> </ul>   |
| <b>Valuation:</b>        | <ul style="list-style-type: none"> <li>18.6x 2013E P/E and 1.35x 1Q13 P/B</li> </ul>  |
| <b>Use of proceeds</b>   | <ul style="list-style-type: none"> <li>Partially fund the acquisition and revitalization of office buildings and residential properties</li> <li>Partially fund the acquisition and development of land for office, residential and commercial properties</li> <li>Co-equity investment in real-estate funds</li> </ul> |
| <b>Daiwa's role</b>      | <ul style="list-style-type: none"> <li><b>Sole Bookrunner and Sole Placing Agent</b></li> </ul>   |

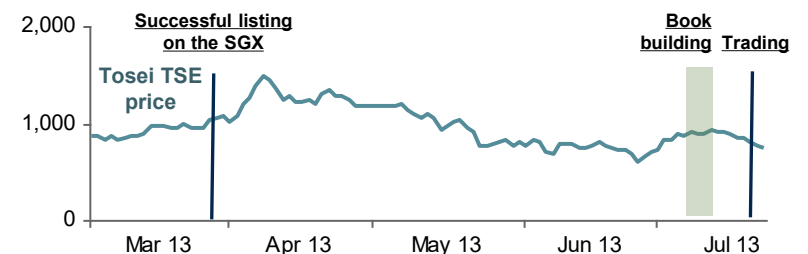
## Company Overview

- Headquartered in Tokyo, Tosei mainly engaged in the renovations, refurbishments and selling of small and mid-sized properties developed by other developers in Tokyo
- Also engaged in property rental, management and alternative investment
- Primarily listed on the first section of the Tokyo Stock Exchange
- Listed on the Singapore Stock Exchange in order to prepare itself for the intended expansion to the South East Asia market

## Daiwa's Contribution

- Acted as Manager to Tosei's successful introduction on the SGX
- Book fully covered on the 1st day of bookbuilding and multiple-times covered at book closed with good mix of long-only investors and hedge funds across Asia, Europe and the U.S.
- Top-end priced (4.05% discount)


## Transaction Timeline





# YTL Corporation Berhad – US\$43.6mn TSE Secondary Listing

February 1996  
Conglomerate



YTL Corporation Bhd  
TSE Secondary Listing  
& Follow-on  
USD 43.6mn  
Sole Bookrunner

First listing of Asian non-Japanese company listed in TSE

Has properties in 3 continents across Australia, Japan, Malaysia, China, Indonesia, Thailand, France, UK and Spain

Largest non-government linked company in Malaysia

Listed subsidiaries has a combined market capitalization of about US\$10.15 billion

## Transaction Summary

|                 |   |
|-----------------|---|
| Issuer          | ▪ YTL Corporation Berhad  |
| Description     | ▪ Conglomerate in Malaysia, engaged in utilities, property development, power generation and hotel management and development |
| Ticker          | ▪ KLSE: YTL.MK / TSE: 1773.JP   |
| Transaction     | ▪ Secondary Listing in TSE (Feb 1996)   |
| Offering dates  | ▪ Trade: Feb 15, 1996; Listing: Feb 29, 1996  |
| Share type      | ▪ 100% Ordinary Shares  |
| Deal Execution  | ▪ Fully Marketed  |
| Distribution    | ▪ Reg. S  |
| Offer price:    | ▪ M\$11.1 (US\$4.358)   |
| Offer size:     | ▪ US\$43.58mn   |
| Use of proceeds | ▪ General corporate purpose   |
| Daiwa's role    | ▪ <b>Sole Bookrunner</b>  |

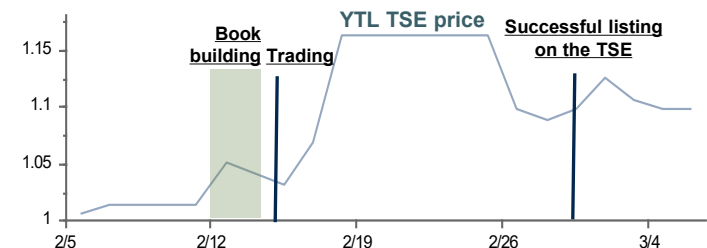
## Company Overview

- Headquartered in Kuala Lumpur, Malaysia, YTL Corporation is the largest non-government linked company in Malaysia
- Principal business is power generation, with other business areas include construction contracting, property development, manufacturing industrial products and supplies and hotel management and development
- Extensive business coverage in Europe, Asia and Australia

## Daiwa's Contribution

- Daiwa blazed the trail by bringing the first non-Japanese company into Japanese stock market
- Deal was successful with shares fully marketed
- YTL is welcomed by Japanese investors, and thus conducted a follow-on issuance in June 1996, with another US\$102.9mn of shares issued

## Transaction Timeline



# POSCO – US\$690.6mn TSE Secondary Listing

October 2005  
Metal & Steel



POSCO  
TSE Secondary Listing

USD 690.6mn

Based in Pohang, South Korea with extensive overseas presence in Asia, America, Europe & Africa

146<sup>th</sup> world's largest corporation by the Fortune global 500 in 2012

3<sup>rd</sup> largest steel maker globally in 2010

Listed in Korea Stock Exchange in 2003, secondary listed in Tokyo Stock Exchange in 2005

## Transaction Summary

|                        |  |
|------------------------|--|
| <b>Issuer</b>          | ▪ POSCO  |
| <b>Description</b>     | ▪ Steel maker based in South Korea with presence in Asia, America, Europe & Africa |
| <b>Ticker</b>          | ▪ KRX 005490.KS / TSE: 5412.JP   |
| <b>Transaction</b>     | ▪ Secondary Listing in TSE (Oct 2005)  |
| <b>Instrument Type</b> | ▪ American Depository Receipt  |
| <b>Deal Execution</b>  | ▪ Fully Marketed   |
| <b>Offer price:</b>    | ▪ US\$ 49.33   |
| <b>Offer size:</b>     | ▪ US\$43.58mn  |
| <b>Use of proceeds</b> | ▪ General corporate purposes   |

## Aftermarket Performance

| Aftermarket | Open  | 1 Day | 1 Week | 2 Weeks | 1 Month | 3 Months | 6 Months | 1 Year |
|-------------|-------|-------|--------|---------|---------|----------|----------|--------|
| Price       | 50.5  | 50.86 | 52.72  | 57.28   | 55.63   | 70.78    | 59.13    | 80.74  |
| % Changes   | 2.37% | 3.10% | 6.87%  | 16.12%  | 12.77%  | 43.48%   | 19.87%   | 63.67% |

## Company Overview


- Recorded the largest profits in global steel industry in 2004.
- Operates a joint venture with U.S. Steel, the 15<sup>th</sup> largest steel maker in 2013, named USS-POSCO in Pittsburg, California.
- Subsidiaries and affiliates reach China, Japan, Vietnam, Myanmar, Malaysia, India, Australia, US, Canada, and Mexico.
- Aims to achieve "Global Top 100, 200 Trillion Sales" by 2020.
- Manufactures six major types of steel products: cold-rolled steel/galvanized steel, hot-rolled steel, steel plates, wire rods, stainless steel and electrical steel plates.

## Timeline

|                                   |               |
|-----------------------------------|---------------|
| <b>Announcement / Filing Date</b> | ▪ 24 Oct 2005 |
| <b>Pricing Date</b>               | ▪ 15 Nov 2005 |
| <b>Trade Date</b>                 | ▪ 15 Nov 2005 |
| <b>First Trade Date</b>           | ▪ 19 Jan 2006 |
| <b>Settlement Date</b>            | ▪ 22 Nov 2005 |

# Fast Retailing –HKSE Secondary Listing by Introduction

February 2014  
Clothing Retail



**FAST RETAILING**  
Fast Retailing  
HKSE  
Secondary Listing

Leading clothing retailer in Asia with an extensive global retail network

Strong portfolio of established brands with “Uniqlo” as one of the most well-known

Known for its high quality clothing, innovation, and exceptional customer value

4<sup>th</sup> Company listed in HKSE through HDR

## Transaction Summary

|                        |   |
|------------------------|---|
| <b>Issuer</b>          | ▪ Fast Retailing Co. Ltd  |
| <b>Description</b>     | ▪ Leading clothing retailer in Asia with an extensive global retail network |
| <b>Ticker</b>          | ▪ TSE: 9983.JP / HKSE: 6288.HK  |
| <b>Transaction</b>     | ▪ Secondary Listing in HKSE (Feb 2014)                                      |
| <b>Instrument Type</b> | ▪ Hong Kong Depository Receipt  |
| <b>Offer price:</b>    | ▪ HKD 27.37 (USD 3.53)  |

## Timeline

|                          |               |
|--------------------------|---------------|
| <b>Announcement Date</b> | ▪ 28 Feb 2014 |
| <b>Amendment Date</b>    | ▪ 03 Mar 2014 |
| <b>Effective Date</b>    | ▪ 05 Mar 2014 |

## Aftermarket Performance

| Aftermarket    | Open  | 1 Day | 1 Week | 2 Weeks | 1 Month | 3 Months | 6 Months | 1 Year |
|----------------|-------|-------|--------|---------|---------|----------|----------|--------|
| Price (in HKD) | 28.90 | 29.40 | 27.75  | 27.70   | 28.55   | 25.75    | 25.60    | 29.65  |
| % Changes      | 5.59% | 7.42% | 1.39%  | 1.21%   | 4.31%   | -5.92%   | -6.47%   | 8.33%  |

## Company Overview

- A Japanese retail holding company whose shares are listed on the TSE and a retailer of quality clothing
- Total market cap reached HK\$282bn by the time it is listed in HKSE
- The listing was by introduction through HDR. 1 TSE Share equals to 100 HDRs
- Largest clothing retailer in Asia Pacific in 2012 according to Euromonitor, with a 2.2% share of the Asia Pacific clothing market
- Uniqlo, its mainstay brand, has 251 stores in China, 19 in Hong Kong and 17 in US as of Nov 30, 2013

## Transaction Highlight

- 4<sup>th</sup> Company listed in HKSE through HDR
- No capital raised. The listing is mainly for marketing purpose, and liquidity is therefore comparatively lower
- Price surged in its Hong Kong trading debut, with intraday high of 31% increase, but then fell back and closed the day 5.6% higher
- Direct comparable stocks include Coach Inc. (HDR), and Prada SpA (primary listing in Hong Kong)

# South Gobi – US\$442.3mn HKSE Secondary Listing

January 2010  
Mining



South Gobi Resources  
HKSE  
Secondary Listing  
USD 442.3mn

High quality coal asset located in Mongolia, targeting at Chinese market

Well received by investors and therefore exercised overallotment option

Attracted cornerstone investors including Baytree Investments and CIC

IPO in TSX on 15 December 2003, and secondary listed in HKSE on 29 Jan 2010

## Transaction Summary

|                 |   |
|-----------------|---|
| Issuer          | ▪ South Gobi Resources  |
| Description     | ▪ Mining company based in Vancouver, Canada, with coal mine in Mongolia |
| Ticker          | ▪ TSX: SGQ.CA/ HKSE: 1878.HK  |
| Transaction     | ▪ Secondary Listing in HKSE (Jan 2010)                                  |
| Distribution    | ▪ Reg. S / 144A   |
| Instrument Type | ▪ Ordinary Shares   |
| Offer price:    | ▪ HKD126.04 (US\$16.23)   |

## Company Overview

- An integrated coal mining, development and exploration company, focused on exploration and development of its Permian-age metallurgical and thermal coal deposits in Mongolia's South Gobi Region
- The coal assets are strategically located on China-Mongolia boundary, targeting at the Chinese market

## Timeline

|                              |               |
|------------------------------|---------------|
| Announcement Date            | ▪ 11 Jan 2010 |
| Roadshow Start Date          | ▪ 11 Jan 2010 |
| Subscription End Date        | ▪ 20 Jan 2010 |
| Pricing Date                 | ▪ 21 Jan 2010 |
| First Trading Date           | ▪ 29 Jan 2010 |
| Overallotment Exercised Date | ▪ 19 Feb 2010 |

## Aftermarket Performance

| Aftermarket    | Open   | 1 Day   | 1 Week | 2 Weeks | 1 Month | 3 Months | 6 Months | 1 Year  |
|----------------|--------|---------|--------|---------|---------|----------|----------|---------|
| Price (in HKD) | 123.5  | 112.00  | 116.60 | 122.50  | 119.90  | 100.00   | 100.50   | 113.20  |
| % Changes      | -2.02% | -11.14% | -7.49% | -2.81%  | -4.87%  | -20.66%  | -20.26%  | -10.19% |

## **Section 3**

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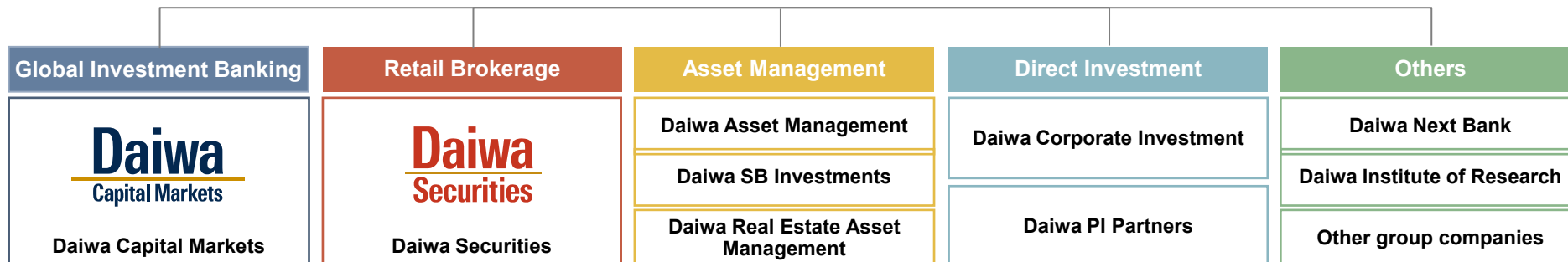
### **Introduction to Daiwa Capital Markets**

# Overview of Daiwa Securities Group

Japan's Leading Financial Services Group with Global Operations

**Daiwa Securities Group Inc.**

Market cap: approx. USD 14 billion  
Employees: over 13,000



Best Samurai House 2014



Most Creative Global Investment Bank 2013



Asia Equity Follow-on 2013



Asia Equity & Equity-linked 2013

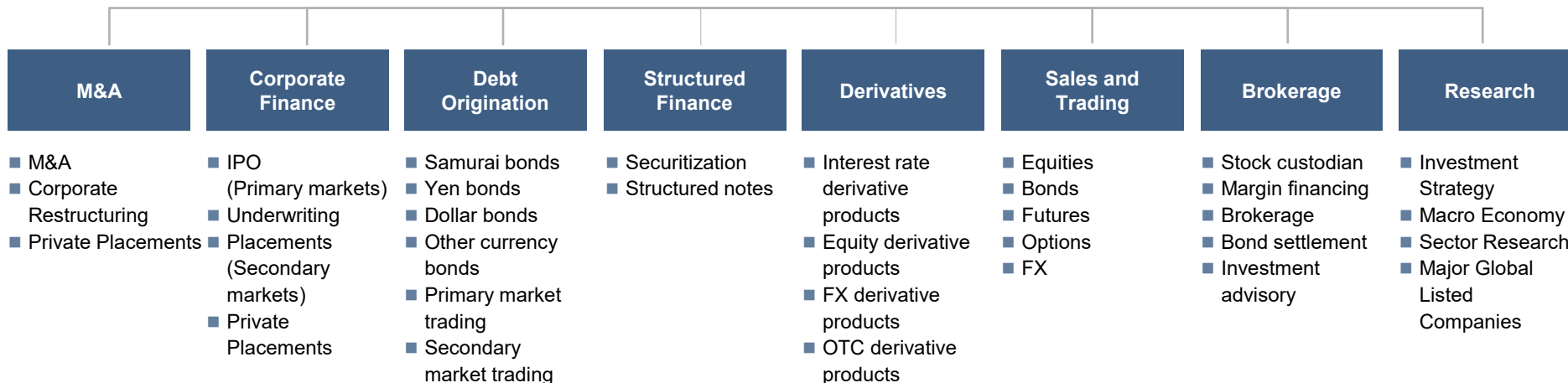


Asia IPO Underwriting 2012

# Overview of Daiwa Capital Markets

A Comprehensive and Award-winning Investment Banking Platform

## Daiwa Capital Markets




**Deal Watch**

- Samurai Bond House of the Year
- Best Yen bond


Mar 2015



**IFR**

- Yen Bond House of the Year

Jan 2015



**Thomson Reuters**

- Most Recognized Investment Bank in Japan

Sep 2014

**Finance Asia**

- Best Samurai House

Apr 2014



**EMEA Finance**

- Yen Bond House of the Year
- Best Yen Bond


Mar 2014



**Euromoney**

- Best Equity House in Japan

Jul 2013



**EMEA Finance**

- Yen Bond House of the Year
- Samurai Bond House of the Year

Mar 2013

**ASIAMONEY**

- Best Yen Bond
- Best IPO
- Best M&A in Japan

Feb 2013

# Overview of Daiwa Capital Markets

Unparalleled Presences Across Asia Pacific

Daiwa Capital Markets  
Hong Kong Limited

Daiwa Capital Markets  
Singapore Limited

Daiwa Securities Capital  
Markets Korea Co., Ltd.

Daiwa Capital Markets  
India Private Ltd.

Daiwa Capital Markets  
Australia Limited



Daiwa Securities Co. Ltd.  
Beijing Representative  
Office

Daiwa (Shanghai)  
Corporate Strategic  
Advisory Co. Ltd.

Daiwa Securities Co.  
Ltd. Bangkok  
Representative Office

Daiwa Securities Co. Ltd.  
Hanoi Representative  
Office

Daiwa-Cathay Capital  
Markets Co.Ltd.

DBP-Daiwa Capital  
Markets Philippines, Inc.



# Daiwa is a Leading Asia Pacific Equity House

## Highly Ranked in Asian Equity League Tables




### 2014 Equity and Equity-linked – Asia <sup>(1)</sup>

| Rank     | Bookrunner                      | Deal Value (USD mm) | No. of Deals | % Market Share |
|----------|---------------------------------|---------------------|--------------|----------------|
| 1        | Morgan Stanley                  | 15,781              | 114          | 9.4%           |
| 2        | Nomura                          | 13,863              | 126          | 8.3%           |
| 3        | Goldman Sachs                   | 11,177              | 82           | 6.7%           |
| 4        | Bank of America Merrill Lynch   | 8,004               | 56           | 4.8%           |
| 5        | UBS                             | 7,391               | 96           | 4.4%           |
| 6        | JPMorgan                        | 6,810               | 64           | 4.1%           |
| 7        | Sumitomo Mitsui Financial Group | 6,247               | 70           | 3.7%           |
| <b>8</b> | <b>Daiwa</b><br>Capital Markets | <b>5,713</b>        | <b>78</b>    | <b>3.4%</b>    |
| 9        | HSBC                            | 5,707               | 47           | 3.4%           |
| 10       | Deutsche Bank                   | 5,256               | 57           | 3.1%           |

### 2014 Equity and Equity-Linked – Major Asian Markets <sup>(2)</sup>

| Rank     | Bookrunner                      | Deal Value (USD mm) | No. of Deals | % Market Share |
|----------|---------------------------------|---------------------|--------------|----------------|
| 1        | Morgan Stanley                  | 14,921              | 100          | 12.8%          |
| 2        | Nomura                          | 13,770              | 122          | 11.8%          |
| 3        | Goldman Sachs                   | 8,647               | 64           | 7.4%           |
| 4        | Bank of America Merrill Lynch   | 6,368               | 42           | 5.5%           |
| 5        | Sumitomo Mitsui Financial Group | 6,247               | 70           | 5.4%           |
| <b>6</b> | <b>Daiwa</b><br>Capital Markets | <b>5,653</b>        | <b>77</b>    | <b>4.9%</b>    |
| 7        | HSBC                            | 5,295               | 40           | 4.6%           |
| 8        | Mizuho                          | 4,557               | 52           | 3.9%           |
| 9        | UBS                             | 4,489               | 70           | 3.9%           |
| 10       | Bank of China                   | 3,496               | 44           | 3.0%           |






















### Key Transactions

|  |  |   |  |
|--|--|---|--|
| <br><b>CT Environmental</b><br><br>Private Placement to GIC<br>USD 80 mm<br><br>Financial Advisor<br><br>Jan 2015 | <br><b>WH Group</b><br><br>HKEx IPO<br>USD 2.4 bn<br><br>Joint POWL Arranger<br><br>Aug 2014  | <br><b>Accordia Golf Trust</b><br><br>SGX IPO<br>USD 612 mm<br><br>Joint GC<br>Joint Bookrunner<br><br>Aug 2014              | <br><b>Neo Solar Power</b><br><br>Convertible Bonds<br>USD 120 mm<br><br>Joint GC<br>Joint Bookrunner<br><br>Jul 2014 |
| <br><b>China CNR</b><br><br>HKEx IPO<br>USD 1.3 bn<br><br>Joint Bookrunner<br>Joint Lead Manager<br><br>May 2014  | <br><b>REXLOT Holdings</b><br><br>Convertible Bonds<br>USD 244 mm<br><br>Joint GC<br>Joint Bookrunner<br><br>Apr 2014                     | <br><b>China Everbright Bank</b><br><br>HKEx IPO<br>USD 3.2 bn<br><br>Joint Bookrunner<br>Sole POWL Arranger<br><br>Dec 2013 | <br><b>econtext Asia</b><br><br>HKEx IPO<br>USD 66 mm<br><br>Sole GC<br>Sole Sponsor<br><br>Dec 2013                  |
| <br><b>Modern Land</b><br><br>HKEx IPO<br>USD 77 mm<br><br>Joint GC<br>Sole Sponsor<br><br>Jul 2013             | <br><b>Tosei Corporation</b><br><br>SGX Listing & Follow-on<br>USD 27 mm<br><br>Sole Bookrunner<br>Sole Listing Manager<br><br>Jul 2013 | <br><b>CPM Resources</b><br><br>Convertible Bonds<br>USD 130 mm<br><br>Sole GC<br>Sole Bookrunner<br><br>Jan 2013          | <br><b>PICC Group</b><br><br>HKEx IPO<br>USD 3.6 bn<br><br>Joint Bookrunner<br>Joint Lead Manager<br><br>Dec 2012   |

# Daiwa is a Leading Asia Pacific Equity House

## Selected ECM Track Record in Asia Ex-Japan






















### Selected ECM Track Record in Asia Ex-Japan

|   |   |   |  |  |  |  |
|---|---|---|--|--|--|--|
|  <p><b>GF Securities</b></p> <p>HKEx IPO<br/>USD 3.6 bn</p> <p>Joint Lead Manager</p> <p>Apr 2015</p>  |  <p><b>CT Environmental</b></p> <p>Private Placement<br/>to GIC<br/>USD 80 mm</p> <p>Financial Advisor</p> <p>Jan 2015</p>                             |  <p><b>Hua Hong<br/>Semiconductor</b></p> <p>HKEx IPO<br/>USD 331 mm</p> <p>Joint Lead Manager</p> <p>Oct 2014</p> |  <p><b>WH Group</b></p> <p>HKEx IPO<br/>USD 2.4 bn</p> <p>Joint POWL Arranger</p> <p>Aug 2014</p>              |  <p><b>Accordia Golf Trust</b></p> <p>SGX IPO<br/>USD 612 mm</p> <p>Joint GC<br/>Joint Bookrunner</p> <p>Aug 2014</p>                                 |  <p><b>Neo Solar Power</b></p> <p>Convertible Bonds<br/>USD 120 mm</p> <p>Joint GC<br/>Joint Bookrunner</p> <p>Jul 2014</p> |  <p><b>China CNR</b></p> <p>HKEx IPO<br/>USD 1.3 bn</p> <p>Joint Bookrunner<br/>Joint Lead Manager</p> <p>May 2014</p>          |
|  <p><b>REXLOT</b><br/>御泰中彩</p> <p>REXLot Holdings</p> <p>Convertible Bonds<br/>USD 244 mm</p> <p>Joint GC<br/>Joint Bookrunner</p> <p>Apr 2014</p> |  <p><b>China Everbright Bank</b></p> <p>HKEx IPO<br/>USD 3.2 bn</p> <p>Joint Bookrunner<br/>Sole POWL Arranger</p> <p>Dec 2013</p>                     |  <p><b>econtext Asia</b></p> <p>HKEx IPO<br/>USD 66 mm</p> <p>Sole GC<br/>Sole Sponsor</p> <p>Dec 2013</p>         |  <p><b>Modern Land</b></p> <p>HKEx IPO<br/>USD 77 mm</p> <p>Joint GC<br/>Sole Sponsor</p> <p>Jul 2013</p>     |  <p><b>Tosei Corporation</b></p> <p>SGX Listing<br/>&amp; Follow-on<br/>USD 27 mm</p> <p>Sole Bookrunner<br/>Sole Listing Manager</p> <p>Jul 2013</p> |  <p><b>Hyundai HYSCO</b></p> <p>Block Trade<br/>USD 13.3 mm</p> <p>Sole Agent</p> <p>Mar 2013</p>                           |  <p><b>CPM Resources</b></p> <p>Convertible Bonds<br/>USD 130 mm</p> <p>Sole GC<br/>Sole Bookrunner</p> <p>Jan 2013</p>         |
|  <p><b>PICC Group</b></p> <p>HKEx IPO<br/>USD 3.6 bn</p> <p>Joint Bookrunner<br/>Joint Lead Manager</p> <p>Dec 2012</p>                          |  <p><b>REXLOT</b><br/>御泰中彩</p> <p>REXLot Holdings</p> <p>Follow-on CB<br/>USD 50 mm</p> <p>Sole Bookrunner<br/>Sole Lead Manager</p> <p>Sep 2012</p> |  <p><b>Huadian Fuxin Energy</b></p> <p>HKEx IPO<br/>USD 319 mm</p> <p>Joint Lead Manager</p> <p>Jun 2012</p>     |  <p><b>Jiangnan Group</b></p> <p>HKEx IPO<br/>USD 70 mm</p> <p>Sole GC<br/>Sole Sponsor</p> <p>Apr 2012</p> |  <p><b>Sato Holdings</b></p> <p>Convertible Bond<br/>USD 226 mm</p> <p>Sole Bookrunner</p> <p>Mar 2012</p>  |  <p><b>InfraWare</b></p> <p>Block Trade<br/>USD 13 mm</p> <p>Sole Bookrunner</p> <p>Feb 2012</p>                          |  <p><b>Beijing Jingneng</b></p> <p>HKEx IPO<br/>USD 272 mm</p> <p>Joint Bookrunner<br/>Joint Lead Manager</p> <p>Dec 2011</p> |

# Daiwa is a Leading Asia Pacific Equity House

## Selected ECM Track Record in Asia Ex-Japan (Cont.)

### Selected ECM Track Record in Asia Ex-Japan

|  |   |   |   |  |  |  |
|--|---|---|---|--|--|--|
|  <p><b>China Outfitters</b></p> <p>HKEx IPO<br/>USD 150 mm</p> <p>Joint Bookrunner<br/>Joint Lead Manager</p> <p>Dec 2011</p> |  <p><b>KDDI Corporation</b></p> <p>Convertible Bond<br/>USD 2.6 bn</p> <p>Sole GC<br/>Joint Bookrunner</p> <p>Nov 2011</p> |  <p><b>REXLOT</b><br/>御泰中彩<br/>REXLot</p> <p>Convertible Bond<br/>USD 124 mm</p> <p>Sole Bookrunner<br/>Sole Lead Manager</p> <p>Sep 2011</p>      |  <p><b>ELPIDA</b></p> <p>Elpida Memory</p> <p>Equity and CB<br/>Dual Offering<br/>USD 938 mm</p> <p>Joint GC<br/>Joint Bookrunner</p> <p>Jul 2011</p> |  <p><b>SF-PV</b></p> <p>Shunfeng PV</p> <p>HKEx IPO<br/>USD 60 mm</p> <p>Joint Bookrunner<br/>Joint Lead Manager</p> <p>Jul 2011</p>  |  <p><b>SK Gas</b></p> <p>Block Trade<br/>USD 31 mm</p> <p>Selling Agent</p> <p>May 2011</p>   |  <p><b>SBI Holdings</b></p> <p>HKEx IPO<br/>USD 210 mm</p> <p>Sole GC<br/>Sole Sponsor</p> <p>Apr 2011</p>  |
|  <p><b>San Miguel</b></p> <p>Follow-on<br/>USD 350 mm</p> <p>International<br/>Co-bookrunner</p> <p>Apr 2011</p>              |  <p><b>CJ E&amp;M Corp.</b></p> <p>Block Trade<br/>USD 45 mm</p> <p>Selling Agent</p> <p>Mar 2011</p>                      |  <p><b>HPH TRUST</b></p> <p>Hutchison Ports Trust</p> <p>SGX IPO<br/>USD 5.5 bn</p> <p>Joint POWL Arranger<br/>Co-lead Manager</p> <p>Mar 2011</p> |  <p><b>ELPIDA</b></p> <p>Elpida Memory</p> <p>TDR Follow-on<br/>USD 145 mm</p> <p>Underwriter</p> <p>Feb 2011</p>                                     |  <p><b>China 33 Media</b></p> <p>HKEx IPO<br/>USD 37.6 mm</p> <p>Sole Sponsor</p> <p>Feb 2011</p>   |  <p><b>China Metal Resources</b></p> <p>Follow-on<br/>USD 37 mm</p> <p>Sole Placing Agent</p> <p>Dec 2010</p>   |  <p><b>SABANA</b><br/>SHANGHAI EQUITY COMPLIANT REIT</p> <p>Sabana REIT</p> <p>SGX IPO<br/>USD 505 mm</p> <p>Joint GC<br/>Issue Manager</p> <p>Nov 2010</p> |
|  <p><b>AIA</b></p> <p>HKEx IPO<br/>USD 20.5 bn</p> <p>Joint POWL<br/>Arranger</p> <p>Oct 2010</p>                            |  <p><b>Sihuan<br/>Pharmaceutical</b></p> <p>HKEx IPO<br/>USD 853 mm</p> <p>Joint Lead Manager</p> <p>Oct 2010</p>         |  <p><b>Strides<br/>ARCOLAB LIMITED</b><br/>Strides Arcolab</p> <p>QIP Offering<br/>USD 100 mm</p> <p>Joint Bookrunner</p> <p>Sep 2010</p>         |  <p><b>Sanjiang Fine<br/>Chemicals</b></p> <p>HKEx IPO<br/>USD 116 mm</p> <p>Joint Bookrunner<br/>Joint Sponsor</p> <p>Sep 2010</p>                 |  <p><b>中国农业银行</b><br/>AGRICULTURAL BANK OF CHINA</p> <p>Agricultural Bank</p> <p>HKEx IPO<br/>USD 22.1 bn</p> <p>Joint POWL Arranger<br/>Co-lead Manager</p> <p>Jul 2010</p> |  <p><b>SS DEE</b><br/>ALUMINIUM LTD.</p> <p>Ess Dee Aluminium</p> <p>QIP Offering<br/>USD 20 mm</p> <p>Joint Bookrunner<br/>Joint Lead Manager</p> <p>Jul 2010</p> |  <p><b>INTERNATIONAL<br/>TAIFENG</b></p> <p>International Taifeng</p> <p>HKEx IPO<br/>USD 74 mm</p> <p>Sole GC<br/>Joint Bookrunner</p> <p>Jun 2010</p>    |

# **Project for Capacity Building of Capital Market in Mongolia: IPO & Dual Listing Seminar Privatizing SOCs - Lessons from Japanese Experiences**

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June 23, 2015

Daiwa Institute of Research  
Japan Economic Research Institute

## **Contents**

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|   |             |
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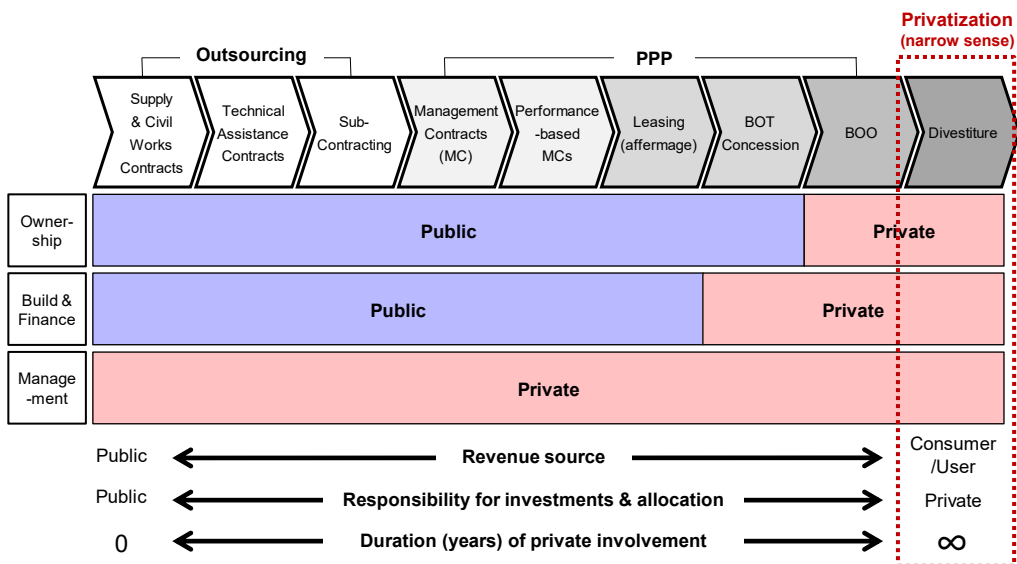
## Privatization: Definition (1)

- Process of **transferring ownership** of a business, enterprise, agency, public service, or public property from the public to the private sector
- Choice of method is influenced by the **depth of capital markets, political & company-specific factors**



3

## Privatization: Definition (2)



4

## Why Privatize?

- Burden of loss making SOEs on gov't budget.  
(SOCs' losses against GDP in '70s)
  - ✓ Average **4.0%** developing countries<sup>(\*)</sup>
  - ✓ Average **1.8%** advanced countries<sup>(\*)</sup>
  - ✓ Mongolia?



- Benefits (Most cases had shown better results)
  - ✓ **Productivity** increase
  - ✓ Faster **growth**
  - ✓ Greater **cost savings**
  - ✓ Enhance domestic **capital markets**



(\*) Source: R.P. Short, *The Role of Public Enterprises: A Statistical Comparison*

5

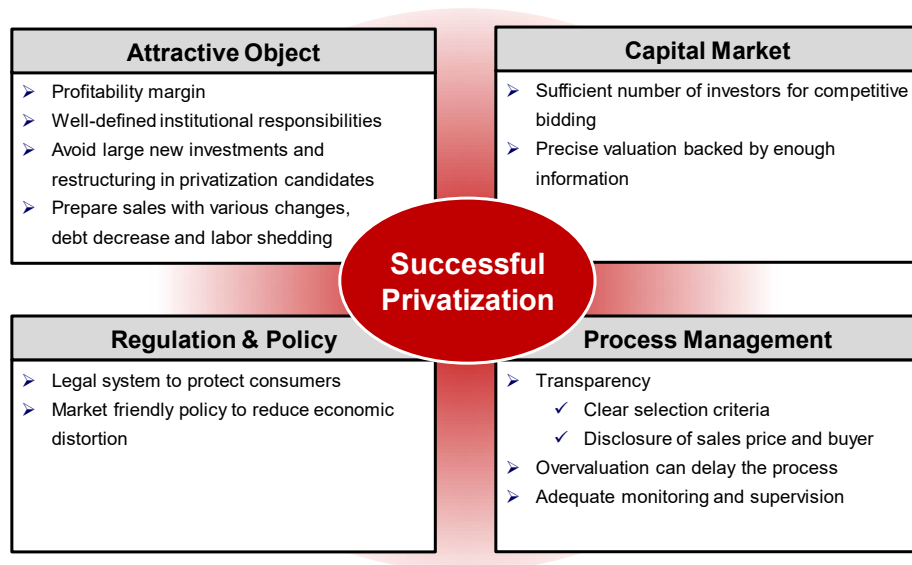
## Strategic Framework

| <i>Setting Policy Target</i>   | <i>Analyzing Strategic Key Factors</i>  | <i>Choosing Method</i>  |
|--|---|---|
| <ul style="list-style-type: none"> <li>● <b>Government's budget reconstruction</b> <ul style="list-style-type: none"> <li>✓ Realize capital gain</li> <li>✓ Securement of tax revenue</li> <li>✓ Reduction of government spending</li> </ul> </li> <li>● <b>Enhance service for consumer</b> <ul style="list-style-type: none"> <li>✓ Reduction of cost</li> <li>✓ Improvement of service quality</li> <li>✓ Depoliticization</li> </ul> </li> <li>● <b>Flourish domestic industry</b> <ul style="list-style-type: none"> <li>✓ Creation of business opportunity</li> <li>✓ Enhancement of competitiveness</li> <li>✓ Developing capital market</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>● <b>Ownership</b> <ul style="list-style-type: none"> <li>✓ Pursuing economical efficiency</li> <li>✓ Improvement of governance</li> <li>✓ Liberation of legal restriction</li> </ul> </li> <li>● <b>Management know-how</b> <ul style="list-style-type: none"> <li>✓ Improve efficiency</li> <li>✓ Benefit by creating demand</li> <li>✓ Enhance convenience</li> </ul> </li> <li>● <b>Finance</b> <ul style="list-style-type: none"> <li>✓ Contribute to government's budget</li> <li>✓ Non-budget system</li> <li>✓ Disciplined control</li> </ul> </li> <li>● <b>Market mechanism</b> <ul style="list-style-type: none"> <li>✓ Improving efficiency</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>● <b>Ownership transfer</b> <ul style="list-style-type: none"> <li>✓ IPO</li> <li>✓ Trade sale</li> <li>✓ MBO</li> </ul> </li> <li>● <b>PPP</b> <ul style="list-style-type: none"> <li>✓ PFI</li> <li>✓ Concession</li> <li>✓ BOT / BOO</li> <li>✓ Outsourcing</li> </ul> </li> <li>● <b>Market liberation</b> <ul style="list-style-type: none"> <li>✓ Bidding</li> <li>✓ Deregulation</li> </ul> </li> </ul> |

Source: Yumiko NODA, *Strategy and Methods of Privatization* 2004

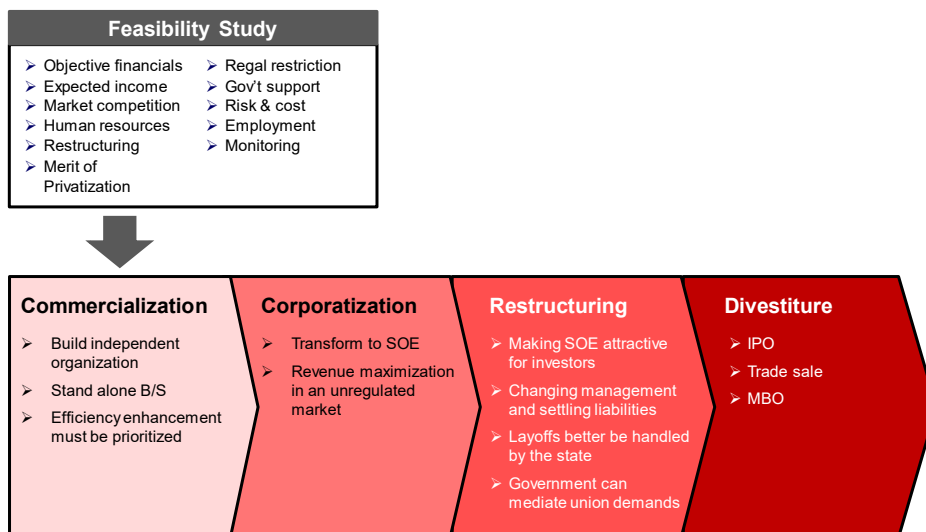
6

## Keys for Success



7

## Four Steps of Privatization



8





## Privatization in Japan: Summary

- Japanese gov't promoted privatization w/strong leadership in **80's**, to address;
  - **Fiscal deterioration**,
  - **Slowdown in economy**, and
  - Pressure from outside for **deregulation**.
- As a result of the privatization;
  - **Fiscal position has improved**,
  - **Market discipline** has been introduced,
  - **Corporate governance** has been improved, and
  - Domestic **capital markets** has grown.
- Privatized companies have become **global players** w/own growth strategies.



9

## Privatization Cases in Japan

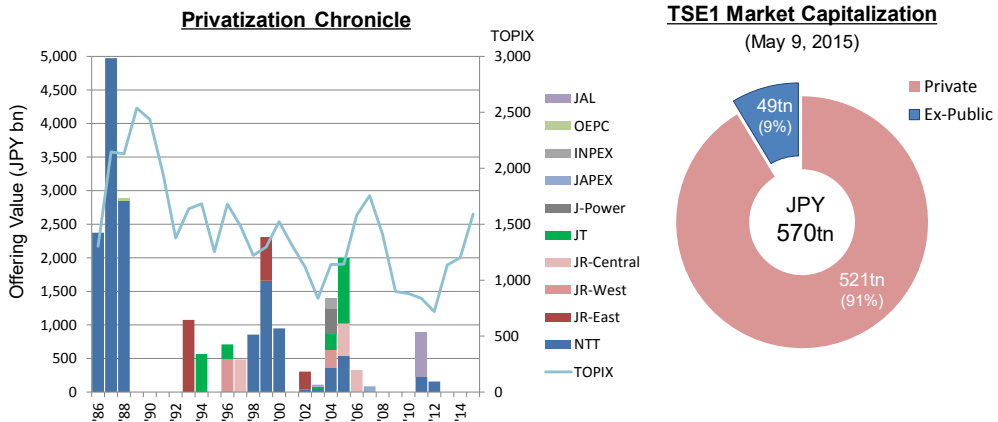
| * Simple sum of the numbers for the group companies                                       |   |  |   |   |
|---|---|--|---|---|
| (As of March 31, 2014)<br>Consolidated  |  |   |  |  |
| Establishment / Listed  | 1985/1985   | East:1987/1992<br>West&Central:1987/1993   | 1985/1994   | 1951/1951   |
| Paid-In Capital<br>(JPY bn)   | 938   | East: 200<br>Group total*: 460   | 100   | 1,400   |
| Total Revenue<br>(JPY bn)   | 10,925  | East: 2,704<br>Group total*: 6,432   | 2,400   | 6,631   |
| Ownership<br>(Voting rights base)<br><small>(red= public sector)</small>                  | MOF: 35.65%<br>Employee: 0.81%  | Privatized 3 companies<br>Private: 100.00%<br><br>Other 4 companies<br>JRTT: 100.00% | MOF: 33.35%   | NDF*: 50.10%<br>Employee: 1.46%<br>Tokyo Metropolis: 1.35%                            |
| <small>* Nuclear Damage Compensation and Decommissioning Facilitation Corporation</small> |   |  |   |   |

10



## Privatization & Capital Markets

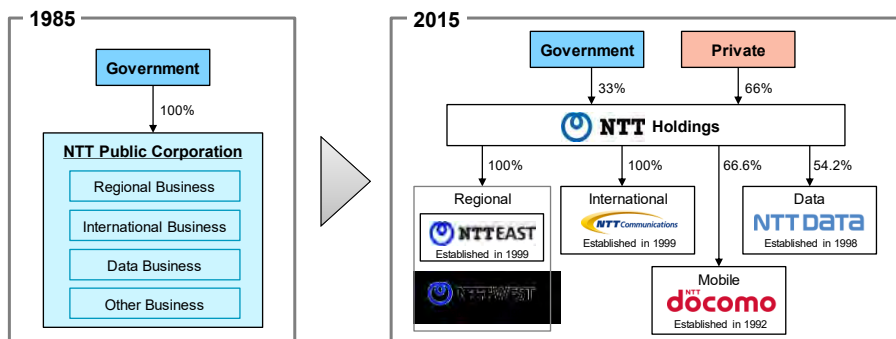
- Privatization in Japan has accelerated in **80's**.
- **NTT** has been the largest privatization, bringing a number of retail investors into the capital market
- Privatized companies currently occupy **9%** of the total market cap in TSE1.



11

## Case Study (Telecom): NTT (1)

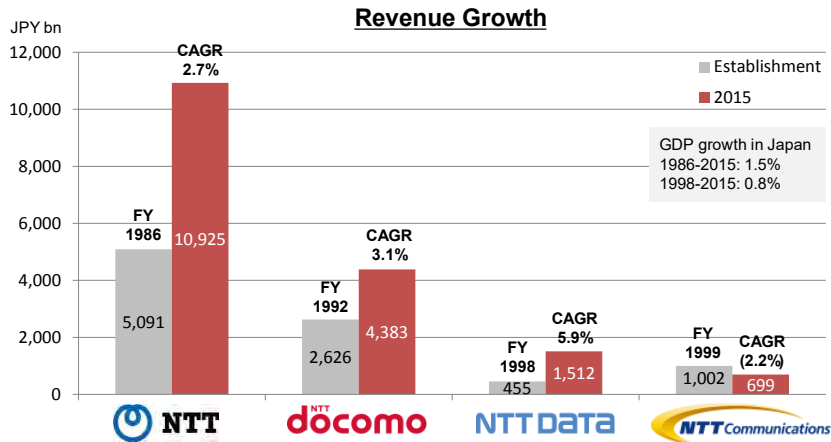
- Why privatized?
  - To **enhance efficiency** by ensuring management independence
  - To **introduce competition** through liberalizing telecom market
- Since the listing in **1987**, gov't gradually sold its holdings until **2005** for **JPY14tn**.
- Gov't still has to hold over **1/3** of total outstanding, and foreign ownership is restricted to **1/3**.



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## Case Study (Telecom): NTT (2)

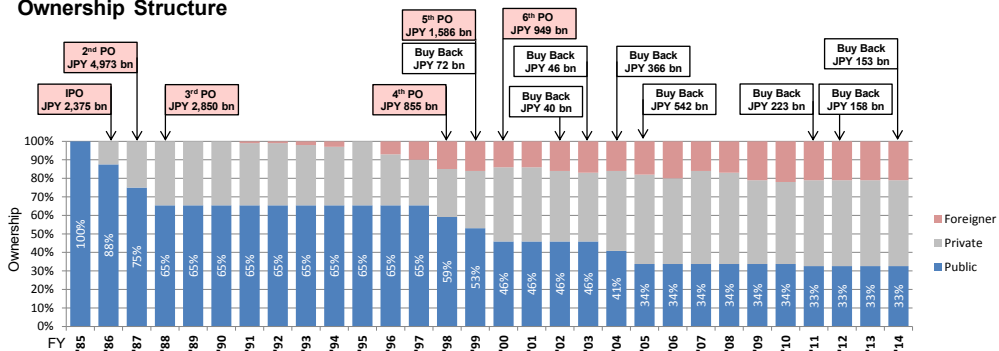
- NTT group has **faster growth than GDP** in Japan after privatization.
- Only NTT Communications (for long-distance & international communications) has gone through revenue decline since its establishment, due to worldwide shrink of the market.



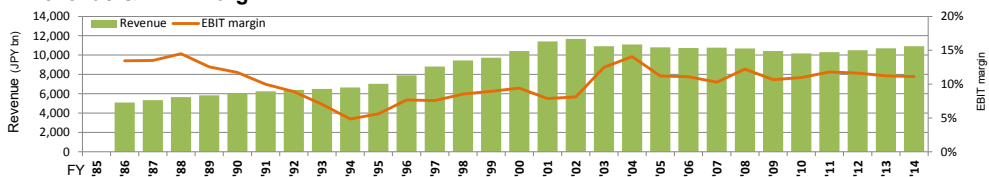
13

## Case Study (Telecom): NTT (3)

### Ownership Structure



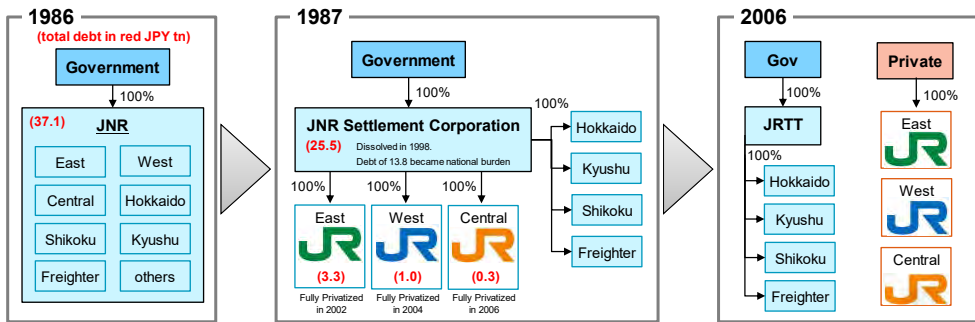
### Revenue & EBIT Margin



14

## Case Study (Railway): JR

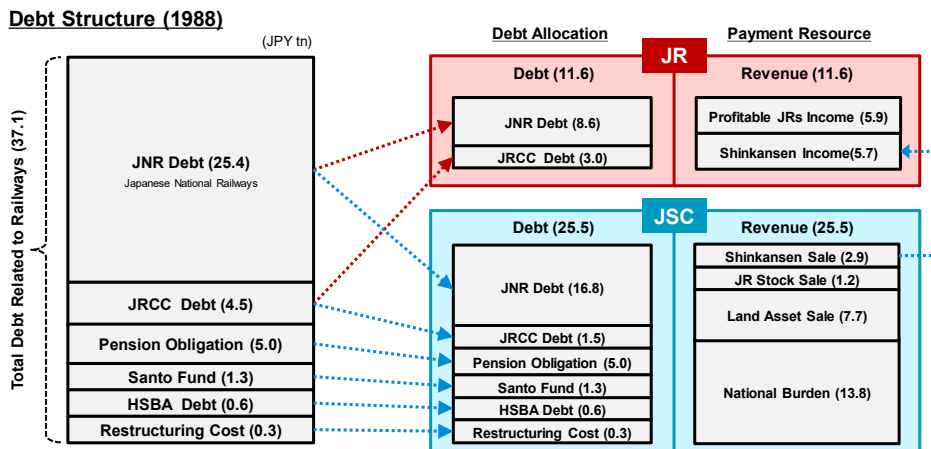
- Why privatized?
  - To reduce huge debt of **JPY 37.1tn** of **Japanese National Railways (JNR)**
  - To optimize management policy suitable for each region
- JNR was divided into **6 regional companies & a freight company**, of which 3 profitable companies were listed, whose shares were sold for **JPY 4.0tn**.
- Privatization effort has **overcome extremely strong union** and the business operation was successfully improved with a reduction of over **30%** of employees.



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## Case Study (Railway): JNR Settlement Corporation (JSC)

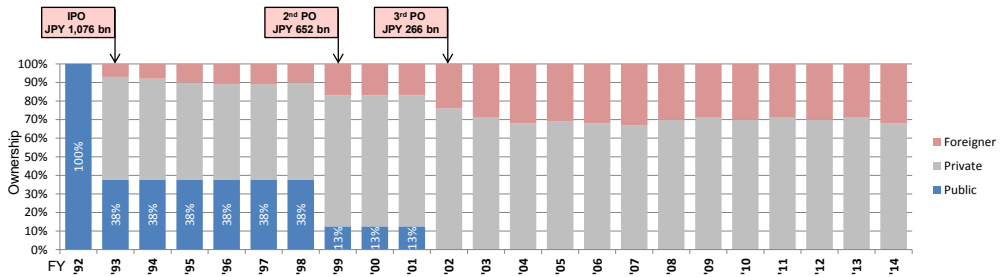
- **JSC** was established for restructuring B/S of JNR.
- Only 4 profitable JR companies took over the debt related to their assets, and JSC succeeded the rest of all the debt.



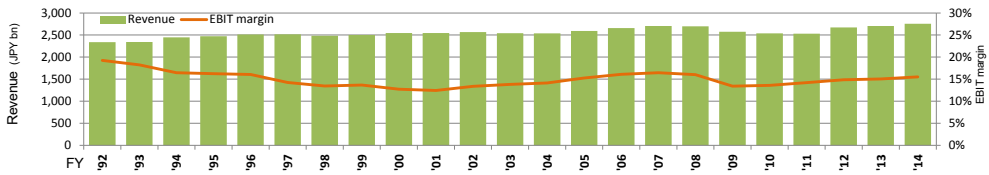
16

## Case Study (Railway): JR East

### Ownership Structure



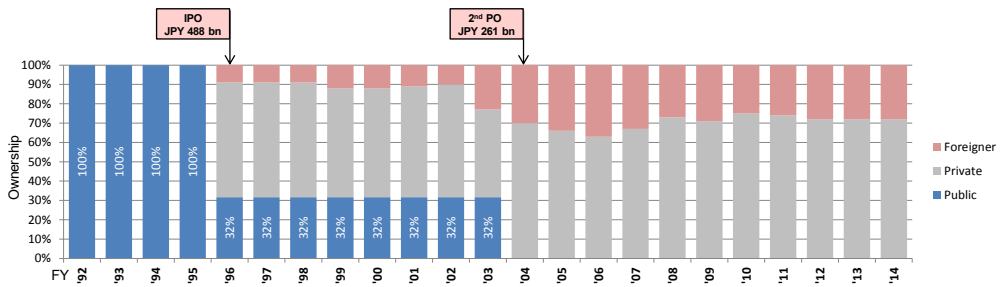
### Revenue & EBIT Margin



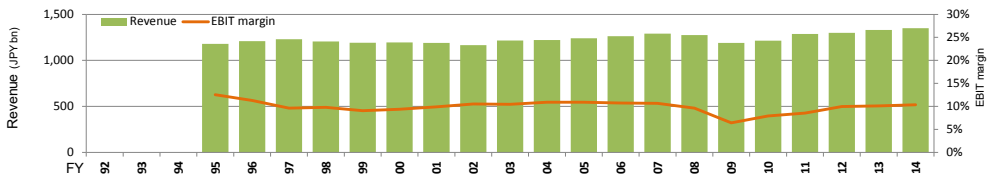
17

## Case Study (Railway): JR West

### Ownership Structure



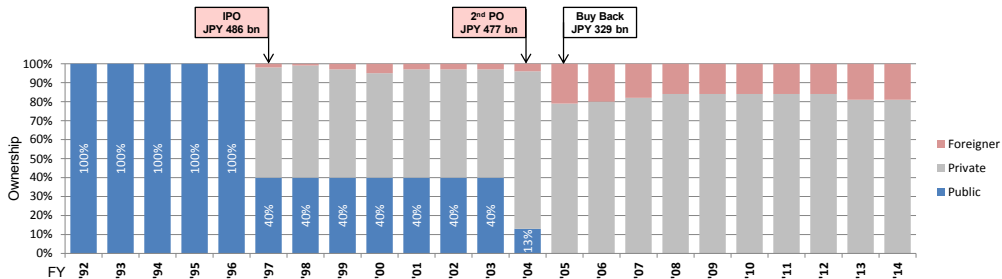
### Revenue & EBIT Margin



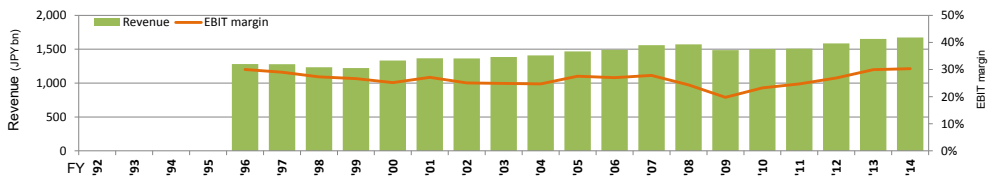
18

## Case Study (Railway): JR Central

### Ownership Structure



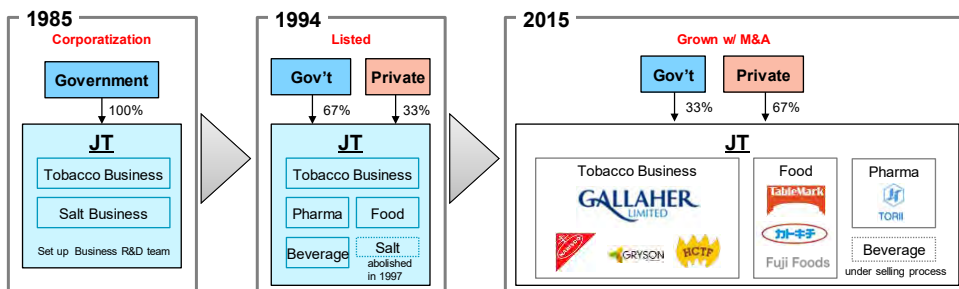
### Revenue & EBIT Margin



19

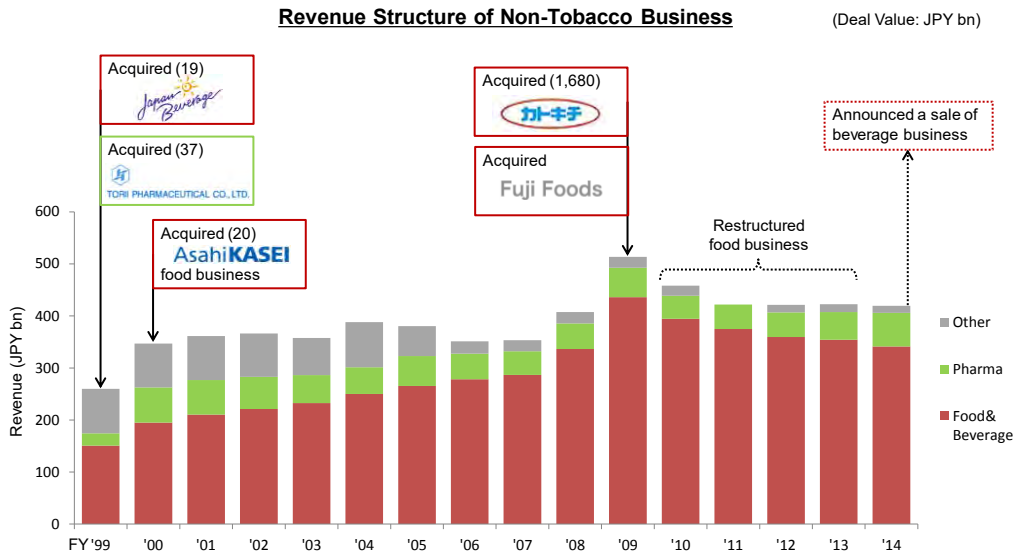
## Case Study (Tobacco) : JT (1)

- Why privatized?
  - **Pressure from outside** to deregulate & open the tobacco market
  - To **enhance efficiency** by allowing independent management
  - To **reduce gov't debt** and to finance for reconstruction after the earthquake in 2011
- Listed in **1985**, and the gov't gradually sold its shares for **JPY1.0tn**.
- Gov't still has to hold over **1/3** of total outstanding, due to its obligation to purchase all domestic tobacco leaves.
- JT has **expanded business scope** & became global player w/own growth strategy.



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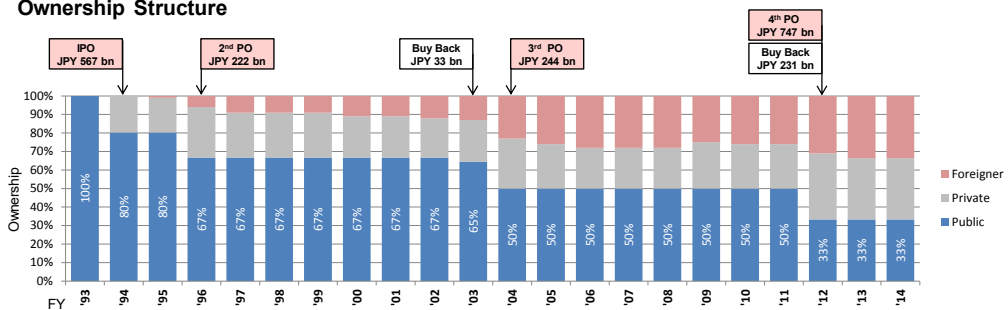
## Case Study (Tobacco) : JT (2)



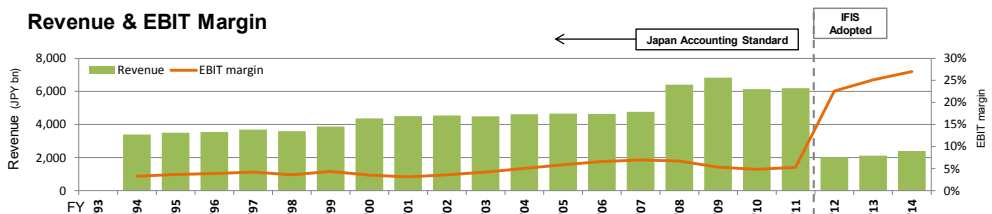
21

## Case Study (Tobacco) : JT (3)

### Ownership Structure



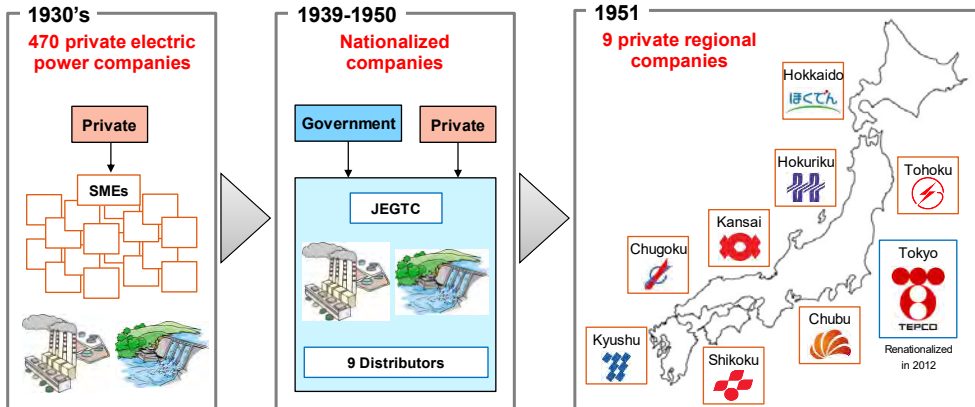
### Revenue & EBIT Margin



22



## Case Study (Electricity): Electric Power Companies

- There were many private electric power companies before WWII.
- During the war, gov't forced to merge them into **Japan Electric Generation & Transmission Co. (JEGTC)** and **9 distributors** under **National General Mobilization Act**.
- GHQ divided JEGTC into 9 regional companies in **1951**, while TEPCO was **renationalized** in **2012** due to the nuclear accident caused by the earthquake.



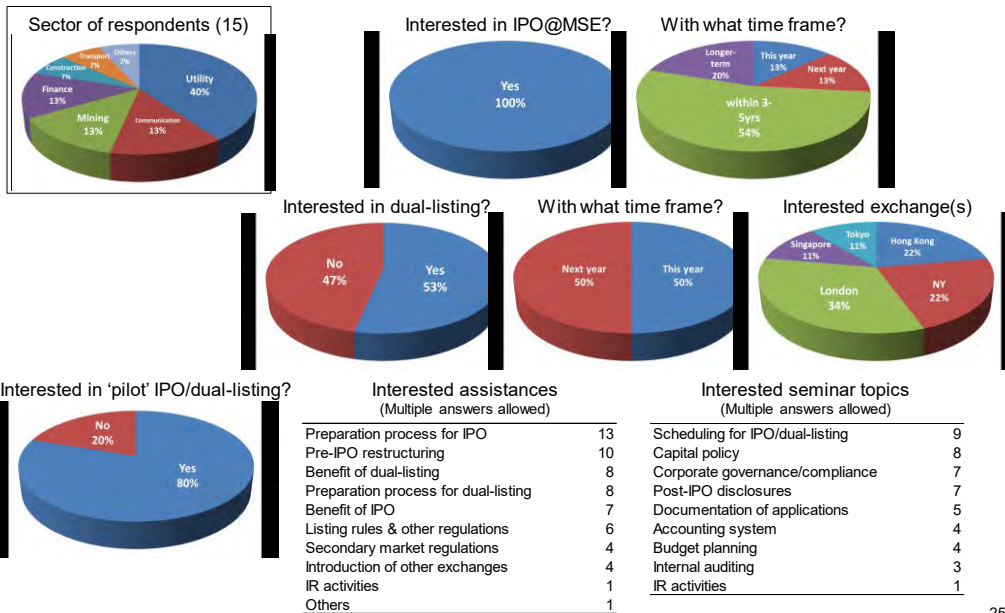
23

## Implications for the Privatization in Mongolia

|                           |   |    |
|---------------------------|--|--|
| <b>Objective</b>          | <ol style="list-style-type: none"> <li>1. Reducing fiscal deficit</li> <li>2. Improving efficiency</li> <li>3. Promoting deregulation</li> </ol>   | <ol style="list-style-type: none"> <li>1. } Same as Japan</li> <li>2. }</li> <li>3. }</li> <li>4. Developing capital markets</li> </ol>  |
| <b>Sector</b>             | <ul style="list-style-type: none"> <li>✓ Telecom</li> <li>✓ Railway</li> <li>✓ Tobacco</li> <li>✓ Electricity</li> <li>✓ Airline</li> <li>✓ Petroleum</li> </ul>   | <ul style="list-style-type: none"> <li>✓ Telecom</li> <li>✓ Electricity</li> <li>✓ Post</li> <li>✓ Mining</li> <li>✓ Airline</li> <li>✓ Exchanges</li> </ul>   |
| <b>Main Consideration</b> | <ul style="list-style-type: none"> <li>✓ Strengthening core business</li> <li>✓ Minimizing capital market impacts</li> <li>✓ Gradual decrease of gov't ownership</li> <li>✓ Dividing operations by region or function</li> </ul> | <ul style="list-style-type: none"> <li>✓ Reaching; <ul style="list-style-type: none"> <li>- Strategic investors</li> <li>- Retail investors</li> <li>- Foreign Investors <ul style="list-style-type: none"> <li>• At MSE</li> <li>• At overseas exchanges</li> </ul> </li> </ul> </li> </ul> |

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## SOCs' Reply to the Questionnaire (Mar 31, 2015)







# Opportunities for Mongolian Companies to IPO in Japan

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**June 23, 2015**

New Listings, Tokyo Stock Exchange, Inc.

# Tokyo Stock Exchange at a Glance

**No. 1** in Asia By Market Capitalization

**51%** by **IT** industry in 2014 IPOs<sup>1</sup>

**50.9 X** Median of **PE Ratio** of 2014 IPOs<sup>1,2</sup>

Note: 1 The number excludes Tokyo Pro Market and REITs.

2 PE Ratio = Market capitalization based on first price / Net profit (last fiscal year).



# 1. Japan-Mongolia Relations

2. Comparison among Major Stock Markets

3. Expansion of IPO Market in Japan

4. Features of IPO Market in Japan

5. Listing on Tokyo Stock Exchange

A. TOKYO PRO Market

B. Overview of the Japanese Financial Market

# Japan-Mongolia Summit Meeting, Signing Ceremony for an Economic Partnership on February 10, 2015

## 1. Japan-Mongolia summit meeting

On February 10, Prime Minister Shinzo Abe held a summit meeting with Mr. Chimed Saikhanbileg, Prime Minister of Mongolia.

### a. Economic areas

The two leaders both celebrated that the Japan-Mongolia EPA had reached the signing stage on this day at the end of negotiations for approximately three years, and confirmed their resolve to take the necessary respective domestic legal procedures in order to bring the EPA into force as quickly as possible.

Prime Minister Abe stated that Japan will continue to support Mongolia's formulation of medium- to long-term economic policy, through measures including dispatching economic advisors, and explained that Japan will provide an additional yen loan of 36.85 billion yen for a new international airport that is currently under construction based by a yen loan.

Prime Minister Saikhanbileg expressed appreciation for this support from Japan, and stated that with the conclusion of the EPA as an opportunity, he wants to further vitalize bilateral cooperation in economic areas, and deepen cooperation between the two countries in economic areas regionally and in the international arena.

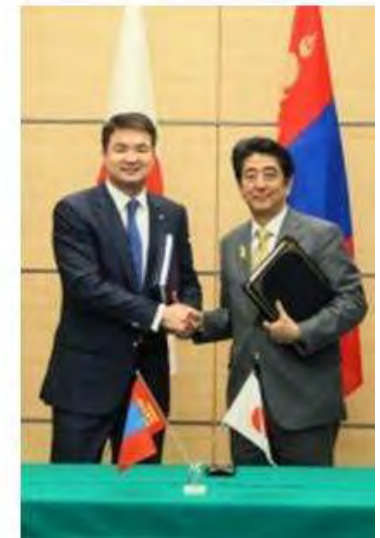
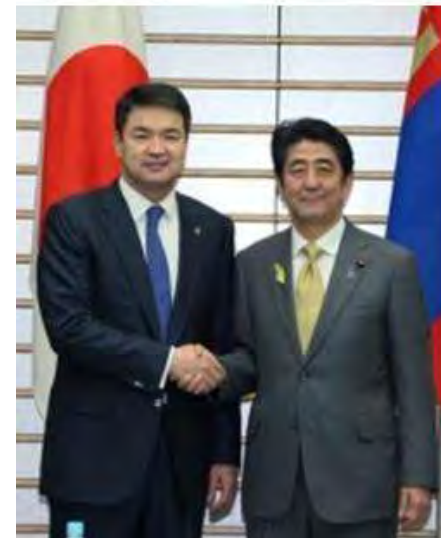
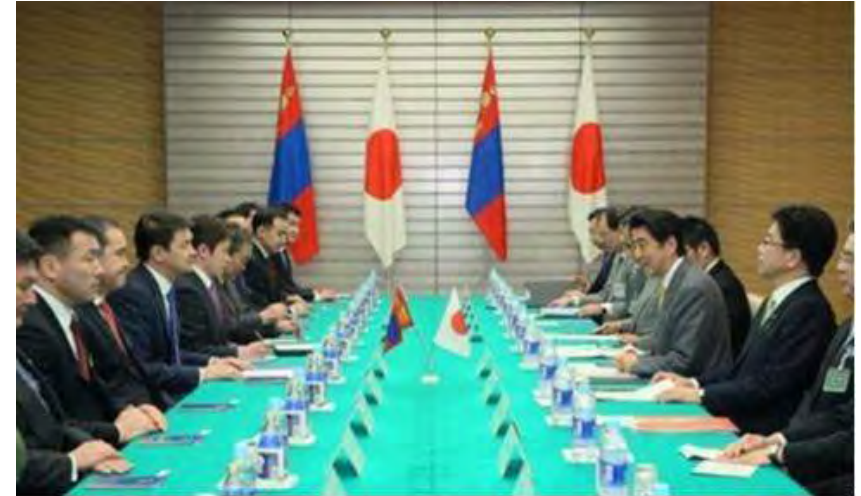
### b. Politics and security

Prime Minister Abe said that based on the policy of Proactive Contribution to Peace, Japan will make a greater contribution to the peace and development of Asia and the world. The two leaders shared the view that the two countries will continue to cooperate closely, both regionally and in the international arena.

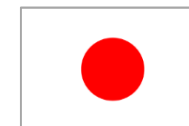
The two leaders also exchanged views on regional affairs in East Asia, including North Korea.

## 2. Signing ceremony and dinner hosted by the Prime Minister

a signing ceremony was held for the Japan-Mongolia EPA, the Implementing Agreement for the EPA, and the "Joint Statement on the Signing of the Agreement between Japan and Mongolia for an Economic Partnership."



# Japan-Mongolia Relations

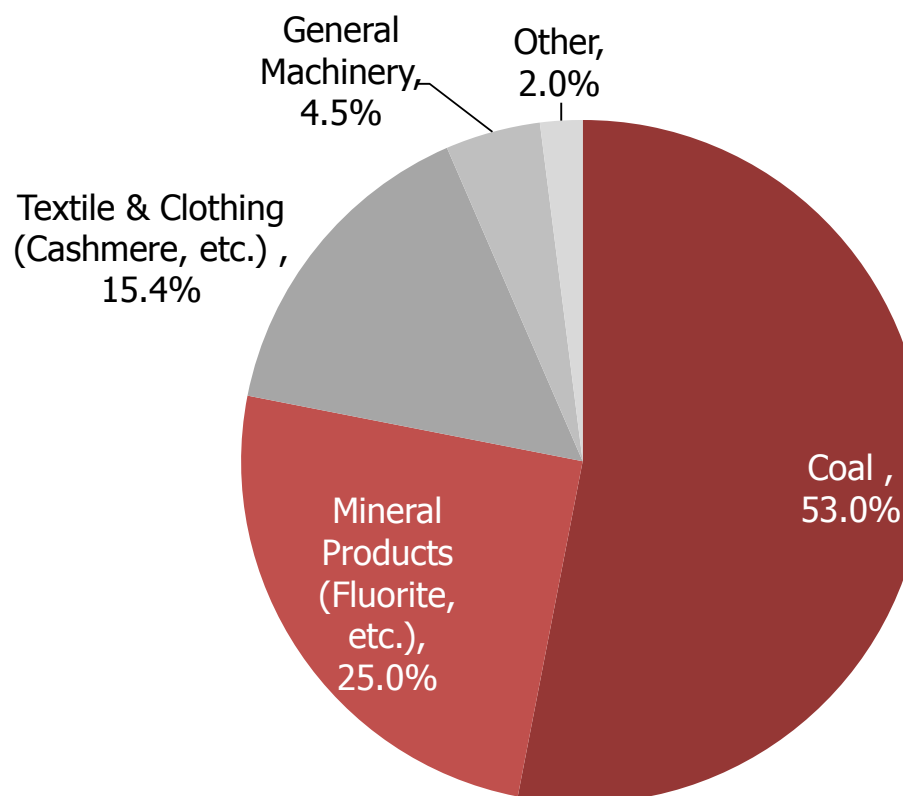


## Recent Political Ties

- 2010: Building a Strategic Partnership
- 2012: New level of expanded commercial relations
- 2013: Developing a Strategic Partnership
  - Prime Minister Abe's visit to Mongolia in March 2013. The two countries shared the intention to enhance mutual relations based on the following three pillars.
  - Prime Minister Altankhuyag's visit to Japan in September 2013. The two countries issued "Joint Statement" and "Mid-term Action Plan", which would become a basis for the two countries to elevate their "strategic partnership" to even higher levels and further strengthen their mutually beneficial and complementary relationship.

- Japan-Mongolia trade: US\$ 311 million
  - Mongolia to Japan: US\$ 18 million
  - Japan to Mongolia: US\$ 293 million

## Mongolia to Japan: US\$ 18 million



# Development Bank of Mongolia Issued Samurai Bonds of JPY 30 billion Guaranteed by JBIC

**JBIC provided this guarantee under the Guarantee and Acquisition toward Tokyo market Enhancement (GATE) facility as the result of exchanging views and information with DBM based on the Mid-term Action Plan agreed on between the top leaders of both countries in Sep. 2013.**

**This was the first JBIC guarantee for issue of Samurai bonds by a Mongolian institution. By supporting the launching of Samurai bonds issued by DBM, JBIC helped diversify funding sources for DBM and the Government of Mongolia.**

**This guarantee provision was expected to strengthen bilateral relations and contribute to more vigorous Japanese business activities in a wide range of areas.**

## Summary of Samurai Bond Issuance

|                                 |   |
|---------------------------------|---|
| Issuer                          | Development Bank of Mongolia (DBM)                        |
| Date of Payment                 | 6-Jan-2014  |
| <b>Maturity</b>                 | <b>10 years</b>   |
| <b>Coupon</b>                   | <b>1.52%</b>  |
| Currency                        | Japanese Yen (JPY)  |
| Issuance                        | Privately Placed Issue                                    |
| <b>Amount</b>                   | <b>JPY 30 billion<br/>(approx. US\$ 300 million)</b>      |
| Guarantee Fee<br>(One-time Fee) | JPY 5.7 billion<br>(approx. US\$ 57 million)              |
| Guarantor <sup>1</sup>          | Japan Bank for International Cooperation (JBIC)           |
| Joint Lead Arrangers            | Nomura Securities Co., Ltd.<br>Daiwa Securities Co., Ltd. |
| Bond Administrator              | Mizuho Bank, Ltd.   |

Source: JBIC, InfoMongolia.com

Note: JBIC's guarantee will cover the principal and part of the interest of the issue.

# Trade and Development Bank of Mongolia (TDB) Opened Tokyo Representative Office



Trade and Development Bank of Mongolia (TDB), Mongolia's financial gateway to the world, has expanded its operation and successfully opened its first international representative office in Tokyo, Japan on July 23, 2014.



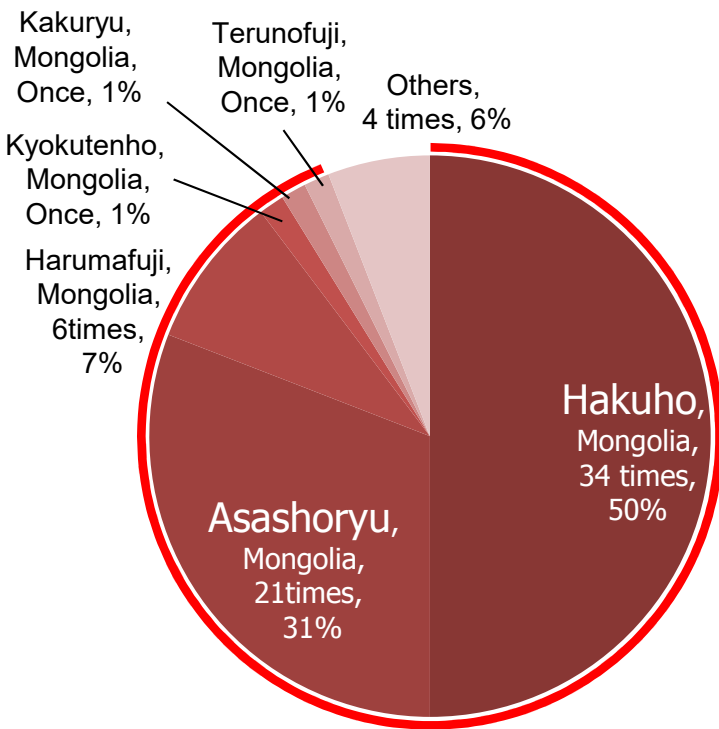
Source: Website of Trade and Development Bank of Mongolia

# Mongolian Sumo Wrestlers in Japan

25 Mongolian wrestlers play an active roles in sumo in Japan. 3 Mongolian wrestlers are "Yokozuna", highest rank in sumo.

Mongolian wrestlers occupy 64 championships of 68 tournaments since 2004.

## Number of Championships (Jan. 2004 – Jul. 2014)



**Mongolian Wrestlers  
64 times, 94%**

## Hakuho Shō

Yokozuna, highest rank in sumo



## Harumafuji Kōhei

Yokozuna, highest rank in sumo



## Kakuryū Rikisaburō

Yokozuna, highest rank in sumo







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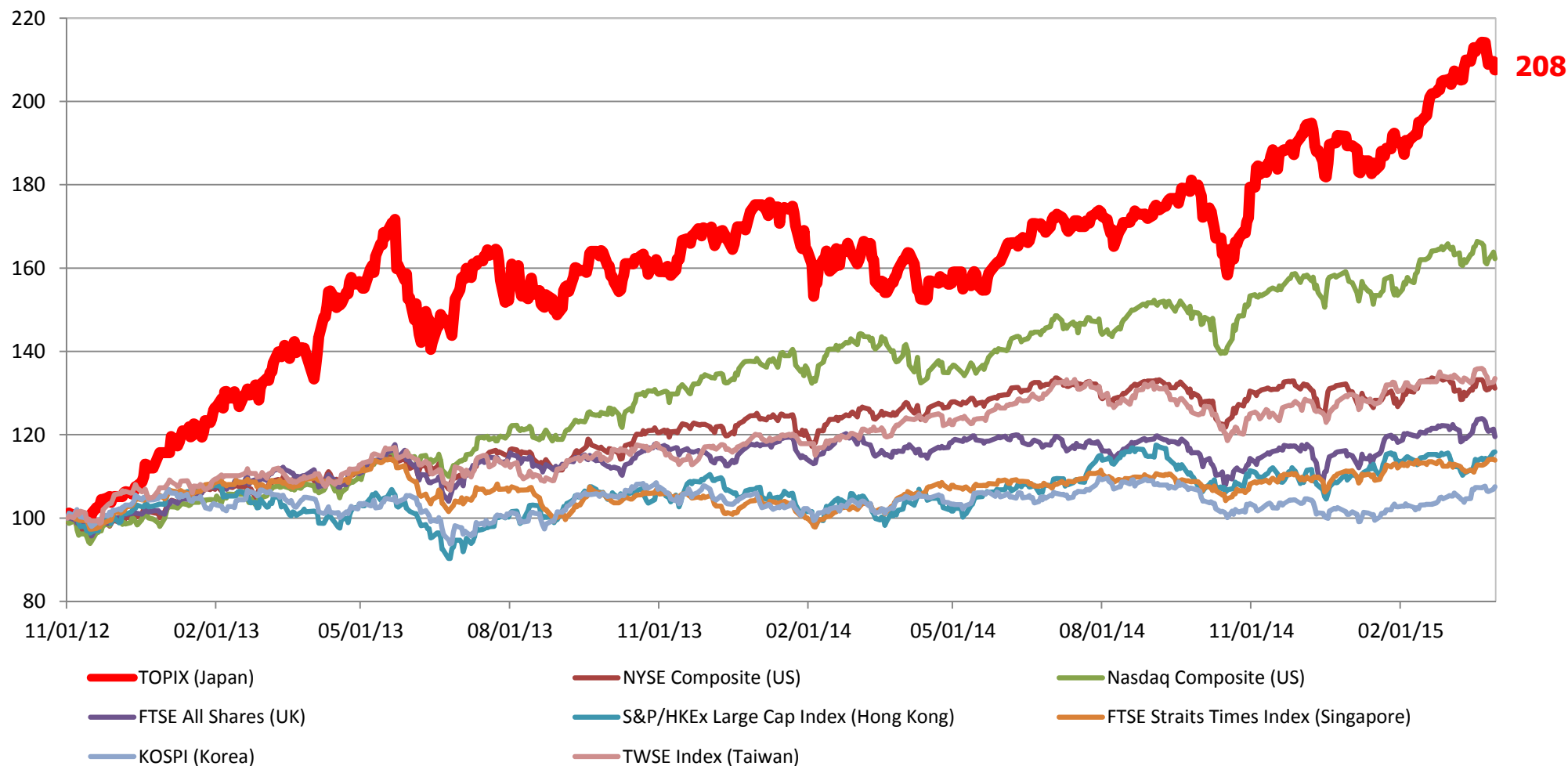
5. Listing on Tokyo Stock Exchange

A. TOKYO PRO Market

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# Stock Market Index Performance

**TOPIX, which represents the movement of the Tokyo market overall, is recording a high growth rate as compared with other markets.**

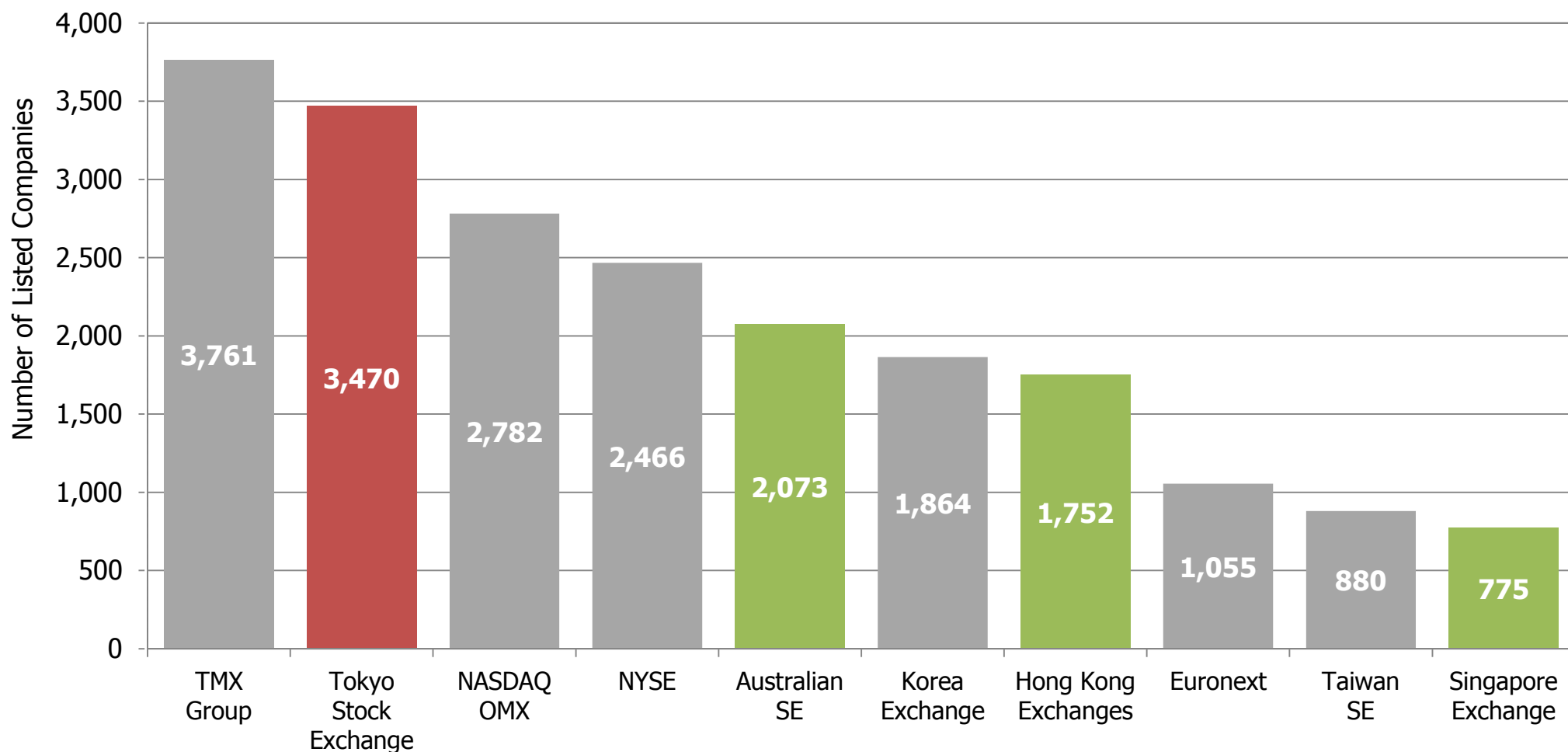


Source: Bloomberg

Note: As of March 31, 2015. Indices rebased to 100 as of November 1, 2012.

# Number of Listed Companies

**Tokyo Stock Exchange exceeds NYSE and NASDAQ in terms of number of listed companies.**

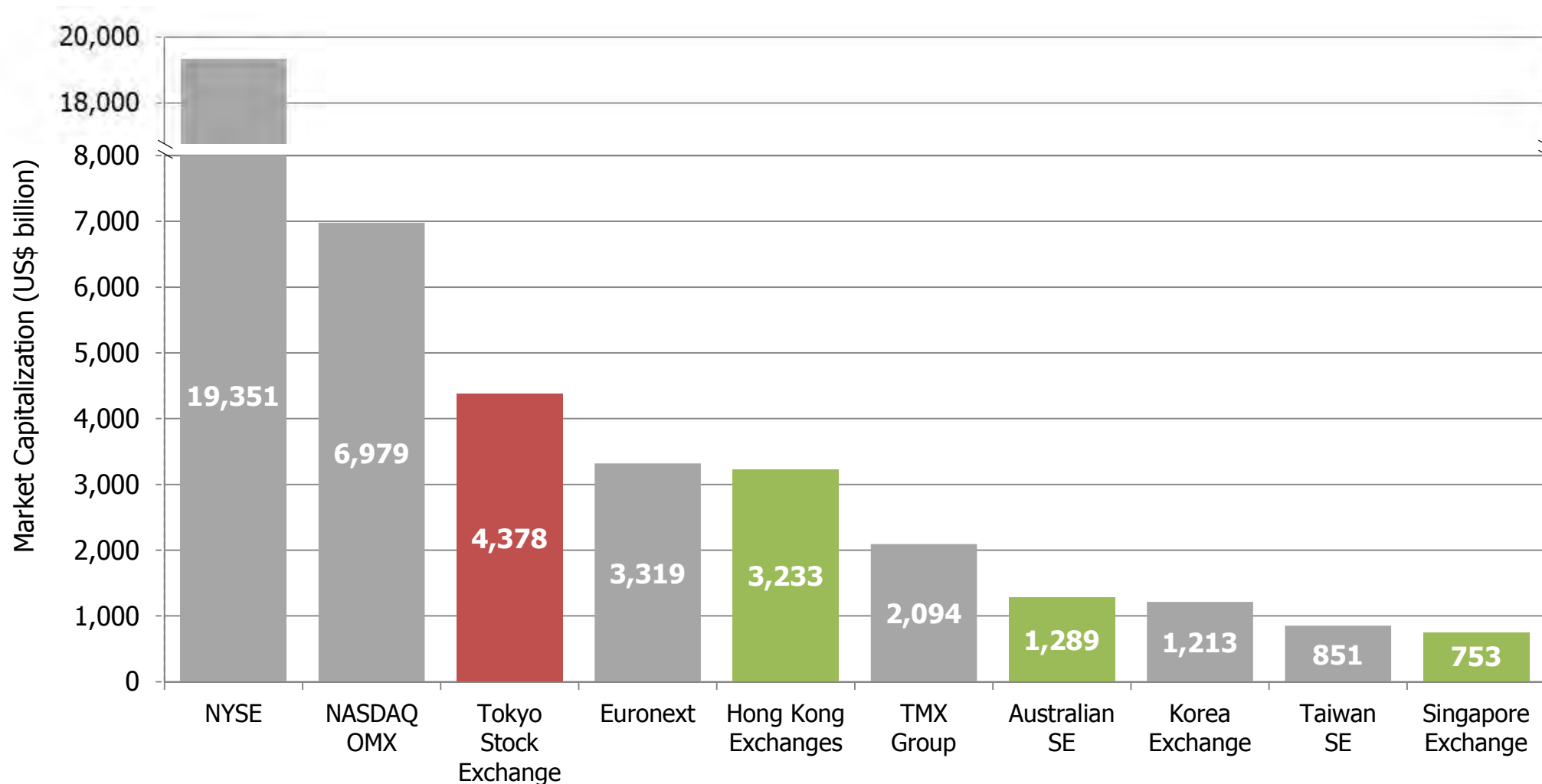


Source: WFE

Note: Number of listed companies as of the end of December 2014

# Market Capitalization

**Tokyo Stock Exchange ranks No.3 globally and No. 1 in Asia by market capitalization.**

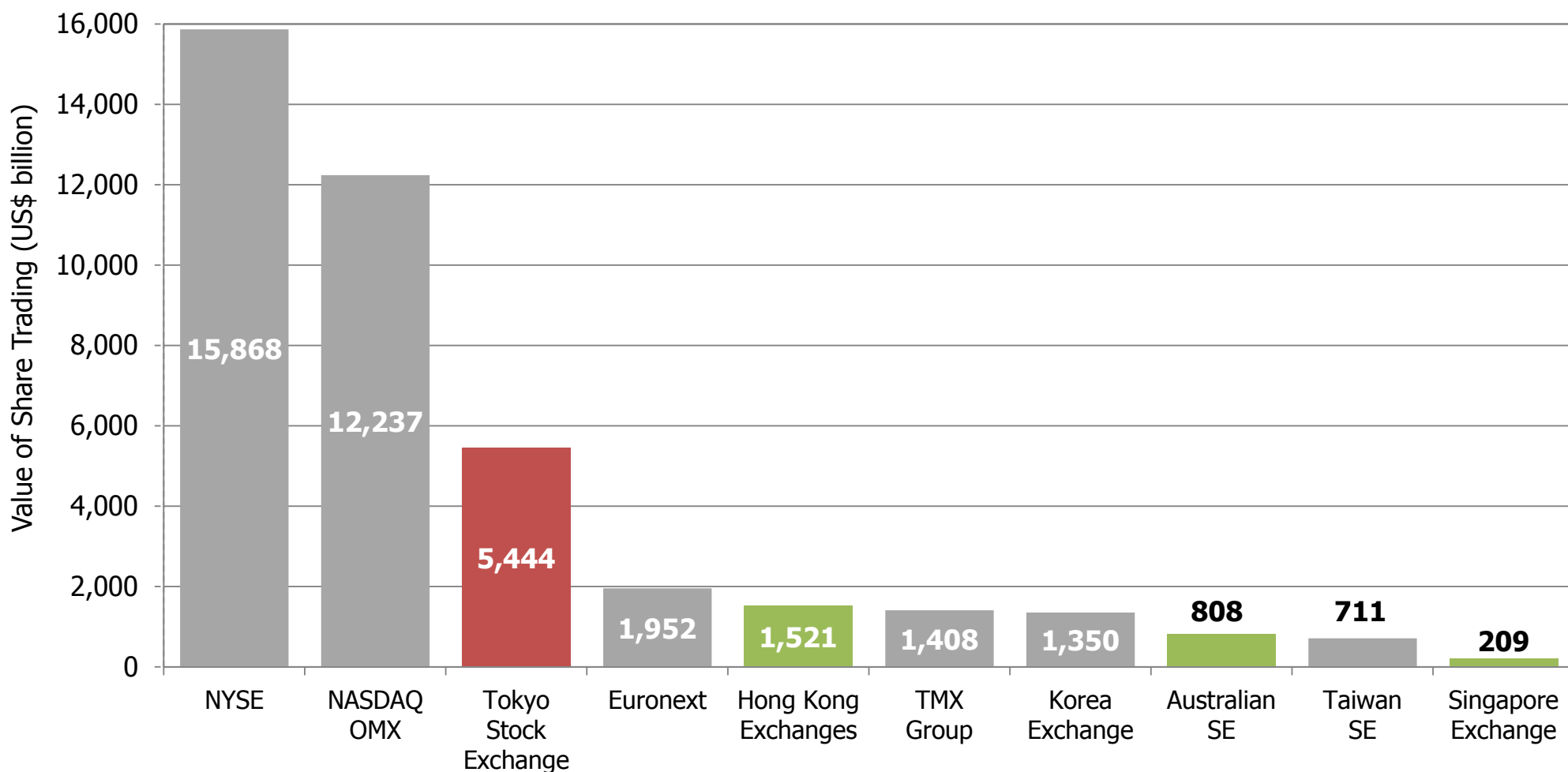


Source: WFE

Note: Domestic market capitalization as of the end of December 2014

# Value of Share Trading in the World

Tokyo Stock Exchange is about 3.6 times larger than Hong Kong Exchanges by value of share trading.



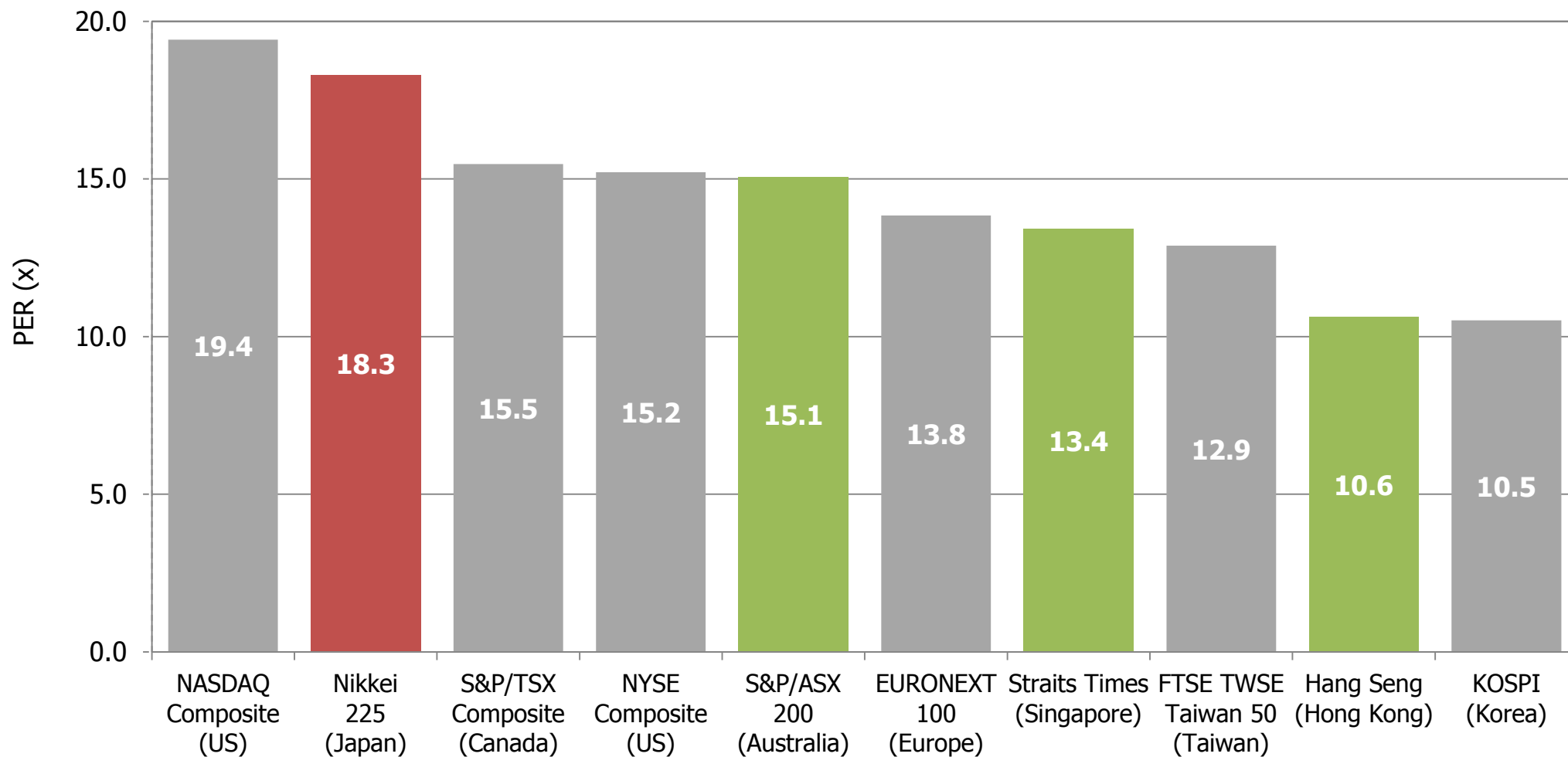
Source: WFE

Note: Value of share trading - Electronic order book trades from January 2014 to December 2014

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# Valuation: PER

Valuations for Japanese companies are highly appreciated based on PER.



Source: Bloomberg

Note: Based on estimated PER from Bloomberg as of January 6, 2015. PER = Price/Estimated EPS Ratio



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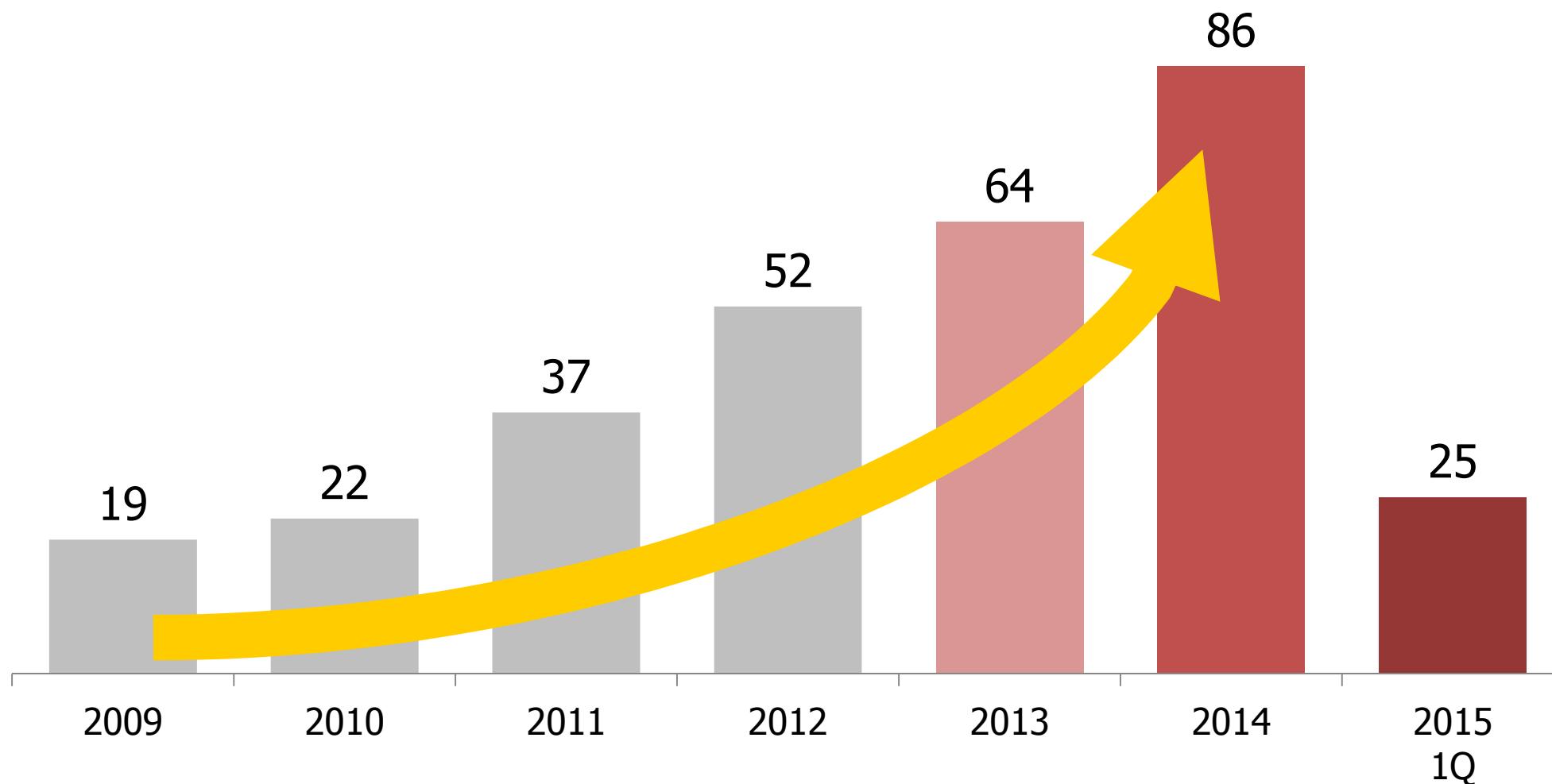
5. Listing on Tokyo Stock Exchange

A. TOKYO PRO Market

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# Number of IPOs in Japan

IPOs figures showed a significant increase to 86<sup>1</sup> in 2014 from 64 in 2013, confirming a full-fledged recovery in the Japanese IPO market. The number of IPOs is expected to increase from 2014 onward.

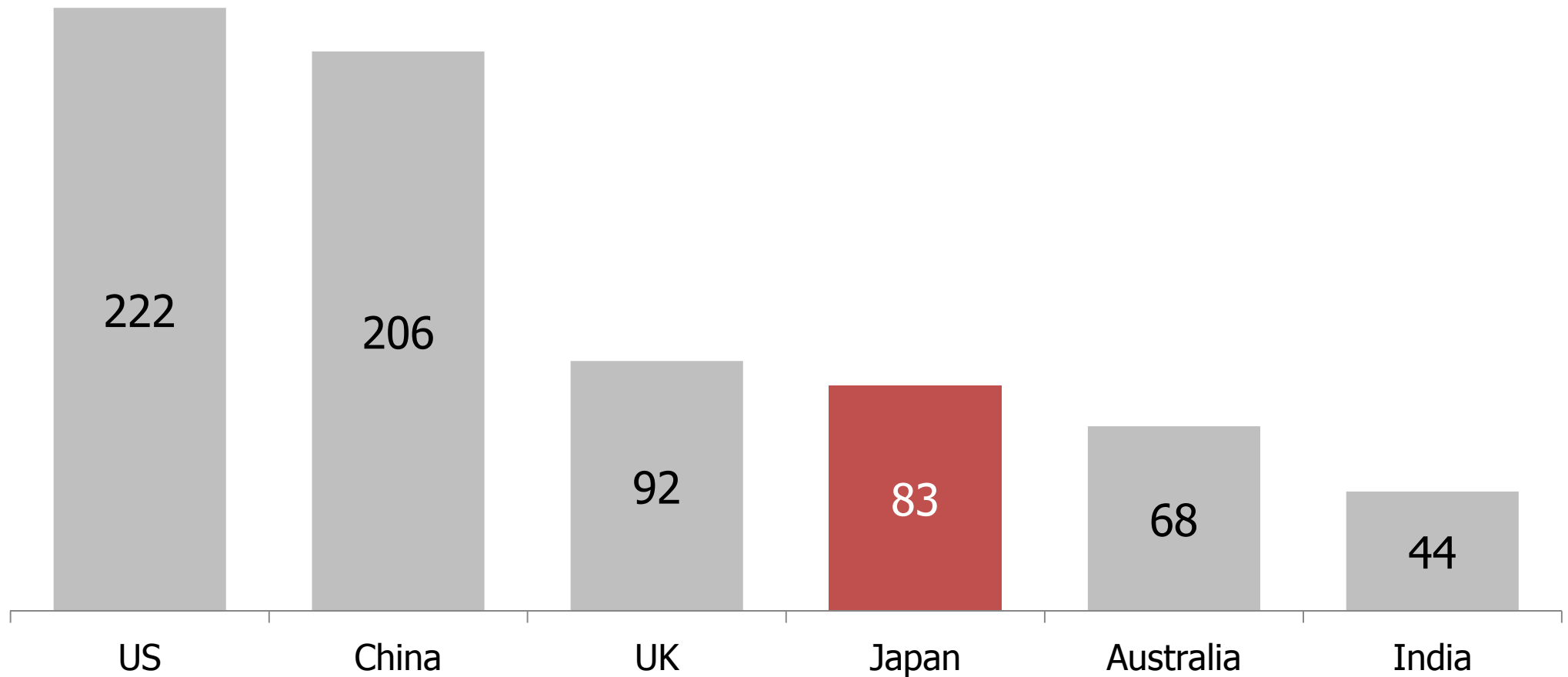


Note 1: The number includes Tokyo Pro Market and REITs.



# Top Six Countries by Number of IPOs in 2014

Japan ranks No.4 globally by number of IPOs in 2014.

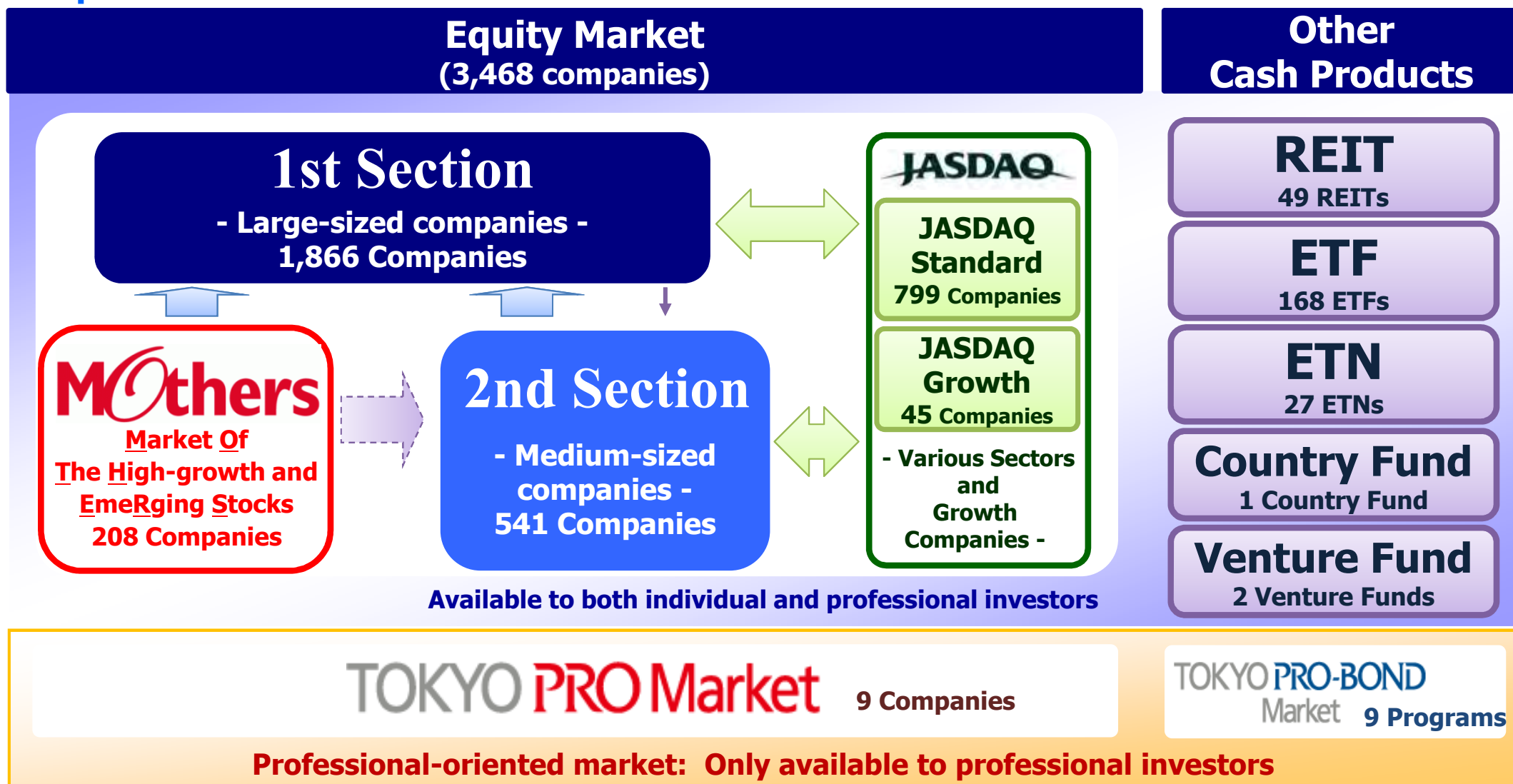


Source: EY Global Trends 2014 4Q

Note: Based on the listed company domicile nation. Number of Japan IPOs does not include TOKYO PRO Market.

# Structure of TSE Cash Equity Market

JPX offers several markets with different concepts to allow companies to make an optimal choice.

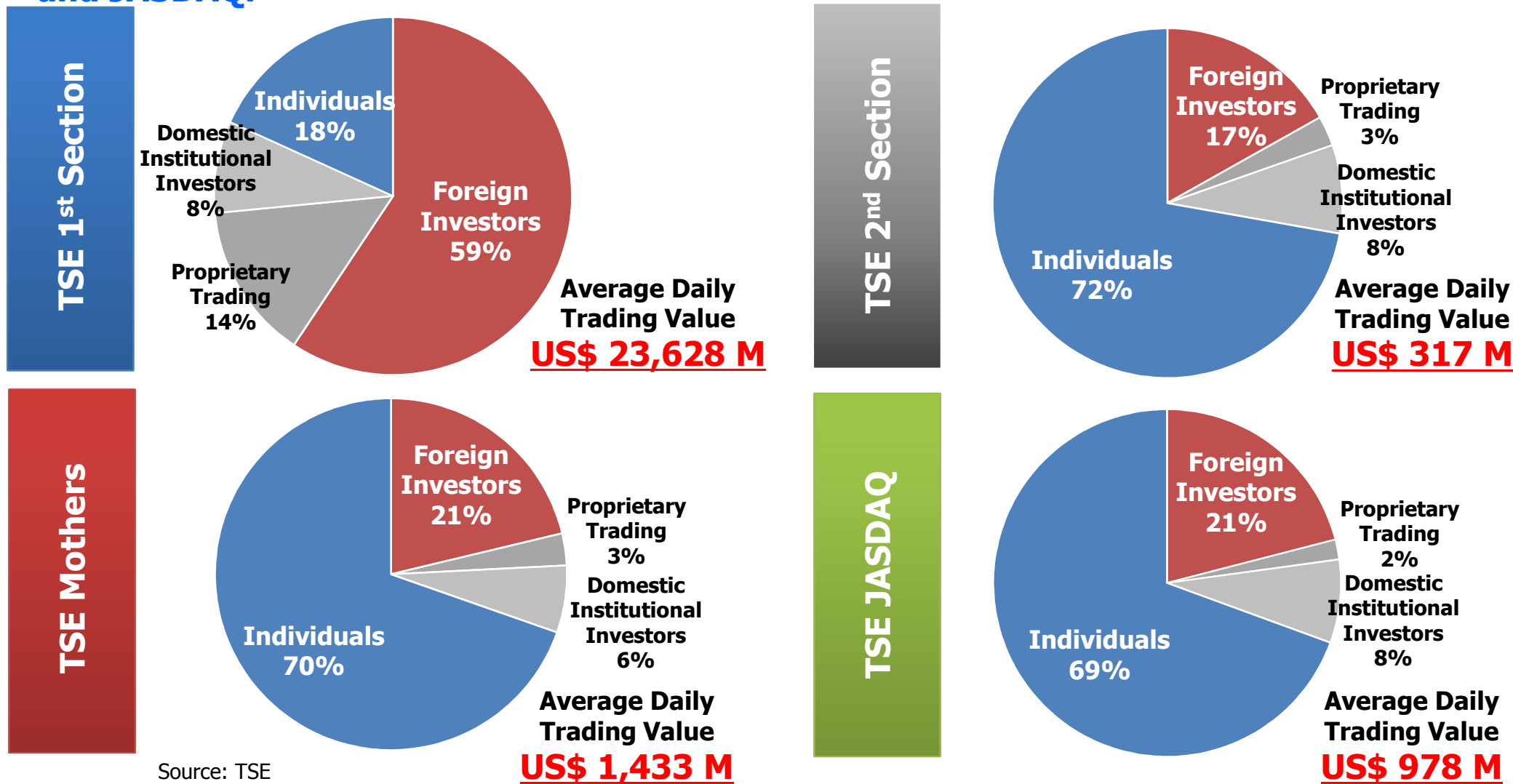


Note: As of December 31, 2014

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# Stock Trading Value by Investor Category (2014)

Foreign investors account for more than half of trading in the TSE 1st Section. By contrast, individual investors make up the majority in the TSE 2nd Section, Mothers, and JASDAQ.



Source: TSE  
Note: 1 US\$= 100 JPY

# IPO Companies Size (2010-2014)

|                | Max<br>Median<br>Min | Revenue   | Net Profit                                 | Net Asset                                   | Market Cap<br>(First Price)                   | Actual<br>PER<br>(First Price)  | IPO<br>Amount <sup>2</sup>                   |
|----------------|----------------------|---|--|---|---|---------------------------------|--|
| <b>TSE 1st</b> |                      | US\$ 52,253M<br><b>US\$ 1,637M</b><br>US\$ 112M | 1,866M<br><b>US\$ 41M</b><br>US\$ -1.8M    | 9,485M<br><b>US\$ 704M</b><br>US\$ -35M     | US\$ 18,197M<br><b>US\$ 958M</b><br>US\$ 297M | 214.6x<br><b>16.5x</b><br>3.7x  | US\$ 10,089M<br><b>US\$ 425M</b><br>US\$ 67M |
| <b>TSE 2nd</b> |                      | US\$ 854M<br><b>US\$ 197M</b><br>US\$ 41M       | US\$ 19M<br><b>US\$ 6.3M</b><br>US\$ -1.0M | US\$ 130M<br><b>US\$ 50M</b><br>US\$ 13M    | US\$ 183M<br><b>US\$ 64M</b><br>US\$ 34M      | 130.8x<br><b>11.8x</b><br>5.6x  | US\$ 455M<br><b>US\$ 69M</b><br>US\$ 34M     |
| <b>Mothers</b> |                      | US\$ 283M<br><b>US\$ 18M</b><br>US\$ 0.5M       | US\$ 26M<br><b>US\$ 1.9M</b><br>US\$ -11M  | US\$ 177M<br><b>US\$ 6.1M</b><br>US\$ -0.8M | US\$ 1,018M<br><b>US\$ 108M</b><br>US\$ 23M   | 10,210x<br><b>63.8x</b><br>9.6x | US\$ 190M<br><b>US\$ 11M</b><br>US\$ 1.7M    |
| <b>JASDAQ</b>  |                      | US\$ 1,173M<br><b>US\$ 69M</b><br>US\$ 0.6M     | US\$ 29M<br><b>US\$ 4.0M</b><br>US\$ -13M  | US\$ 91M<br><b>US\$ 17M</b><br>US\$ 1.6M    | US\$ 1,478M<br><b>US\$ 41M</b><br>US\$ 9.6M   | 71.4x<br><b>15.0x</b><br>2.8x   | US\$ 74M<br><b>US\$ 7.9M</b><br>US\$ 3.6M    |

Source: TSE

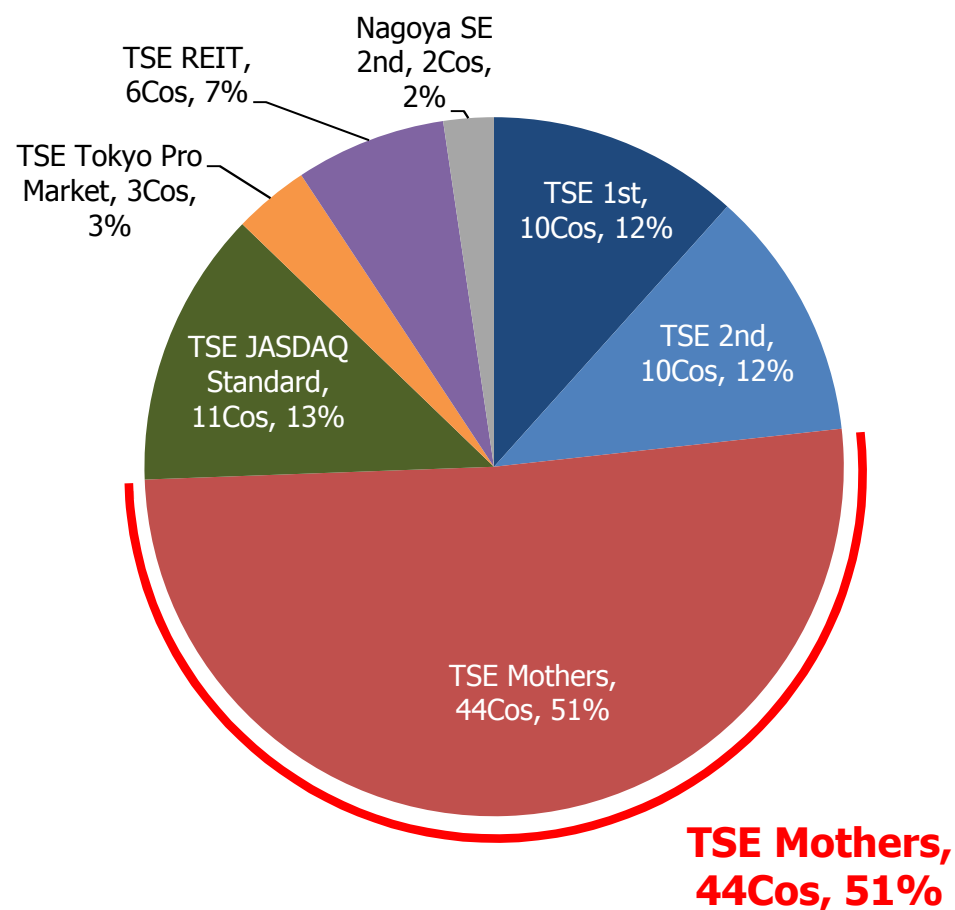
Note:

1 Excluding REIT. US\$ = 100JPY.

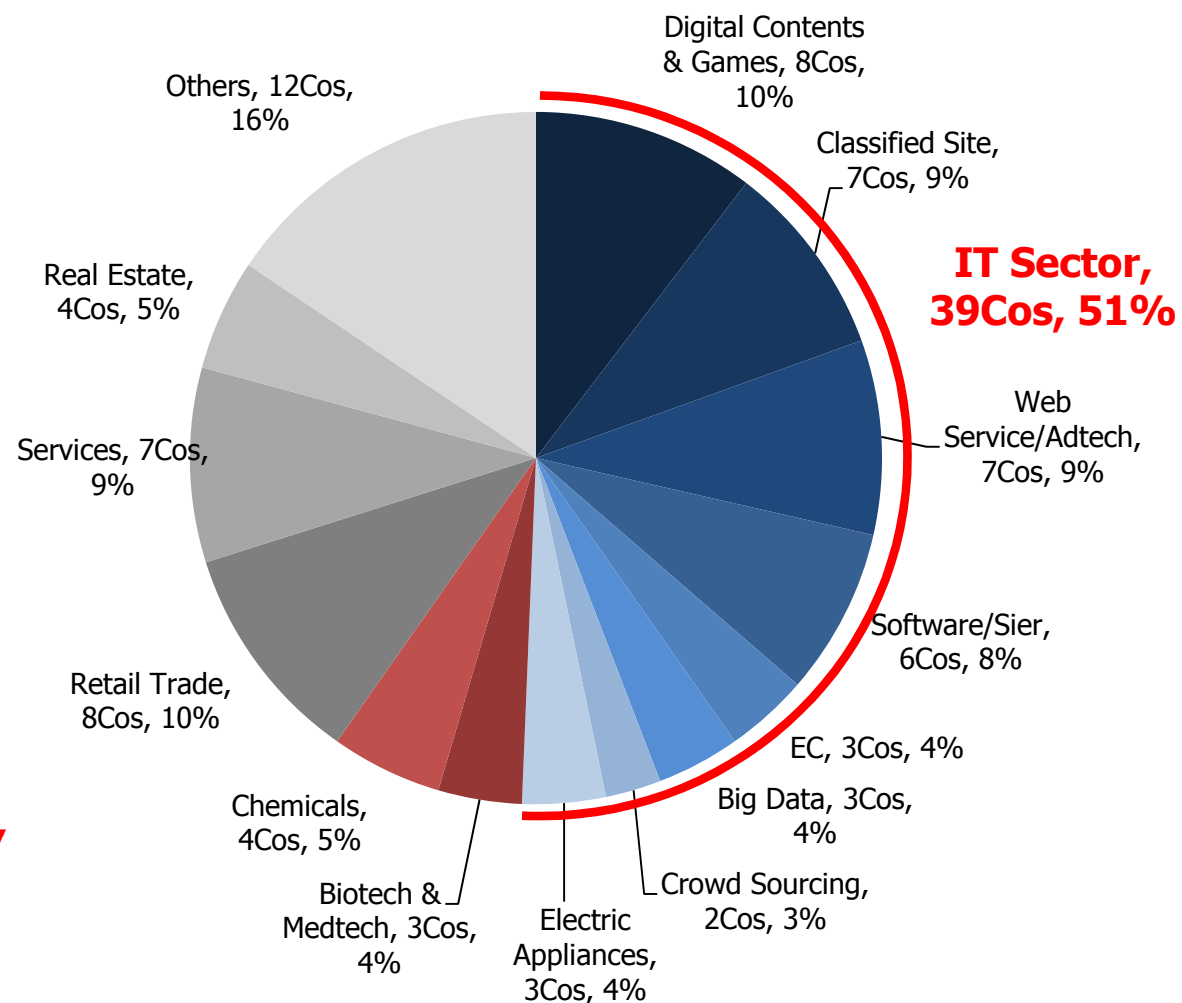
2 Total of offering and sales.

# IPOs in Japan in 2014 - Markets & Sectors

**Number of IPOs by Market in Japan in 2014  
(Total: 86 Cos)<sup>1</sup>**



**Number of IPOs by Sector in Japan in 2014  
(Total: 77 Cos)<sup>2</sup>**



Note: 1 The data includes Tokyo Pro Market and REITs.  
2 The data excludes Tokyo Pro Market and REITs.

# E-Commerce IPOs from 2013 to 2014

| Listing date | Ticker | Company Name    | Market  | Lead Underwriter | Revenue (US\$ m) | Net Profit (US\$ m) | Total IPO Amt (US\$ m) | Market Cap (IPO Price) (US\$ m) | Market Cap (First Price) (US\$ m) | PSR (Frist Price) (x) | PER (Frist Price) (x) | Market Cap (12/30/14) (US\$ m) | Change (IPO to 12/30/14) |
|--------------|--------|-----------------|---------|------------------|------------------|---------------------|------------------------|---------------------------------|-----------------------------------|-----------------------|-----------------------|--------------------------------|--------------------------|
| 18-Dec-14    | 6030   | ADVENTURE       | Mothers | Daiwa            | 8.9              | 0.2                 | 9.5                    | 54.6                            | 124.0                             | 13.9                  | 586.7                 | 83.7                           | 53%                      |
| 24-Sep-14    | 3195   | GENERATION PASS | Mothers | Nomura           | 36.7             | 0.5                 | 5.6                    | 19.7                            | 43.2                              | 1.2                   | 83.0                  | 22.0                           | 11%                      |
| 23-Apr-14    | 3192   | SHIROHATO       | JQS     | Nomura           | 29.5             | 0.7                 | 6.8                    | 19.6                            | 28.7                              | 1.0                   | 42.0                  | 30.2                           | 54%                      |
| 19-Nov-13    | 3189   | ANAP            | JQS     | Daiwa            | 84.1             | 2.3                 | 5.4                    | 20.6                            | 105.1                             | 1.2                   | 44.7                  | 14.3                           | -31%                     |
| 13-Sep-13    | 3187   | SANWA COMPANY   | Mothers | Nomura           | 46.4             | 1.8                 | 4.2                    | 26.4                            | 97.3                              | 2.1                   | 55.3                  | 126.3                          | 378%                     |
| 10-Jul-13    | 3185   | DREAM VISION    | Mothers | Nomura           | 62.0             | 0.3                 | 12.0                   | 34.9                            | 70.0                              | 1.1                   | 252.5                 | 8.1                            | -77%                     |
| 13-Mar-13    | 3182   | OISIX           | Mothers | Mizuho           | 126.1            | 3.3                 | 9.7                    | 64.4                            | 198.8                             | 1.6                   | 59.9                  | 120.0                          | 86%                      |
| 14-Feb-13    | 3180   | BEAUTY GARAGE   | Mothers | SBI              | 43.5             | 1.5                 | 5.5                    | 26.5                            | 48.0                              | 1.1                   | 32.6                  | 35.5                           | 34%                      |
|              |        | <b>Median</b>   |         |                  | <b>44.9</b>      | <b>1.1</b>          | <b>6.2</b>             | <b>26.5</b>                     | <b>83.7</b>                       | <b>1.2</b>            | <b>57.6</b>           | <b>32.8</b>                    | <b>44%</b>               |

**ADVENTURE**  
(Air Ticket)



**GENERATION PASS**  
(Multiple Platforms)



**SHIROHATO**  
(Women's Underwear)



**ANAP**  
(Women's Fashion)



**SANWA COMPANY**  
(Housing Equipment)



**DREAM VISION**  
(Women's Fashion)



**OISIX**  
(Food)



**BEAUTY GARAGE**  
(for Beauty Salons)



Source: Bloomberg,  
Companies' website

Note:

- 1 US\$ = 100 JPY
- 2 As of December 30, 2014.

# Crowd Sourcing IPOs from 2013 to 2014

| Listing date | Ticker | Company Name | Market  | Lead Underwriter | Revenue (US\$ m) | Net Profit (US\$ m) | Total IPO Amont (US\$ m) | Market Cap (IPO Price) (US\$ m) | Market Cap (First Price) (US\$ m) | PSR (Frist Price) (x) | PER (Frist Price) (x) | Market Cap (12/30/14) (US\$ m) | Change (IPO to 12/30/14) |
|--------------|--------|--------------|---------|------------------|------------------|---------------------|--------------------------|---------------------------------|-----------------------------------|-----------------------|-----------------------|--------------------------------|--------------------------|
| 12-Dec-14    | 3900   | CROWDWORKS   | Mothers | Daiwa            | 0.5              | -1.6                | 16.2                     | 95.4                            | 165.1                             | 321.3                 | na                    | 152.2                          | 60%                      |
| 18-Sep-14    | 3691   | REAL WORLD   | Mothers | Daiwa            | 20.7             | 0.0                 | 14.3                     | 68.4                            | 121.8                             | 5.9                   | 5,914.2               | 57.5                           | -16%                     |
| 10-Jul-13    | 6075   | PHOTOCREATE  | Mothers | SBI              | 24.8             | 0.6                 | 3.8                      | 19.6                            | 44.2                              | 1.8                   | 68.5                  | 17.5                           | -10%                     |
|              |        |              |         | <b>Median</b>    | <b>20.7</b>      | <b>0.0</b>          | <b>14.3</b>              | <b>68.4</b>                     | <b>121.8</b>                      | <b>5.9</b>            | <b>2,991.3</b>        | <b>57.5</b>                    | <b>-10%</b>              |

## CROWDWORKS (Crowd Sourcing)



## REAL WORLD (Crowd Sourcing)



## PHOTOCREATE (Photography)



Source: Bloomberg, Companies' website

Note:

1 US\$ = 100 JPY

2 As of December 30, 2014

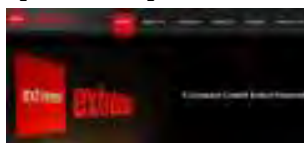
# Digital Contents & Games IPOs from 2013 to 2014

| Listing date  | Ticker | Company Name           | Market  | Lead Underwriter | Revenue (US\$ m) | Net Profit (US\$ m) | Total IPO Amont (US\$ m) | Market Cap (IPO Price) (US\$ m) | Market Cap (First Price) (US\$ m) | PSR (Frist Price) (x) | PER (Frist Price) (x) | Market Cap (12/30/14) (US\$ m) | Change (IPO to 12/30/14) |
|---------------|--------|------------------------|---------|------------------|------------------|---------------------|--------------------------|---------------------------------|-----------------------------------|-----------------------|-----------------------|--------------------------------|--------------------------|
| 25-Dec-14     | 3904   | KAYAC                  | Mothers | Daiwa            | 28.0             | 1.3                 | 8.9                      | 42.1                            | 135.5                             | 4.8                   | 102.8                 | 117.2                          | 178%                     |
| 25-Dec-14     | 6033   | EXTREME                | Mothers | Daiwa            | 13.3             | -0.3                | 4.0                      | 15.8                            | 62.7                              | 4.7                   | na                    | 72.9                           | 362%                     |
| 18-Dec-14     | 3903   | GUMI                   | TSE 1st | Nomura           | 111.9            | -1.8                | 450.4                    | 945.9                           | 945.9                             | 8.5                   | na                    | 763.6                          | -19%                     |
| 16-Dec-14     | 9418   | U-NEXT                 | Mothers | Daiwa            | 179.0            | 11.8                | 46.9                     | 158.1                           | 208.2                             | 1.2                   | 17.7                  | 375.1                          | 137%                     |
| 30-Oct-14     | 9467   | ALPHAPOLIS             | Mothers | Daiwa            | 20.5             | 3.9                 | 28.5                     | 102.9                           | 198.7                             | 9.7                   | 50.9                  | 91.4                           | -11%                     |
| 15-Jul-14     | 3689   | IGNIS                  | Mothers | Nomura           | 8.7              | 2.0                 | 26.1                     | 111.3                           | 492.2                             | 56.3                  | 245.2                 | 290.2                          | 161%                     |
| 26-Mar-14     | 3686   | DLE                    | Mothers | Nomura           | 9.4              | 0.7                 | 18.0                     | 62.3                            | 125.2                             | 13.3                  | 188.9                 | 129.4                          | 108%                     |
| 12-Mar-14     | 9414   | NIPPON BS BROADCASTING | TSE 2nd | Nomura           | 70.2             | 13.2                | 48.8                     | 156.1                           | 166.4                             | 2.4                   | 12.6                  | 171.4                          | 10%                      |
| 20-Nov-13     | 3678   | MEDIA DO               | Mothers | Ichiyoshi        | 40.9             | 0.0                 | 12.9                     | 73.6                            | 262.5                             | 6.4                   | 5,848.3               | 206.5                          | 181%                     |
| 14-Mar-13     | 3672   | ALTPLUS                | Mothers | Nomura           | 9.1              | 1.1                 | 23.4                     | 60.0                            | 160.6                             | 17.6                  | 143.2                 | 84.5                           | 41%                      |
| <b>Median</b> |        |                        |         |                  | <b>24.3</b>      | <b>1.2</b>          | <b>24.7</b>              | <b>88.2</b>                     | <b>182.6</b>                      | <b>7.4</b>            | <b>123.0</b>          | <b>150.4</b>                   | <b>122%</b>              |

## KAYAC (Games & Apps)



## EXTREME (Games)



## GUMI (Games)



## U-NEXT (Video on demand)



## AlphaPolis (Novel/Comic)



## IGNIS (Apps & Games)



## DLE (Animation)



## NIPPON BS BROADCASTING (Television Broadcasting)



## MEDIA DO (Electronic Book)



## ALTPLUS (Mobile Social Game)



Source: Bloomberg, Companies' website

Note:

1 US\$ = 100 JPY

2 As of December 30, 2014



# Classified Site IPOs from 2013 to 2014

| Listing date  | Ticker | Company Name     | Market  | Lead Underwriter | Revenue (US\$ m) | Net Profit (US\$ m) | Total IPO Amont (US\$ m) | Market Cap (IPO Price) (US\$ m) | Market Cap (First Price) (US\$ m) | PSR (Frist Price) (x) | PER (Frist Price) (x) | Market Cap (12/30/14) (US\$ m) | Change (IPO to 12/30/14) |
|---------------|--------|------------------|---------|------------------|------------------|---------------------|--------------------------|---------------------------------|-----------------------------------|-----------------------|-----------------------|--------------------------------|--------------------------|
| 26-Dec-14     | 6034   | MRT              | Mothers | Daiwa            | 7.3              | 0.1                 | 6.7                      | 18.1                            | 74.0                              | 10.2                  | 1,178.7               | 64.6                           | 257%                     |
| 22-Dec-14     | 6032   | INTERWORKS       | Mothers | Daiwa            | 26.7             | 2.9                 | 18.5                     | 83.7                            | 97.7                              | 3.7                   | 33.3                  | 82.4                           | -2%                      |
| 16-Dec-14     | 3901   | MARKLINES        | JQS     | SBI              | 8.5              | 1.5                 | 6.5                      | 61.8                            | 109.6                             | 12.9                  | 71.4                  | 91.6                           | 48%                      |
| 11-Dec-14     | 6027   | BENGO4.COM       | Mothers | Nomura           | 2.9              | 0.1                 | 15.8                     | 86.9                            | 274.1                             | 94.1                  | 2,044.3               | 188.9                          | 117%                     |
| 16-Oct-14     | 6098   | RECRUIT HOLDINGS | TSE 1st | Nomura           | 11,916           | 654                 | 2,138                    | 17,795                          | 18,197                            | 1.5                   | 27.8                  | 19,447                         | 9%                       |
| 27-Jun-14     | 6095   | MEDPEER          | Mothers | Nomura           | 5.7              | 1.1                 | 10.8                     | 65.1                            | 150.5                             | 26.2                  | 132.5                 | 123.4                          | 90%                      |
| 25-Mar-14     | 3685   | MINNANO WEDDING  | Mothers | Nomura           | 10.1             | 1.1                 | 47.6                     | 205.4                           | 261.2                             | 25.8                  | 237.7                 | 85.8                           | -58%                     |
| 11-Dec-13     | 6084   | O-UCCINO         | Mothers | SBI              | 14.0             | 1.2                 | 5.6                      | 43.3                            | 99.7                              | 7.1                   | 83.0                  | 19.9                           | -54%                     |
| 22-Nov-13     | 3679   | ZIGEXN           | Mothers | Nomura           | 11.7             | 3.6                 | 59.0                     | 306.3                           | 893.4                             | 76.2                  | 250.4                 | 374.8                          | 22%                      |
| <b>Median</b> |        |                  |         |                  | <b>10.1</b>      | <b>1.2</b>          | <b>15.8</b>              | <b>83.7</b>                     | <b>150.5</b>                      | <b>12.9</b>           | <b>132.5</b>          | <b>91.6</b>                    | <b>22%</b>               |

**MRT**  
(Medical Staffing Site)



**INTERWORKS**  
(Staffing Site)



**MARKLINES**  
(Automobile Industry Site)



**BENGO4.COM**  
(Lawyer Advisory Site)



**Recruit Holdings**  
(Sites for HR, Housing, Bridal, Travel, Restaurants, Beauty, Automobiles, Education and more)



**MEDPEER**  
(Medical SNS)



**Minnano Wedding**  
(Wedding Site)



**O-uccino**  
(Housing Site)



**ZIGEXN**  
(Classified Sites)



Source: Bloomberg, Companies' website

Note:

1 US\$ = 100 JPY

2 As of December 30, 2014

# Big Data IPOs from 2013 to 2014

| Listing date | Ticker | Company Name | Market  | Lead Underwriter | Revenue (US\$ m) | Net Profit (US\$ m) | Total IPO Amont (US\$ m) | Market Cap (IPO Price) (US\$ m) | Market Cap (First Price) (US\$ m) | PSR (Frist Price) (x) | PER (Frist Price) (x) | Market Cap (12/30/14) (US\$ m) | Change (IPO to 12/30/14) |
|--------------|--------|--------------|---------|------------------|------------------|---------------------|--------------------------|---------------------------------|-----------------------------------|-----------------------|-----------------------|--------------------------------|--------------------------|
| 24-Dec-14    | 3905   | DATASECTION  | Mothers | Daiwa            | 3.2              | 0.5                 | 13.2                     | 48.6                            | 84.1                              | 26.5                  | 186.1                 | 106.2                          | 119%                     |
| 19-Dec-14    | 6031   | SCIGINEER    | Mothers | SMBC Nikko       | 5.6              | -1.0                | 11.6                     | 50.3                            | 113.6                             | 20.5                  | na                    | 178.9                          | 256%                     |
| 24-Jun-14    | 6094   | FREAKOUT     | Mothers | Nomura           | 21.6             | 0.9                 | 16.0                     | 120.4                           | 421.3                             | 19.5                  | 485.6                 | 202.0                          | 68%                      |
| 9-Dec-13     | 3680   | HOTTO LINK   | Mothers | Nomura           | 6.4              | 0.3                 | 14.6                     | 49.3                            | 130.9                             | 20.5                  | 446.3                 | 109.0                          | 121%                     |
| 25-Apr-13    | 3674   | AUCFAN       | Mothers | SMBC Nikko       | 6.2              | 1.0                 | 9.6                      | 45.9                            | 184.8                             | 29.8                  | 182.9                 | 97.1                           | 112%                     |
|              |        |              |         | <b>Median</b>    | <b>6.2</b>       | <b>0.5</b>          | <b>13.2</b>              | <b>49.3</b>                     | <b>130.9</b>                      | <b>20.5</b>           | <b>316.2</b>          | <b>109.0</b>                   | <b>119%</b>              |

## DATASECTION (Social Data Analysis)



## SCIGINEER (Personalized Recommendation)



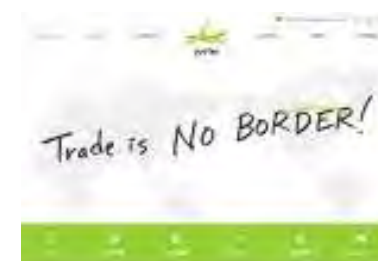
## FREAKOUT (Big Data Analysis)



## HOTTO LINK (SNS Data Analysis)



## AUCFAN (EC Statistics)



Source: Bloomberg, Companies' website

Note:

- 1 US\$ = 100 JPY
- 2 As of December 30, 2014

# Web Service and AdTech IPOs from 2013 to 2014

| Listing date  | Ticker | Company Name      | Market  | Lead Underwriter | Revenue (US\$ m) | Net Profit (US\$ m) | Total IPO Amont (US\$ m) | Market Cap (IPO Price) (US\$ m) | Market Cap (First Price) (US\$ m) | PSR (Frist Price) (x) | PER (Frist Price) (x) | Market Cap (12/30/14) (US\$ m) | Change (IPO to 12/30/14) |
|---------------|--------|-------------------|---------|------------------|------------------|---------------------|--------------------------|---------------------------------|-----------------------------------|-----------------------|-----------------------|--------------------------------|--------------------------|
| 11-Dec-14     | 6026   | GMO TECH          | Mothers | Daiwa            | 23.7             | 1.1                 | 18.4                     | 63.8                            | 150.0                             | 6.3                   | 130.9                 | 73.3                           | 15%                      |
| 22-Oct-14     | 3696   | CERES INC/JAPAN   | Mothers | SBI              | 11.7             | 0.9                 | 11.9                     | 84.4                            | 131.2                             | 11.2                  | 145.8                 | 93.8                           | 11%                      |
| 21-Oct-14     | 3695   | GMO RESEARCH      | Mothers | Daiwa            | 19.4             | 0.9                 | 10.9                     | 33.8                            | 78.9                              | 4.1                   | 87.7                  | 44.6                           | 32%                      |
| 17-Sep-14     | 3690   | LOCKON            | Mothers | Nomura           | 10.9             | 0.4                 | 5.1                      | 39.7                            | 152.8                             | 14.0                  | 360.4                 | 103.6                          | 161%                     |
| 2-Jul-14      | 3688   | VOYAGE GROUP      | Mothers | Nomura           | 98.6             | 3.1                 | 104.9                    | 265.4                           | 371.6                             | 3.8                   | 120.1                 | 253.8                          | -4%                      |
| 27-Jun-14     | 6096   | RAREJOB           | Mothers | Daiwa            | 11.3             | -1.1                | 3.5                      | 22.2                            | 60.0                              | 5.3                   | na                    | 54.2                           | 144%                     |
| 6-Mar-14      | 3683   | CYBERLINKS        | JQS     | Mizuho           | 71.1             | 1.5                 | 6.9                      | 35.1                            | 95.7                              | 1.3                   | 62.0                  | 69.1                           | 97%                      |
| 10-Dec-13     | 3681   | V-CUBE            | Mothers | Nomura           | 20.1             | 1.2                 | 44.3                     | 141.8                           | 215.3                             | 10.7                  | 184.3                 | 143.6                          | 1%                       |
| 29-Nov-13     | 6081   | ALLIED ARCHITECTS | Mothers | Nomura           | 10.7             | 1.3                 | 13.0                     | 70.3                            | 231.5                             | 21.5                  | 171.6                 | 43.7                           | -38%                     |
| <b>Median</b> |        |                   |         |                  | <b>19.4</b>      | <b>1.1</b>          | <b>11.9</b>              | <b>63.8</b>                     | <b>150.0</b>                      | <b>6.3</b>            | <b>138.3</b>          | <b>73.3</b>                    | <b>15%</b>               |

**GMO TECH**  
(SEO Service)



**CERES**  
(Point Media)



**GMO Research**  
(Research via Internet)



**LOCKON**  
(AdTech)



**VOYAGE GROUP**  
(Web Media & AdTech)



**RAREJOB**  
(Online English)



**CYBERLINKS**  
(Cloud Computing)



**V-CUBE**  
(Video Conferencing)



**Allied Architects**  
(Social Media Marketing)



Source: Bloomberg, Companies' website

Note:

1 US\$ = 100 JPY

2 As of December 30, 2014

# Software/Sier IPOs from 2013 to 2014

| Listing date  | Ticker | Company Name                       | Market  | Lead Underwriter                 | Revenue (US\$ m) | Net Profit (US\$ m) | Total IPO Amont (US\$ m) | Market Cap (IPO Price) (US\$ m) | Market Cap (First Price) (US\$ m) | PSR (Frist Price) (x) | PER (Frist Price) (x) | Market Cap (12/30/14) (US\$ m) | Change (IPO to 12/30/14) |
|---------------|--------|------------------------------------|---------|----------------------------------|------------------|---------------------|--------------------------|---------------------------------|-----------------------------------|-----------------------|-----------------------|--------------------------------|--------------------------|
| 16-Dec-14     | 3902   | MEDICAL DATA VISION                | Mothers | SMBC Nikko                       | 15.3             | 2.0                 | 14.3                     | 57.2                            | 135.0                             | 8.8                   | 65.9                  | 114.6                          | 100%                     |
| 27-Nov-14     | 3698   | CRI MIDDLEWARE                     | Mothers | HS                               | 9.9              | 0.5                 | 7.6                      | 33.6                            | 188.9                             | 19.1                  | 377.8                 | 146.1                          | 335%                     |
| 13-Nov-14     | 3697   | SHIFT                              | Mothers | Nomura                           | 13.1             | -0.9                | 7.8                      | 34.3                            | 158.3                             | 12.1                  | na                    | 137.4                          | 301%                     |
| 22-Oct-14     | 3694   | OPTIM                              | Mothers | Daiwa                            | 17.1             | 0.5                 | 10.6                     | 64.7                            | 233.1                             | 13.6                  | 466.2                 | 399.8                          | 518%                     |
| 30-Sep-14     | 3692   | FFRI                               | Mothers | Nomura                           | 6.6              | 1.2                 | 5.6                      | 26.7                            | 73.9                              | 11.2                  | 63.8                  | 456.8                          | 1608%                    |
| 23-Apr-14     | 3687   | FIXSTARS                           | Mothers | Mitsubishi UFJ<br>Moraan Stanley | 17.3             | 1.7                 | 4.9                      | 42.4                            | 111.0                             | 6.4                   | 65.6                  | 193.0                          | 356%                     |
| 11-Dec-13     | 3682   | ENCOURAGE TECHNOLOGIES             | Mothers | Nomura                           | 9.2              | 1.9                 | 12.9                     | 55.2                            | 119.8                             | 13.1                  | 62.7                  | 69.4                           | 26%                      |
| 22-Oct-13     | 3677   | SYSTEM INFORMATION                 | JQS     | SBI                              | 40.4             | 1.4                 | 5.1                      | 19.0                            | 90.0                              | 2.2                   | 64.3                  | 34.6                           | 82%                      |
| 22-Mar-13     | 3673   | BROADLEAF                          | TSE 1st | Nomura                           | 153.2            | 35.0                | 233.2                    | 267.4                           | 297.2                             | 1.9                   | 8.5                   | 444.7                          | 66%                      |
| 12-Mar-13     | 3671   | SOFTMAX                            | Mothers | Nomura                           | 29.6             | 0.5                 | 7.5                      | 24.9                            | 105.3                             | 3.6                   | 193.0                 | 38.2                           | 54%                      |
| 20-Feb-13     | 3670   | KYORITSU COMPUTER & COMMUNICATIONS | JQS     | Mizuho                           | 42.7             | 1.1                 | 6.0                      | 18.0                            | 60.0                              | 1.4                   | 57.1                  | 26.6                           | 48%                      |
| <b>Median</b> |        |                                    |         |                                  | <b>17.1</b>      | <b>1.2</b>          | <b>7.6</b>               | <b>34.3</b>                     | <b>119.8</b>                      | <b>8.8</b>            | <b>64.9</b>           | <b>137.4</b>                   | <b>100%</b>              |

**MEDICAL DATA VISION**  
(Medical System)



**CRI MIDDLEWARE**  
(Middleware)



**SHIFT**  
(Software Testing)



**OPTiM**  
(Security Software)



**FFRI**  
(Security Software)



**FIXSTARS**  
(Software & Multi-core Processors)



**ENCOURAGE TECHNOLOGIES**  
(IT Systems Monitoring Software)



**SYSTEM INFORMATION**  
(Customized Development of Software)



**BROADLEAF**  
(Software Development & Support)



**SOFTMAX**  
(Medical Record System)



**KYORITSU COMPUTER & COMMUNICATIONS**  
(System Solution for SMEs)



Source: Bloomberg, Companies' website

Note:

- 1 US\$ = 100 JPY
- 2 As of December 30, 2014

# Biotech/Medtech IPOs from 2013 to 2014

| Listing date  | Ticker | Company Name                 | Market  | Lead Underwriter              | Revenue (US\$ m) | Net Profit (US\$ m) | Total IPO Amont (US\$ m) | Market Cap (IPO Price) (US\$ m) | Market Cap (First Price) (US\$ m) | PSR (Frist Price) (x) | PER (Frist Price) (x) | Market Cap (12/30/14) (US\$ m) | Change (IPO to 12/30/14) |
|---------------|--------|------------------------------|---------|-------------------------------|------------------|---------------------|--------------------------|---------------------------------|-----------------------------------|-----------------------|-----------------------|--------------------------------|--------------------------|
| 25-Sep-14     | 4591   | RIBOMIC                      | Mothers | Daiwa                         | 1.5              | -2.1                | 57.2                     | 277.8                           | 221.0                             | 146.2                 | na                    | 165.1                          | -41%                     |
| 26-Mar-14     | 7779   | CYBERDYNE                    | Mothers | SMBC Nikko                    | 2.9              | -5.7                | 89.6                     | 401.6                           | 923.6                             | 322.4                 | na                    | 3,171.1                        | 690%                     |
| 13-Feb-14     | 4589   | ACUCELA                      | Mothers | Mitsubishi UFJ Morgan Stanley | 47.6             | 4.3                 | 190.4                    | 641.2                           | 819.3                             | 17.2                  | 191.4                 | 254.2                          | -60%                     |
| 24-Dec-13     | 6090   | HUMAN METABOLOME TECHNOLOGIE | Mothers | Ichiyoshi                     | 5.0              | -1.0                | 22.0                     | 66.3                            | 146.8                             | 29.6                  | na                    | 64.0                           | -4%                      |
| 6-Dec-13      | 4588   | ONCOLYS BIOPHARMA            | Mothers | SMBC Nikko                    | 4.0              | -1.0                | 66.4                     | 221.3                           | 297.9                             | 75.1                  | na                    | 71.4                           | -68%                     |
| 26-Jun-13     | 4978   | REPROCELL                    | JQG     | SMBC Nikko                    | 3.2              | -0.2                | 47.7                     | 265.6                           | 1,477.6                           | 466.8                 | na                    | 399.2                          | 50%                      |
| 11-Jun-13     | 4587   | PEPTIDREAM                   | Mothers | Mizuho                        | 2.7              | 0.1                 | 77.6                     | 322.2                           | 1,018.0                           | 378.4                 | 10,209.8              | 1,443.2                        | 348%                     |
| 13-Feb-13     | 4586   | MEDRX                        | Mothers | Nomura                        | 7.4              | -4.3                | 26.8                     | 51.1                            | 112.5                             | 15.2                  | na                    | 58.3                           | 14%                      |
| <b>Median</b> |        |                              |         |                               | <b>3.6</b>       | <b>-1.0</b>         | <b>61.8</b>              | <b>271.7</b>                    | <b>558.6</b>                      | <b>110.6</b>          | <b>5,200.6</b>        | <b>209.7</b>                   | <b>5%</b>                |

**RIBOMIC**  
(Biotech - Aptamers)



**CYBERDYNE**  
(Medical Device  
-Cyborg-type Robot)



**ACUCELA**  
(Biotech -Ophthalmic)



**HUMAN METABOLOME TECHNOLOGIE**  
(Metabolome Analysis Service)



**ONCOLYS BIOPHARMA**  
(Biotech -Infectious)



**REPROCELL**  
(iPS Cell Supply)



**PEPTIDREAM**  
(Peptide Therapeutics)



**MEDRX**  
(Biotech – Cardiovascular,  
Inflammation)














Source: Bloomberg,  
Companies' website

Note:

1 US\$ = 100 JPY

2 As of December 30, 2014

# (Reference) Mining Sector

| Ticker | Sector             | Name   | Revenue<br>(US\$ M) | Net Profit<br>(US\$ M) | Net Asset<br>(US\$ M) | Market Cap<br>(US\$ M) | PER<br>(x) | PBR<br>(x) |
|--------|--------------------|--|---------------------|------------------------|-----------------------|------------------------|------------|------------|
| 8058   |                    |  MITSUBISHI CORP<br>Mitsubishi Corporation              | 76,352              | 3,614                  | 55,394                | 35,266                 | 9.8        | 0.64       |
| 8031   |                    |  MITSUI & CO LTD<br>MITSUI & CO., LTD.                  | 57,319              | 3,501                  | 41,003                | 30,837                 | 8.8        | 0.75       |
| 8001   | Trading<br>Company |  ITOCHU CORP<br>ITOCHU                                  | 55,875              | 2,453                  | 23,995                | 22,067                 | 9.0        | 0.92       |
| 8053   |                    |  SUMITOMO CORP<br>Sumitomo Corporation                  | 33,174              | 2,231                  | 25,402                | 16,752                 | 7.5        | 0.66       |
| 8002   |                    |  MARUBENI CORP<br>Marubeni                              | 70,557              | 2,109                  | 15,332                | 13,130                 | 6.2        | 0.86       |
| 2768   |                    |  SOJITZ CORP<br>Sojitz                                  | 18,031              | 273                    | 4,930                 | 2,165                  | 7.9        | 0.44       |
| 1605   | Oil, Gas           |  INPEX CORP<br>INPEX CORPORATION                        | 13,346              | 1,837                  | 29,960                | 21,825                 | 11.9       | 0.73       |
| 1662   |                    |  JAPAN PETROLEUM EXPLORATION<br>JAPEX                   | 2,766               | 290                    | 4,969                 | 2,206                  | 7.6        | 0.44       |
| 1515   | Limestone          |  NITTETSU MINING CO LTD<br>NITTETSU MINING              | 1,143               | 39                     | 848                   | 373                    | 9.5        | 0.44       |
| 1518   | Coal               |  MITSUI MATSUSHIMA CO LTD<br>Mitsui Matsushima Co Ltd | 773                 | 15                     | 328                   | 189                    | 12.3       | 0.57       |
| 1514   |                    |  SUMISEKI HOLDINGS INC<br>SUMISEKI                    | 246                 | 4                      | 58                    | 71                     | 18.3       | 1.21       |
|        |                    | Average (Trading Cos)  | 51,885              | 2,363                  | 27,676                | 20,036                 | 8.2        | 0.71       |
|        |                    | Median (Trading Cos)   | 56,597              | 2,342                  | 24,699                | 19,409                 | 8.4        | 0.71       |
|        |                    | Average (excluding Trading Cos)  | 3,655               | 437                    | 7,233                 | 4,933                  | 11.9       | 0.68       |
|        |                    | Median (excluding Trading Cos)   | 1,143               | 39                     | 848                   | 373                    | 11.9       | 0.57       |
|        |                    | Average (Coal Cos)   | 510                 | 10                     | 193                   | 130                    | 15.3       | 0.89       |
|        |                    | Average  | 29,962              | 1,488                  | 18,384                | 13,171                 | 9.9        | 0.70       |
|        |                    | Median   | 18,031              | 1,837                  | 15,332                | 13,130                 | 9.0        | 0.66       |

Source: Bloomberg

Note: As of August 22, 2014

# (Reference) Privatization

| Ticker           | Sector               | Name   | Revenue<br>(US\$ M) | Net Profit<br>(US\$ M) | Net Asset<br>(US\$ M) | Market Cap<br>(US\$ M) | PER<br>(x) | PBR<br>(x) |
|------------------|----------------------|--|---------------------|------------------------|-----------------------|------------------------|------------|------------|
| 1605             | Mining<br>(Oil, Gas) | INPEX CORP<br><br>INPEX CORPORATION | 13,346              | 1,837                  | 29,960                | 21,825                 | 11.9       | 0.73       |
| 1662             |                      | JAPAN PETROLEUM EXPLORATION<br>     | 2,766               | 290                    | 4,969                 | 2,206                  | 7.6        | 0.44       |
| 9513             | Power<br>Utilities   | ELECTRIC POWER DEVELOPMENT CO<br>   | 7,068               | 287                    | 5,195                 | 5,630                  | 19.6       | 1.08       |
| 9432             | Telecom              | NIPPON TELEGRAPH & TELEPHONE<br>    | 109,252             | 5,855                  | 109,248               | 78,546                 | 13.4       | 0.72       |
| 9437             |                      | NTT DOCOMO INC<br>                  | 44,612              | 4,647                  | 56,935                | 79,639                 | 17.1       | 1.40       |
| 2914             | Tobacco              | JAPAN TOBACCO INC<br>               | 23,998              | 4,280                  | 25,961                | 72,610                 | 17.0       | 2.80       |
| 9020             | Railway              | EAST JAPAN RAILWAY CO<br>         | 27,029              | 1,999                  | 21,994                | 33,030                 | 16.5       | 1.50       |
| 9022             |                      | CENTRAL JAPAN RAILWAY CO<br>      | 16,525              | 2,557                  | 18,023                | 30,993                 | 12.1       | 1.72       |
| 9021             |                      | WEST JAPAN RAILWAY CO<br>         | 13,310              | 656                    | 8,074                 | 9,542                  | 14.5       | 1.18       |
| Average (Mining) |                      |  | 8,056               | 1,064                  | 17,465                | 12,016                 | 9.7        | 0.59       |
| Average          |                      |  | 28,656              | 2,490                  | 31,151                | 37,114                 | 14.4       | 1.29       |
| Median           |                      |  | 16,525              | 1,999                  | 21,994                | 30,993                 | 14.5       | 1.18       |

Source: Bloomberg

Note: As of August 22, 2014



1. Japan-Mongolia Relations

2. Comparison among Major Stock Markets

3. Expansion of IPO Market in Japan

**4. Features of IPO Market in Japan**

5. Listing on Tokyo Stock Exchange

A. TOKYO PRO Market

B. Overview of the Japanese Financial Market



# Features of IPO Market in Japan

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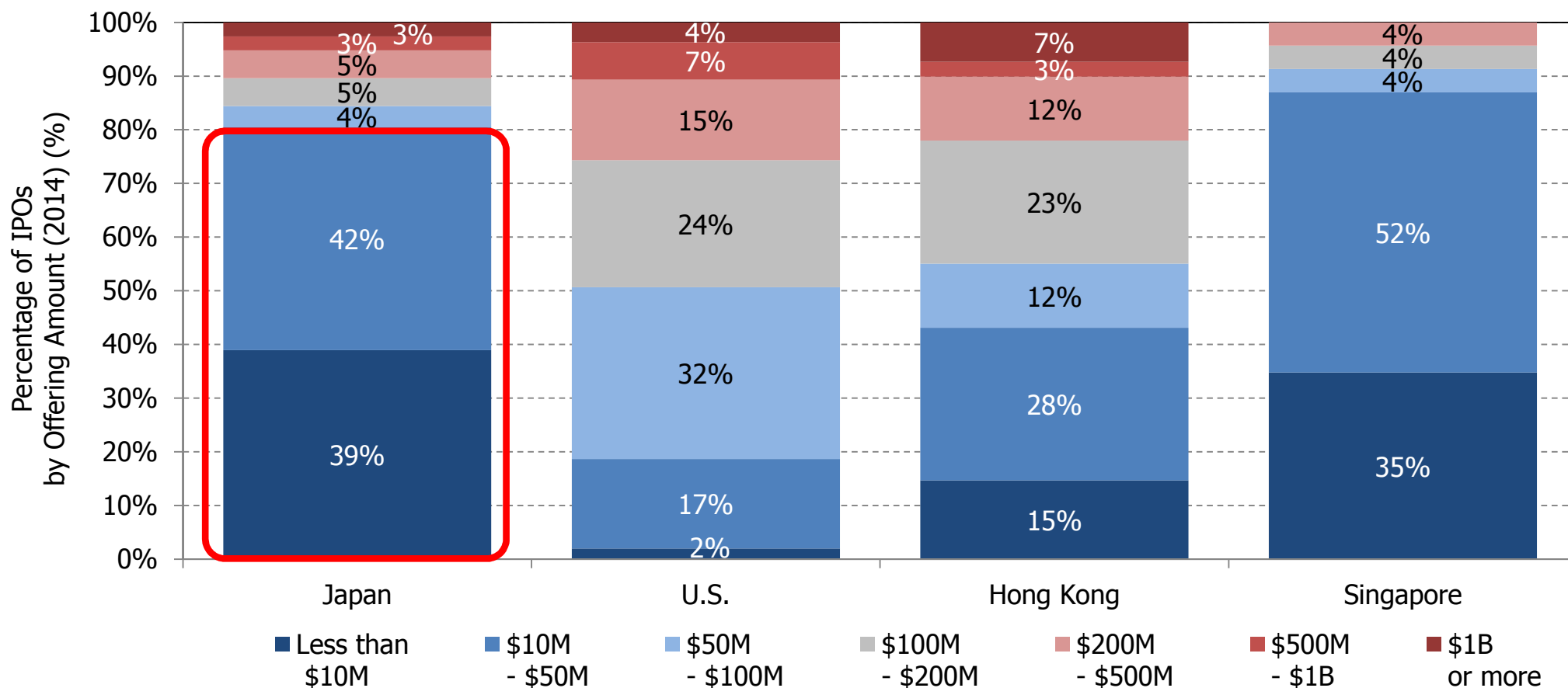
- 1 Successful Small IPOs**
- 2 High Liquidity**
- 3 Low IPO Cost & High IPO Valuation**
- 4 Many Companies Moved up to the TSE 1st Section**
- 5 Successful Follow-on Offerings**
- 6 Large IPOs**

# 1. Successful Small IPOs

## - IPO Deal Size Comparison of JP, US, HK and SG

More than 80% of IPOs in Japan raised less than \$50M.

Comparison of Number of IPOs by Offering Amount in 2014 (Japan, US, Hong Kong, Singapore)



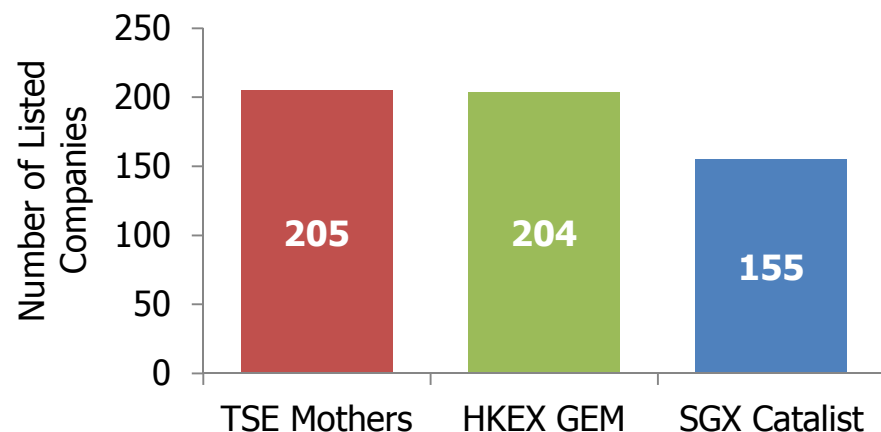
Source: Tokyo Stock Exchange, NASDAQ website, Hong Kong Exchanges and Clearing Limited website, Singapore Exchange website

Note: The total number of IPOs in each country. It includes new listings of foreign companies in the country, excludes listings without public offerings or selling and JREIT. It includes new listings on NASDAQ and NYSE in the United States. Exchange rates as of the listing date.

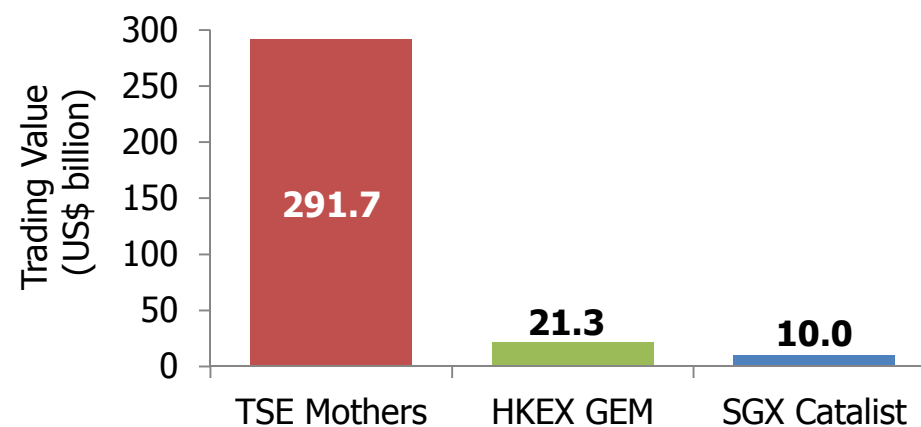
## 2. High Liquidity - Comparison of Emerging Enterprise Markets

**TSE Mothers is larger and more liquid than HKEX GEM and SGX Catalyst.**

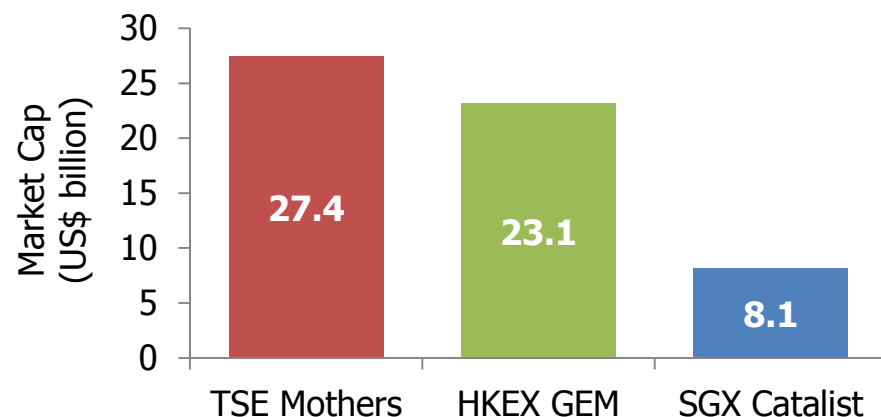
**Number of Listed Companies (as at of end of Dec. 2014)**



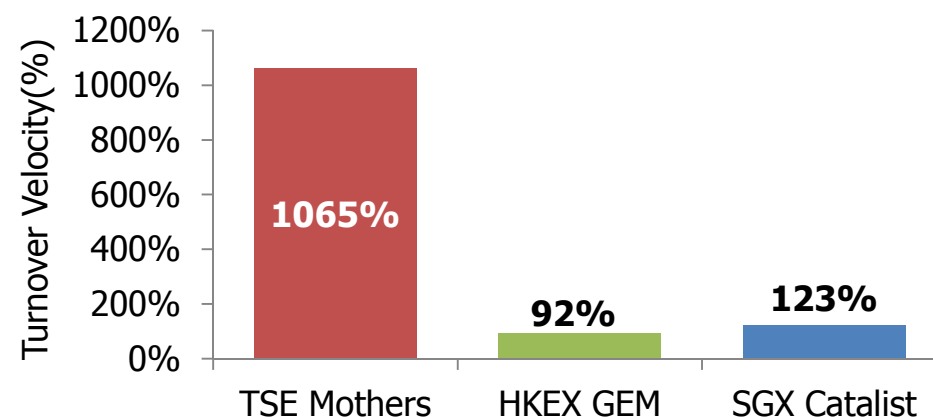
**Annual Trading Value (2014)<sup>1</sup>**



**Market Capitalization (as of end of Dec. 2014)<sup>1</sup>**



**Turnover Velocity (2014)<sup>2</sup>**



Source: Tokyo Stock Exchange, Hong Kong Exchanges and Clearing Limited, Singapore Exchange

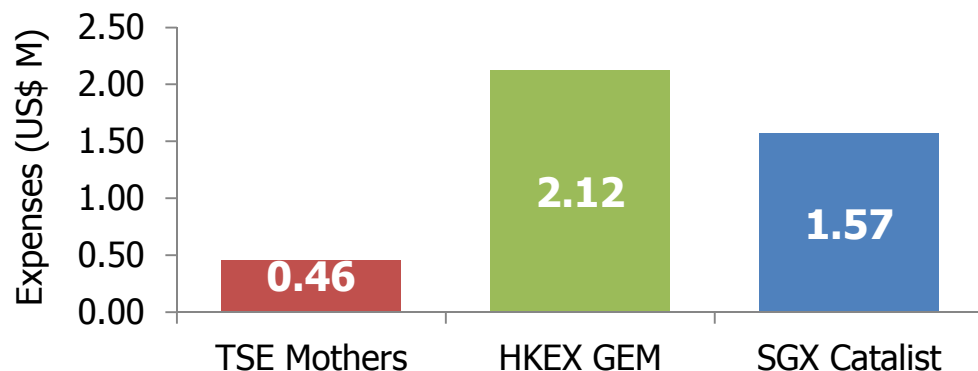
Note: 1 Converted into USD as at the end of Dec 2014

2 Turnover Velocity = Annual Trading Value / Market Capitalization as at the end of Dec. 2014

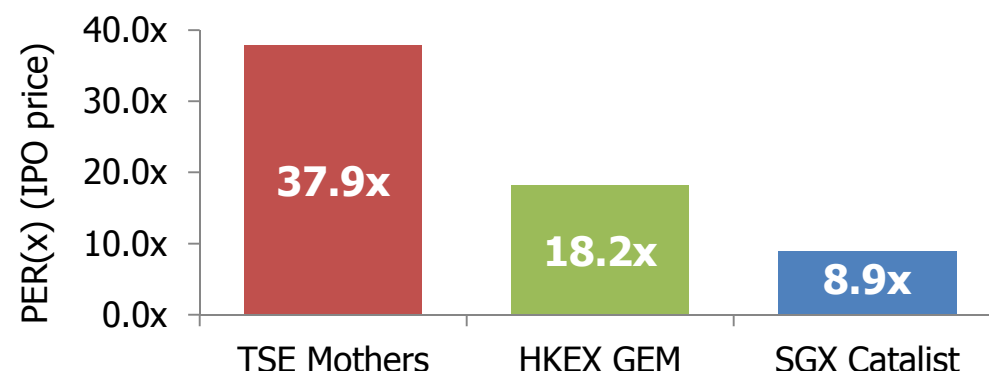
# 3. Low IPO Cost & High IPO Valuation

**Listing expenses at listing on TSE Mothers is much lower than the others.  
 IPO valuation in TSE Mothers is relatively higher than IPO valuation in the others.**

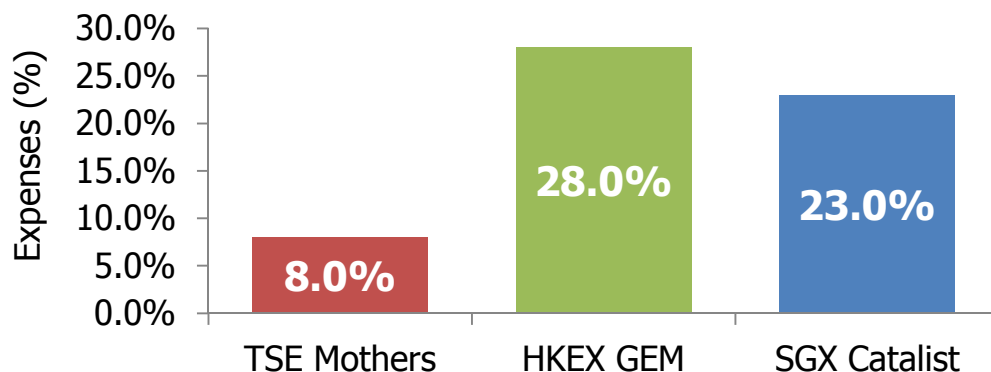
**The Median of Expenses through IPO (2014)**



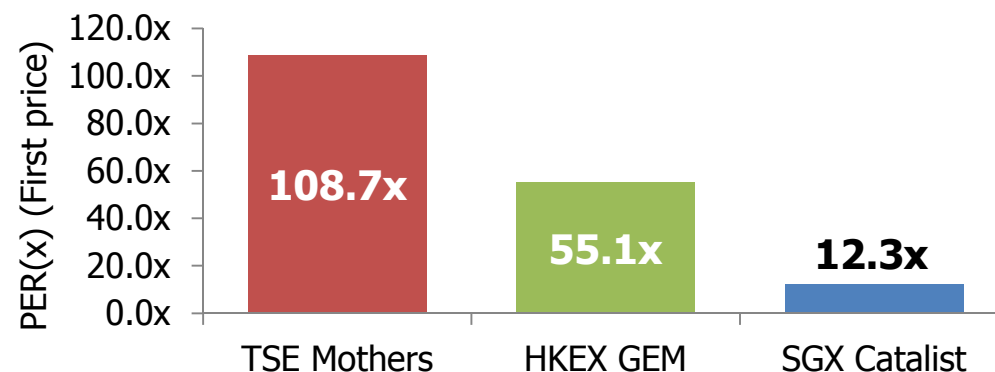
**The Median of PE Ratio of IPO Price (2014)**



**The Median of Expenses Ratio through IPO (2014)**



**The Median of PE Ratio of First Price (2014)**



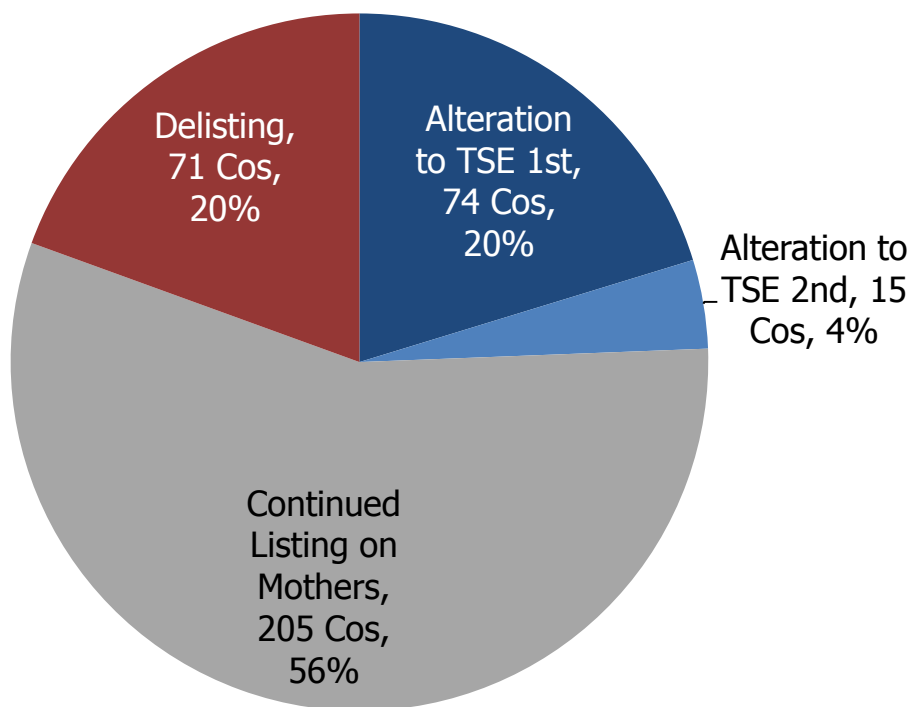
Source: Prospectus and annual report of each company.

- Note: 1 Listing expenses is defined as the difference between gross proceeds and net proceeds.  
 2 Currency exchange rates are as of the listing date.

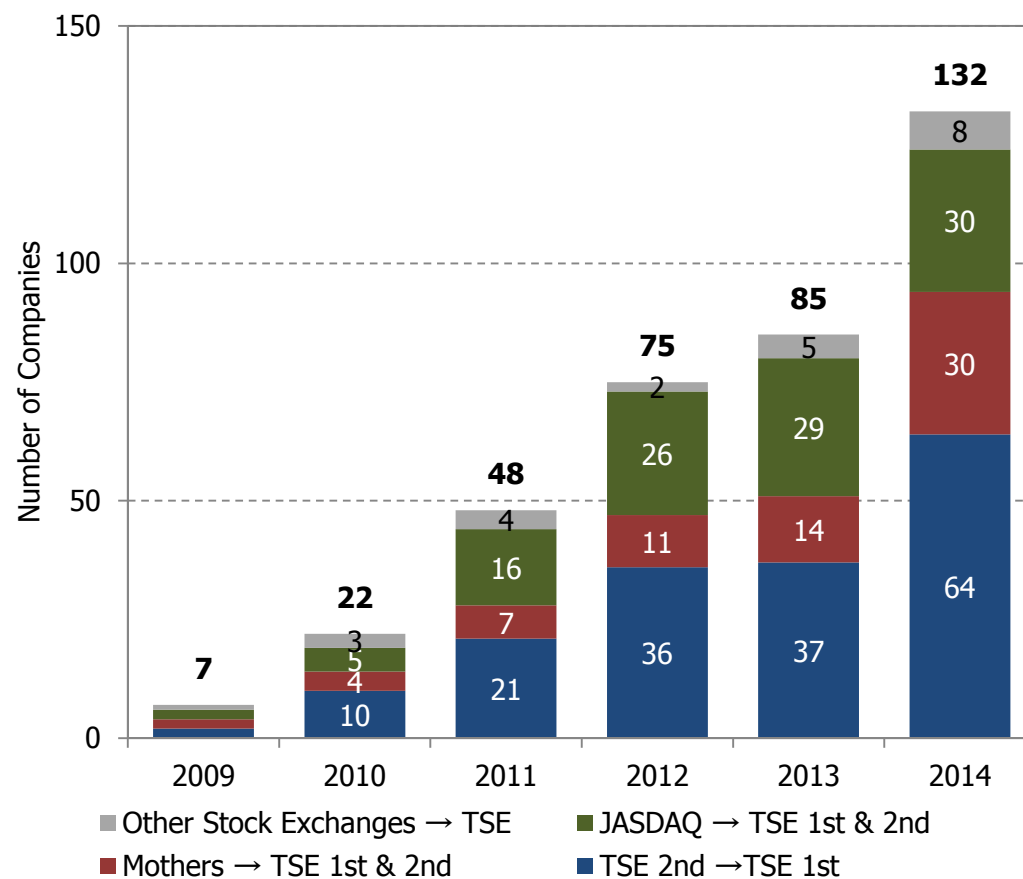
# 4. Post-listing Trends on Mothers

**20% of Mothers IPO companies (74 cos.) moved up to the TSE 1st Section.**

**Post-listing Trends on Mothers  
(365 companies)**



**Trend of Market Transfers**



Note: As of the end of 2014

Note: As of the end of 2014

# 5. Successful Follow-on Offerings

Companies of Emerging Enterprise Markets successfully conduct follow-on offerings.

## Largest 25 Follow-on Offerings in 2014

| #         | Date             | Ticker      | Market         | Company                      | Sector                                 | Offering Amount<br>(US\$ M) | Offering Place     |
|-----------|------------------|-------------|----------------|------------------------------|--|-----------------------------|--------------------|
| 1         | 23-Jun-14        | 8801        | TSE 1st        | MITSUI FUDOSAN CO LTD        | Real Estate                            | 3,138                       | Japan and Overseas |
| 2         | 23-Jul-14        | 8750        | TSE 1st        | DAI-ICHI LIFE INSURANCE      | Insurance                              | 2,590                       | Japan and Overseas |
| 3         | 29-Jan-14        | 7211        | TSE 1st        | MITSUBISHI MOTORS CORP       | Transportation Equipment               | 2,439                       | Japan and Overseas |
| 4         | 26-Feb-14        | 5406        | TSE 1st        | KOBE STEEL LTD               | Iron & Steel                           | 650                         | Japan and Overseas |
| 5         | 12-Mar-14        | 7550        | TSE 1st        | ZENSHO HOLDINGS CO LTD       | Retail Trade                           | 251                         | Japan              |
| <b>6</b>  | <b>12-Dec-14</b> | <b>7779</b> | <b>Mothers</b> | <b>CYBERDYNE INC</b>         | <b>Precision Instruments</b>           | <b>221</b>                  | <b>Overseas</b>    |
| 7         | 19-Mar-14        | 6141        | TSE 1st        | DMG MORI SEIKI CO LTD        | Machinery                              | 209                         | Overseas           |
| 8         | 16-Dec-14        | 9044        | TSE 1st        | NANKAI ELECTRIC RAILWAY CO   | Land Transportation                    | 188                         | Japan              |
| 9         | 22-Oct-14        | 3360        | TSE 1st        | SHIP HEALTHCARE HOLDINGS INC | Wholesale Trade                        | 173                         | Japan              |
| 10        | 17-Jun-14        | 3880        | TSE 1st        | DAIO PAPER CORP              | Pulp & Paper                           | 132                         | Japan              |
| 11        | 25-Nov-14        | 3258        | TSE 1st        | JOWA HOLDINGS CO LTD         | Real Estate                            | 103                         | Japan              |
| 12        | 17-Jun-14        | 4631        | TSE 1st        | DIC CORP                     | Chemicals                              | 98                          | Japan              |
| <b>13</b> | <b>21-Apr-14</b> | <b>3668</b> | <b>Mothers</b> | <b>COLOPL INC</b>            | <b>Information &amp; Communication</b> | <b>98</b>                   | <b>Japan</b>       |
| 14        | 27-Nov-14        | 2193        | TSE 1st        | COOKPAD INC                  | Services                               | 90                          | Overseas           |
| <b>15</b> | <b>17-Mar-14</b> | <b>2121</b> | <b>Mothers</b> | <b>MIXI INC</b>              | <b>Services</b>                        | <b>69</b>                   | <b>Japan</b>       |
| 16        | 22-Apr-14        | 6269        | TSE 1st        | MODEC INC                    | Machinery                              | 62                          | Japan              |
| <b>17</b> | <b>09-Jul-14</b> | <b>7777</b> | <b>JASDAQ</b>  | <b>3-D MATRIX LTD</b>        | <b>Precision Instruments</b>           | <b>53</b>                   | <b>Overseas</b>    |
| <b>18</b> | <b>04-Jun-14</b> | <b>6079</b> | <b>Mothers</b> | <b>ENERES CO LTD</b>         | <b>Services</b>                        | <b>51</b>                   | <b>Japan</b>       |
| 19        | 02-Sep-14        | 7294        | TSE 1st        | YOROZU CORP                  | Transportation Equipment               | 47                          | Japan              |
| 20        | 22-Jul-14        | 7283        | TSE 1st        | AISAN INDUSTRY CO LTD        | Transportation Equipment               | 47                          | Japan              |
| <b>21</b> | <b>11-Mar-14</b> | <b>4565</b> | <b>Mothers</b> | <b>SOSEI GROUP CORP</b>      | <b>Pharmaceutical</b>                  | <b>44</b>                   | <b>Japan</b>       |
| 22        | 27-Nov-14        | 3397        | TSE 1st        | TORIDOLL.CORP                | Retail Trade                           | 42                          | Japan              |
| 23        | 27-Jan-14        | 7212        | TSE 1st        | F-TECH INC                   | Transportation Equipment               | 39                          | Japan              |
| 24        | 16-Jun-14        | 7148        | TSE 1st        | FINANCIAL PRODUCTS GROUP CO  | Securities & Commodity Futures         | 38                          | Japan              |
| 25        | 06-Mar-14        | 5852        | TSE 2nd        | AHRESTY CORP                 | Nonferrous Metals                      | 34                          | Japan              |

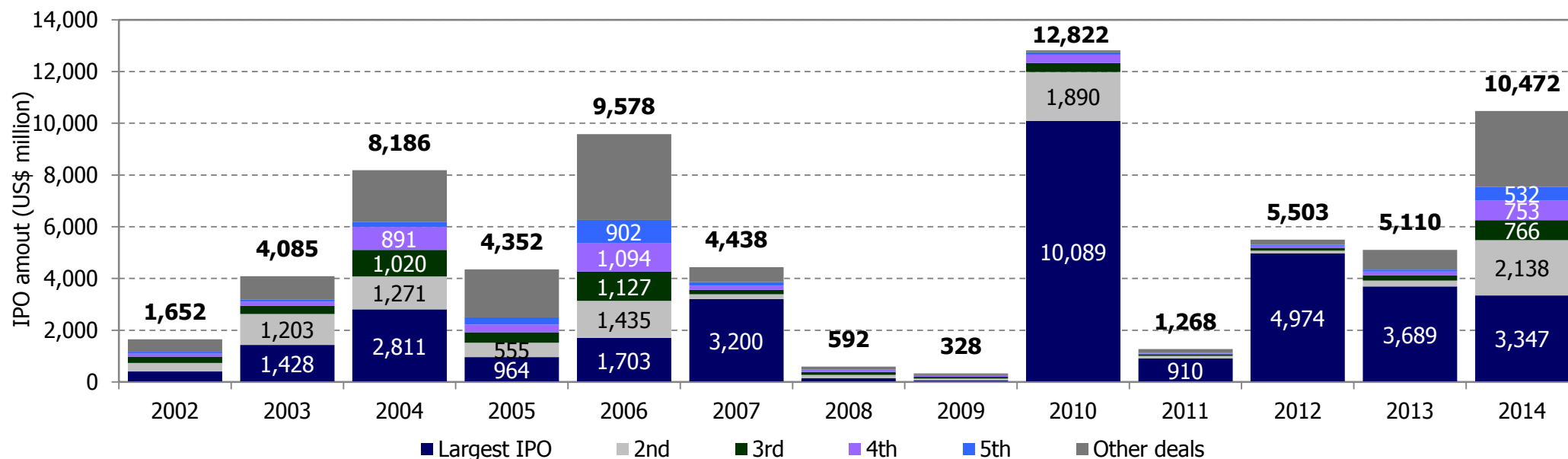
Source: TSE

Note: 1 US\$ = 100 JPY

# 6. Large IPOs

**Dai-ichi Life's IPO in 2010 was the largest deal that exceeded US\$ 1 billion.**

## Historical IPO Amount on TSE



|                | 2002                    | 2003                        | 2004                       | 2005                 | 2006                        | 2007                    | 2008               | 2009                          | 2010                        | 2011                       | 2012              | 2013                    | 2014               |
|----------------|-------------------------|-----------------------------|----------------------------|----------------------|-----------------------------|-------------------------|--------------------|-------------------------------|-----------------------------|----------------------------|-------------------|-------------------------|--------------------|
| <b>Largest</b> | SOHGO SECURITY SERVICES | NEC Electronics             | Electric Power Development | SUMCO                | Aozora Bank                 | Sony Financial Holdings | Hulic              | Japan Drilling                | The Dai-ichi Life Insurance | NEXON                      | Japan Airlines    | Suntory Beverage & Food | Japan Display      |
| <b>2nd</b>     | NEC Fielding            | SEIKO EPSON                 | Shinsei Bank               | The Tokyo Star Bank  | Nomura Real Estate Holdings | KITO                    | Morimoto           | FOI                           | Otsuka Holdings             | CALBEE                     | LIFENET INSURANCE | Ashikaga Holdings       | Recruit Holdings   |
| <b>3rd</b>     | NS Solutions            | Japan Petroleum Exploration | Elpida Memory              | PGM Holdings         | Accordia Golf               | Universal Studios Japan | GREE               | Mitsubishi Research Institute | Paltac                      | W-SCOPE                    | ZENKOKU HOSHO     | Broadleaf               | Hitachi Maxell     |
| <b>4th</b>     | AEON Mall               | OncoTherapy Science         | NTT URBAN DEVELOPMENT      | So-net Entertainment | Idemitsu Kosan              | TS TECH                 | HOSHIZAKI ELECTRIC | Jowa Holdings                 | POLA ORBIS HOLDINGS         | Poletowin Pitcrew Holdings | CHIMNEY           | Open House              | Skylark            |
| <b>5th</b>     | NEC Mobiling            | Century Leasing System      | ULVAC                      | HAKUHODO DY HOLDINGS | Takata                      | The Yachiyo Bank        | Tri-Stage          | COOKPAD                       | Tera Probe                  | Kurotani Corporation       | COLOPL            | Tama Home               | TechnoPro Holdings |

Source: TSE

Note: Including domestic selling. Excluding REITs, overseas selling, and over-allotment. Shaded pink deals exceeded US\$ 500 million. 1 USD = 100 JPY  
IPOs on OSE including JASDAQ has included since July 16, 2013 when the equity market of TSE and OSE.



1. Japan-Mongolia Relations

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# Key Benefits of Listing on TSE

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## Fundraising

- ✓ Expand fundraising opportunities with High Net Worth Individuals that hold US\$15.68 trillion in assets as of end of 2013
  - ✓ High valuation due to great interest in foreign stocks
- 

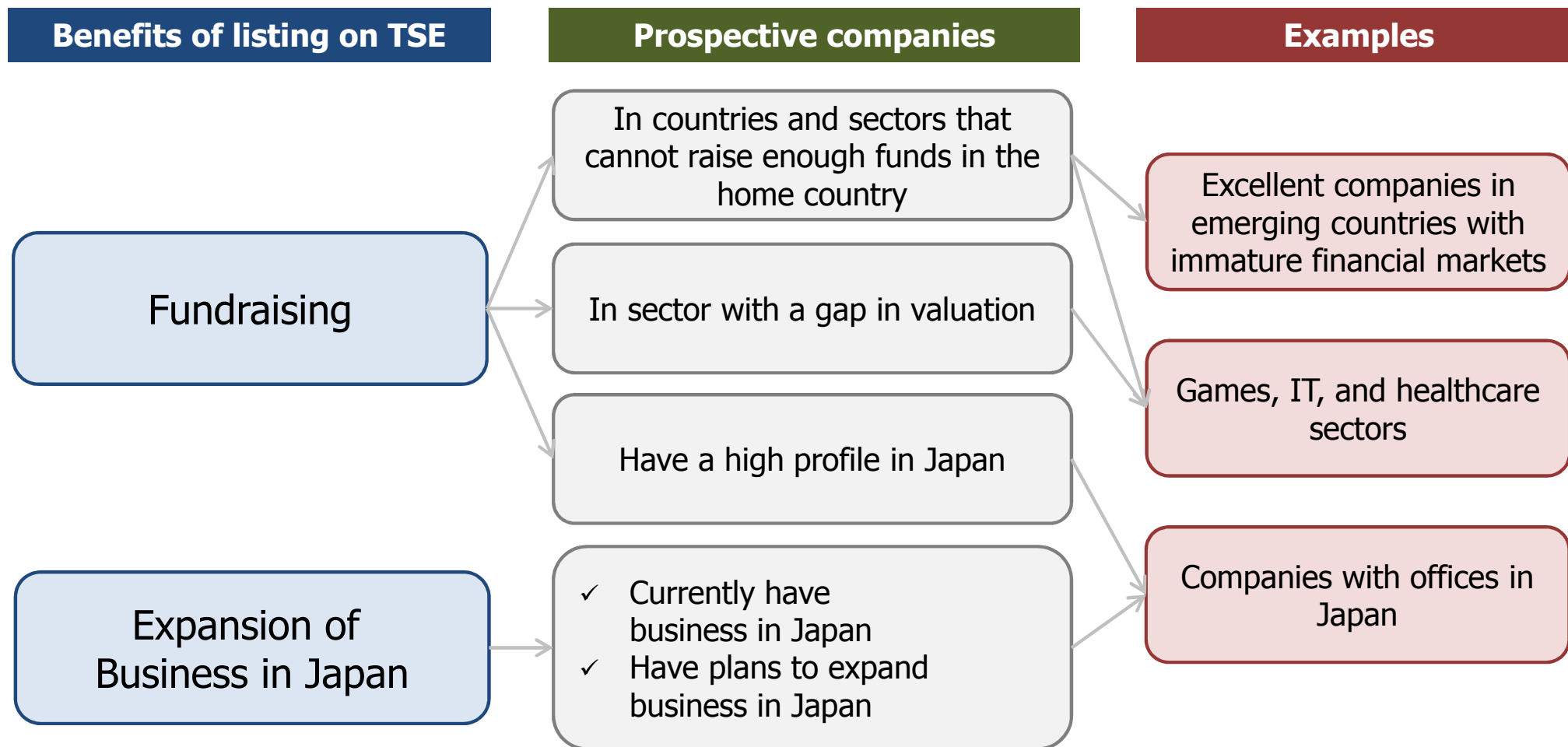
## Expansion of Business in Japan

- ✓ Enhance corporate profile and credibility in Japan
  - ✓ Expand opportunities for strategic alliances with Japanese corporations
- 

## M&A with Japanese Companies

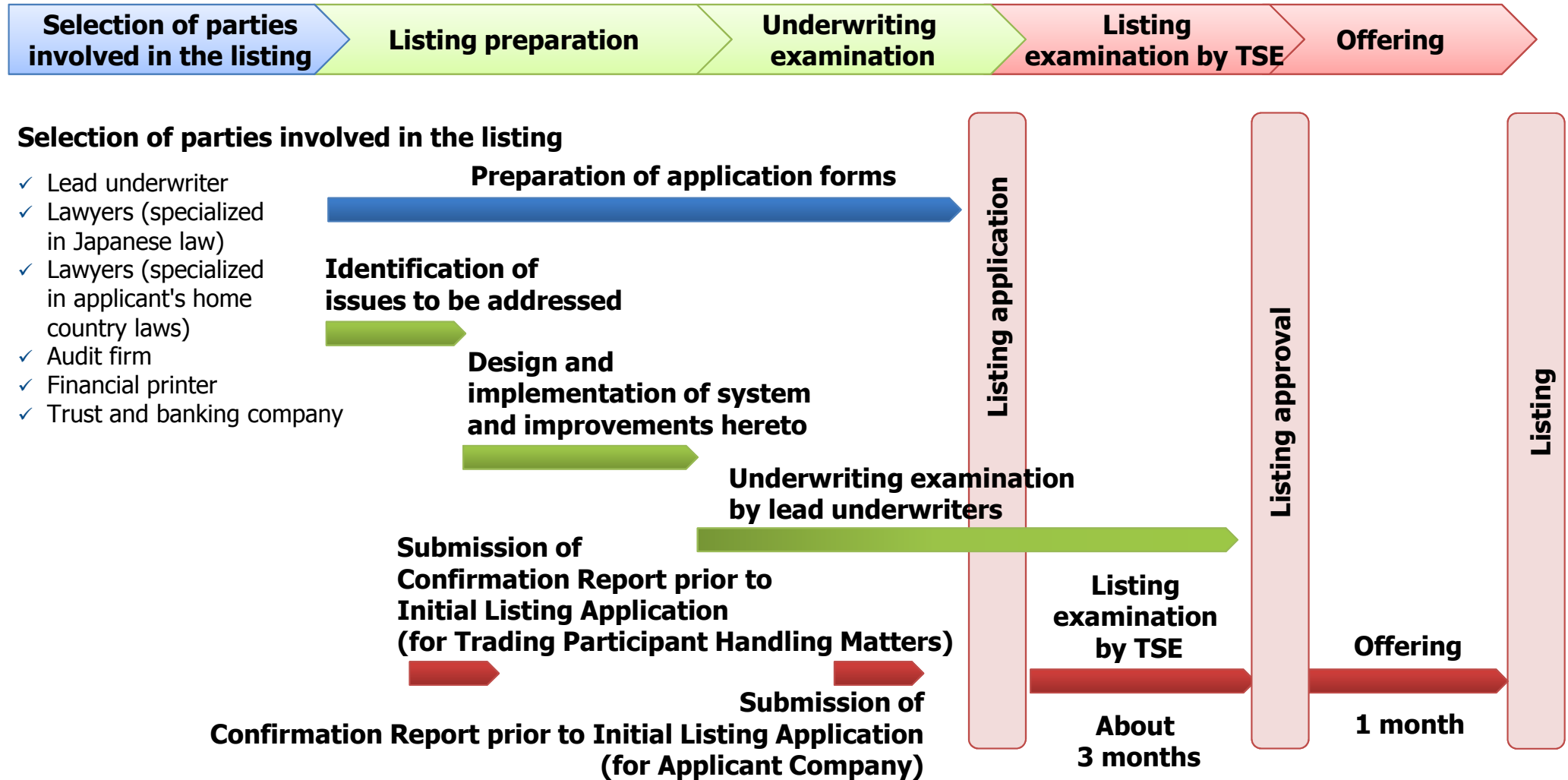
- ✓ Increase chances of M&A with Japanese corporations
-

# Prospective Companies

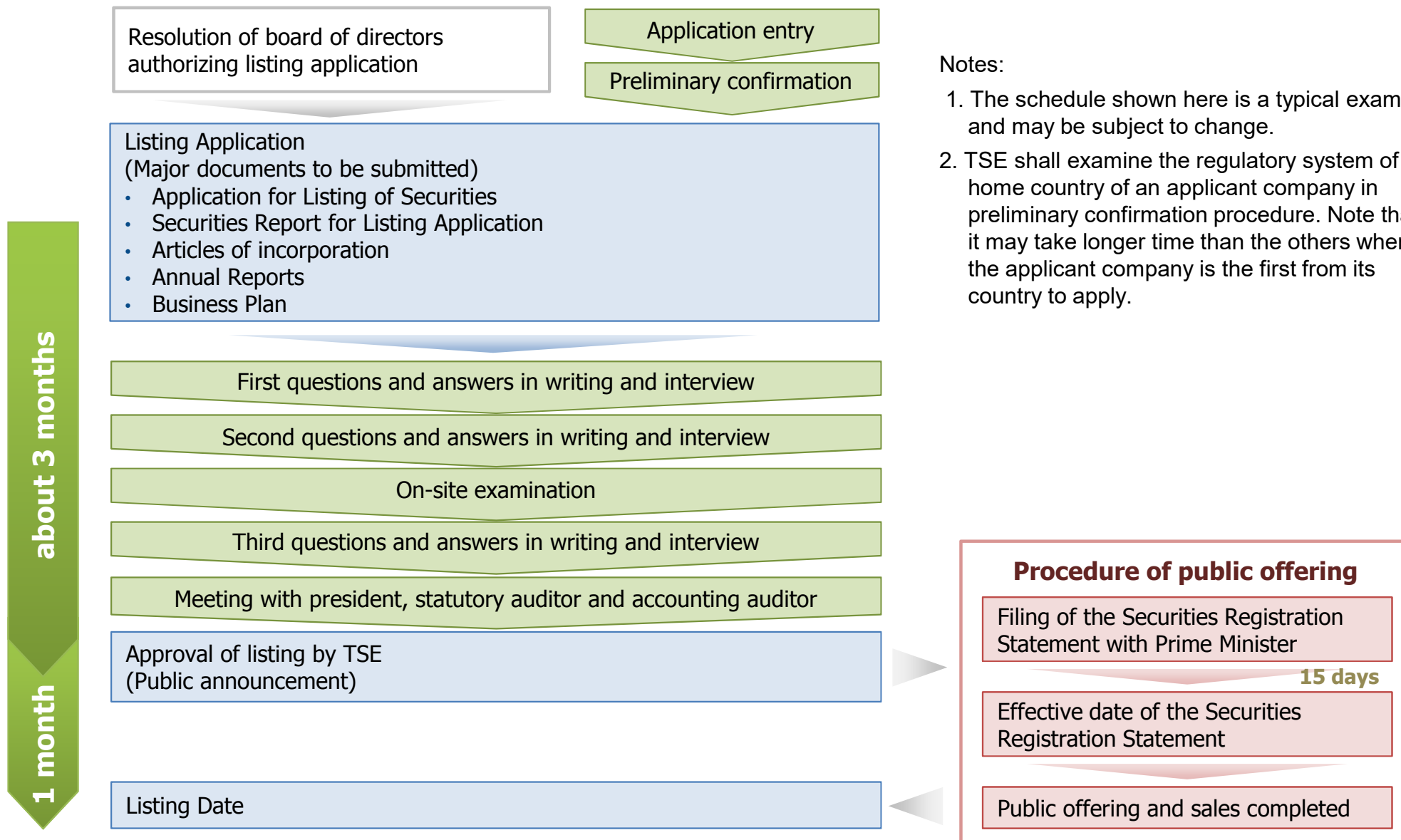


# Listing Schedule

Depending on the internal systems of the company, however, it takes about one year from kick-off to listing. Note that the company needs to be audited for two business years.



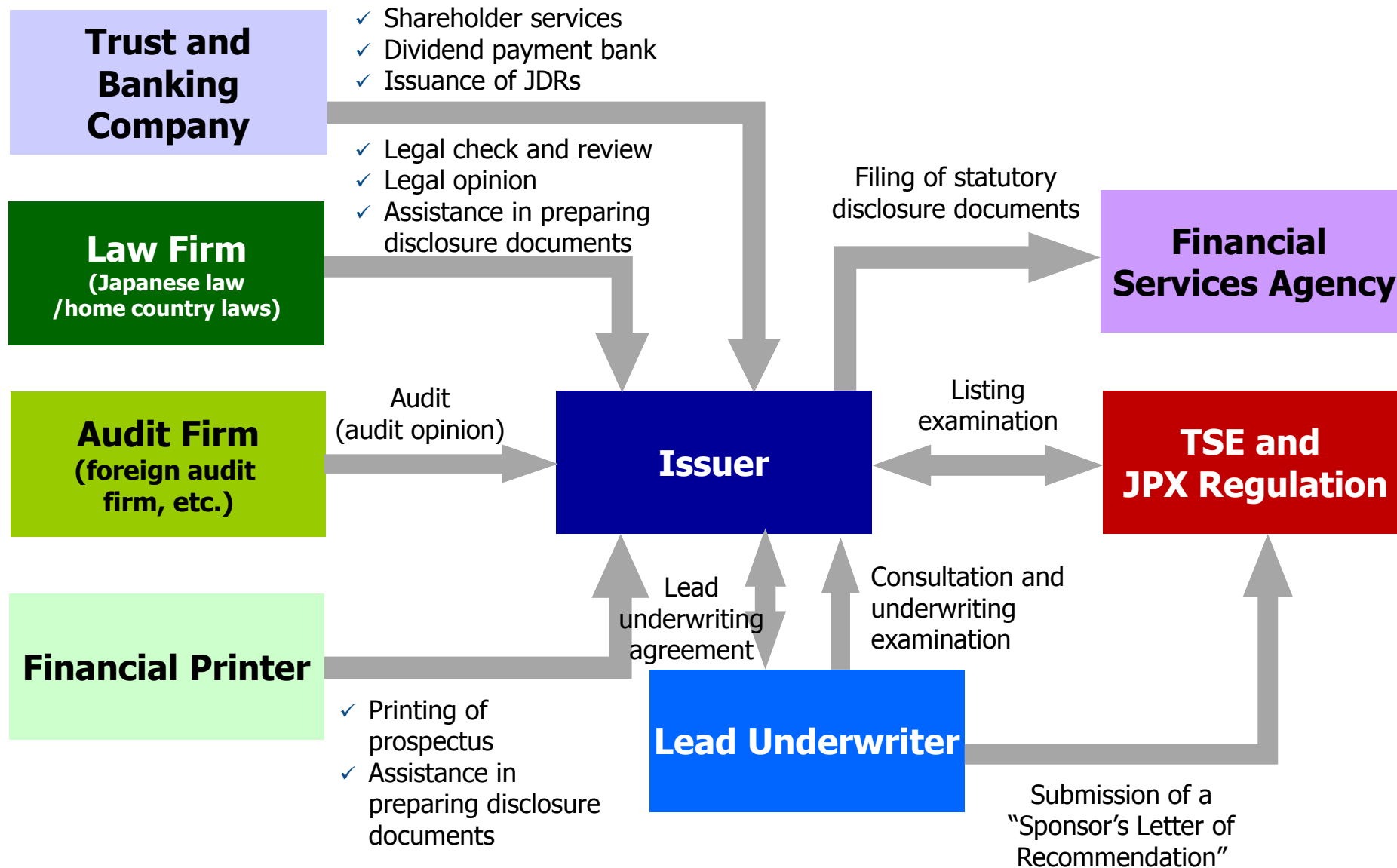
# Listing Examination Schedule



**Notes:**

1. The schedule shown here is a typical example and may be subject to change.
2. TSE shall examine the regulatory system of the home country of an applicant company in preliminary confirmation procedure. Note that, it may take longer time than the others when the applicant company is the first from its country to apply.

# Roles of Each Party Involved in an IPO



# Roles of Each Party Involved in an IPO

The following are the key parties in Japan and the home country who support the listing of a foreign company on TSE. These participants work together closely during the pre-listing process to support preparations for a listing.

● **Lead Underwriter (TSE trading participant)**, is comprehensively involved in the procedures and preparations for listing overall. It provides underwriting business by entering into a lead underwriting agreement with an issuer and provides advice and consultation on the listing and listing schedule. At the time of listing, the lead underwriter submits a Sponsor's Letter of Recommendation to TSE.

● **Law Firm**, checks and reviews listing-related matters from a legal perspective and prepares a legal opinion. It also helps the applicant prepare disclosure documents. After listing, it discloses corporate information as a legal representative of the listed foreign company.

● **Audit Firm (foreign audit firm, etc.)**, provides provides advice on the design and implementation of the accounting organization and financial statements and also audits the financial statements (expression of an audit opinion).

● **Trust and Banking company**, acts as a shareholder services agent for Japanese shareholders after the listing and may act as a dividend payment bank to provide services related to dividend payment. If a foreign company lists through JDRs, the trust and banking company will be responsible for the issuance of the JDRs. Please see section 7 for details on listing through JDRs.

● **Tokyo Stock Exchange**, explains its listing system to companies, IPO-related parties, and so on, and provides preliminary or prior consultation on the listing.

# Formal Requirements for Listing

Each market has different criteria in line with its concept.

|  | Main Market  |                                 | Mothers                          | JASDAQ   |              | TOKYO PRO Market |
|--|--|---------------------------------|----------------------------------|--|--------------|------------------|
|  | 1st Section  | 2nd Section                     |                                  | Standard   | Growth       |                  |
| Number of shareholders                     | 2,200 or more  | 800 or more                     | 200 or more                      | 200 or more  |              | —                |
| Tradable shares                            |  |                                 |                                  |  |              |                  |
| Number of tradable shares                  | 20,000 units or more   | 4,000 units or more             | 2,000 units or more              | —  |              | —                |
| Market capitalization of tradable shares   | JPY 1 billion (USD 10m) or more  | JPY 1 billion (USD 10m) or more | JPY 500 million (USD 5m) or more | JPY 500 million (USD 5m) or more   |              | —                |
| Ratio of tradable shares to listed shares  | 35% or more  | 30% or more                     | 25% or more                      | —  |              | —                |
| Public offering                            | —  | —                               | 500 trading units or more        | 10 percent or more or 1,000 trading units  |              | —                |
| Market capitalization of listed shares     | JPY 25 billion (USD 250m) or more  | JPY 2 billion (USD 20m) or more | JPY 1 billion (USD 10m) or more  | —  |              | —                |
| Number of years of business operation      | 3 years or more  |                                 | 1 year or more                   | —  |              | —                |
| Shareholders' equity                       | JPY 1 billion (USD 10m) or more  |                                 | —                                | JPY 200 million (USD 2m) or more   | Not negative | —                |
| Amount of profits or Market capitalization | [Ordinary profit]<br>Total amount of JPY500 million (USD 5m) or more in the last 2 fiscal years<br>[Market cap]<br>Market cap: JPY 50 billion (USD 500m) or more<br>Sales: JPY 10 billion (USD 100m) or more |                                 | —                                | [Ordinary profit]<br>JPY100 million (USD 1m) or more<br>[Market cap]<br>JPY5 billion (USD 50m) or more | —            | —                |

Note: 1US\$ = 100JPY

# Overview of Listing Examination for Mothers

TSE examines the company, which meets “Formal Requirements” and conducts an examination based on the “Eligibility Requirements.”

When applying TSE rules to a foreign country or a foreign corporation where the foreign country or the foreign corporation is an issuer of a listed security, TSE shall also take into account the legal systems, practices and customs in such foreign country or the country of the foreign corporation.

- 1 Appropriateness of the Disclosure of Corporate Information, Risk Information, etc.**
  - The company is able to make disclosure of the corporate information, risk information, etc. may be carried out in an appropriate manner
- 2 Soundness of Corporate Management**
  - The company is carrying out business in a fair and faithful manner
- 3 Effectiveness of Corporate Governance and Internal Management System of an Enterprise**
  - Corporate governance and internal management system are developed in accordance with the size, corporate maturity, etc. of the enterprise, and functioning properly
- 4 Reasonableness of the business plan**
  - The listing applicant has developed reasonable and suitable business plans, and has developed the operating base necessary for executing such business plans, or there is reasonable expectation that it will develop such operating base
- 5 Other matters deemed necessary by the Exchange from the viewpoint of the public interest or the protection of investors**
  - a. Shareholders’ rights and exercise of such rights are not unduly restricted.
  - b. Relationship with a parent company is deemed appropriate.
  - c. Other matters are deemed appropriate in light of public interest and investor protection.



# Listing Fees to Tokyo Stock Exchange

## Fees for Initial Listing on TSE

|                                  | When TSE is the main market  |                | When TSE is not the main market                | Mothers  | JASDAQ      |
|----------------------------------|--|----------------|--|--|-------------|
|                                  | First Section  | Second Section | First & Second Sections                        |  |             |
| <b>Listing Examination Fee</b>   | US\$ 40,000  |                | US\$ 20,000                                    | US\$ 20,000  | US\$ 20,000 |
| <b>Initial Listing Fee</b>       | US\$ 150,000   | US\$ 120,000   | US\$ 25,000<br>+ Fixed rate fee<br>(See below) | US\$ 10,000  | US\$ 60,000 |
| <b>Public Offering/Sales Fee</b> | Number of new shares offered × offer price × (9/10,000)<br>Number of existing shares sold × sales price × (1/10,000) |                | —  | Number of new shares offered × offer price × (9/10,000)<br>Number of existing shares sold × sales price × (1/10,000) | —           |

Note:

- 1 US\$ = 100JPY
- 2 Furthermore, in cases where an applicant previously filed a listing application or preliminary application and the applicant intends to file a re-application within three years counting from the beginning of the business year to which the most recent application date belongs (in case of the preliminary application, the date which was described in the preliminary application form for listing of securities as the date on which the listing application was expected to be filed), the listing fees is expected to be halved.
- 3 When TSE implements a on-site visit or meeting, etc. at locations remote from Japan, in particular including Europe, the US, and so on, TSE will separately charge the applicant the amount equivalent to actual expenses incurred for the on-site visit and meeting purposes.

## Initial Listing Fee for Foreign Stock, etc. with a Main Market Listing on any Overseas Exchange

Initial listing fee for foreign stock, etc. with a main market listing on any overseas exchange is computed as JPY2.5 million plus a fixed rate fee as shown in the table below:

| Ratio of number of foreign stock, etc. held by individuals and legal entities having address and residence in Japan to the total number of listed foreign stock, etc. | Initial Listing Fee  |
|---|--|
| More than 5%  | US\$ 25,000 + Number of Listed Foreign Stock, etc. × (225/10 <sup>6</sup> ) × 1/10 |
| More than 2% and less than or equal to 5%   | US\$ 25,000 + Number of Listed Foreign Stock, etc. × (225/10 <sup>6</sup> ) × 1/20 |
| Less than or equal to 2%  | US\$ 25,000 + Number of Listed Foreign Stock, etc. × (225/10 <sup>6</sup> ) × 1/50 |

Note:

- 1 US\$ = 100JPY

# List of TSE-listed Foreign Companies

**Asian companies on TSE include those based in Korea, Malaysia, and China.  
U.S. drug development companies, MediciNova and Acucela, had successful IPOs on TSE.**

| Region        | Country            | Ticker | Issue name                         | Market  | Sector                      | Stock / DR | English Disclosure | Accounting standard | Multiple /Single |
|---------------|--------------------|--------|------------------------------------|---------|-----------------------------|------------|--------------------|---------------------|------------------|
| Asia          | S. Korea           | 5412   | POSCO                              | TSE 1st | Iron & Steel                | ADR        | -                  | K-IFRS              | Multiple         |
|               | Malaysia           | 1773   | YTL Corporation Berhad             | TSE 1st | Construction                | Stock      | -                  | Malaysia GAAP       | Multiple         |
|               | The Cayman Islands | 9399   | Xinhua Holdings Limited            | TSE 2nd | Information & Communication | Stock      | -                  | JGAAP               | Single           |
| North America | US                 | 4850   | THE DOW CHEMICAL COMPANY           | TSE 1st | Chemicals                   | Stock      | -                  | US GAAP             | Multiple         |
|               | US                 | 8648   | Bank of America Corporation        | TSE 1st | Banks                       | Stock      | -                  | US GAAP             | Multiple         |
|               | US                 | 8685   | American International Group, Inc. | TSE 1st | Insurance                   | Stock      | Conducting         | US GAAP             | Multiple         |
|               | US                 | 8686   | Aflac Incorporated                 | TSE 1st | Insurance                   | Stock      | -                  | US GAAP             | Multiple         |
|               | US                 | 8710   | Citigroup Inc.                     | TSE 1st | Banks                       | Stock      | Conducting         | US GAAP             | Multiple         |
|               | US                 | 4589   | Acucela Inc.                       | Mothers | Pharmaceuticals             | Stock      | -                  | US GAAP             | Single           |
|               | US                 | 4875   | MediciNova, Inc.                   | JQ      | Pharmaceuticals             | Stock      | -                  | US GAAP             | Multiple (IPO)   |



1. Japan-Mongolia Relations

2. Comparison among Major Stock Markets

3. Expansion of IPO Market in Japan

4. Features of IPO Market in Japan

5. Listing on Tokyo Stock Exchange

**A. TOKYO PRO Market**

B. Overview of the Japanese Financial Market

# History of TOKYO PRO Market

| Year | Summary  | Number of J-Adviser | Number of Listing Companies |
|------|--|---------------------|-----------------------------|
| 2009 | <b><u>(Jun) Launch of "TOKYO AIM"</u></b><br>(Jun) Admission of J-Nomad (Current J-Adviser)  | 6<br>(+6)           | 0                           |
| 2011 | (Jun) Admission of J-Adviser: <b>Phillip Securities</b><br>(Jul) <b>Mebio Pharm</b> (Tokyo) Listed on TOKYO AIM (J-A: Phillip) <u>*Mebio delisted in 2013.</u>   | 7<br>(+1)           | 1<br>(+1)                   |
| 2012 | <b><u>(Mar) TSE acquired the remaining 49% in TOKYO AIM held by London Stock Exchange</u></b><br>(May) <b>GOYO foods Industry</b> (Fukuoka) Listed on TOKYO AIM (J-A: Phillip)<br><b><u>(Jul) Integrate "TOKYO AIM" in TSE's Market and launch of "TOKYO PRO Market"</u></b><br>(Sep) Shintokyo Group (Chiba) Listed on TPM (J-A: Phillip)<br>(Nov) Admission of J-Adviser: <b>OKINAWA J-Adviser</b> | 8<br>(+1)           | 3<br>(+2)                   |
| 2013 | (Jun) <b>HEKI</b> (Okinawa) Listed on TPM (J-A: OKINAWA)<br>(Jul) <b>HABITA CRAFT</b> (Gunma) listed on TPM (J-A: Phillip)<br>(Sep) <b>Ad Me Tech</b> (Ehime) listed on TPM (J-A: Phillip)<br>(Oct) <b>Eco Green</b> (Tokyo) listed on TPM (J-A: Phillip)  | 7社<br>(-1)          | 6<br>(+3)                   |
| 2014 | (Jul) <b>CHUOU INTERNATIONAL GROUP</b> (Saga) listed on TPM (J-A:OKINAWA)<br>(Jul) <b>HAKATA TAKUMI KOUGEI</b> (Fukuoka) listed on TPM (J-A: Phillip)<br>(Aug) Admission of J-Adviser: <b>Leading Securities</b><br>(Oct) <b>E-COMETRUE</b> (Hokkaido) listed on TPM (J-A: Phillip)  | 8<br>(+1)           | 9<br>(+3)                   |
| 2015 | (Jan) <b>Simplex Financial Holdings</b> (Tokyo) listed on TPM (J-A:OKINAWA)<br>(Mar) <b>TSON</b> (Nagoya) listed on TPM (J-A: Phillip)   | 8<br>(+1)           | 11<br>(+2)                  |

Note: As of March 31, 2015

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# Main Features of TOKYO PRO Market

## Professional Investors

**TOKYO PRO Market prohibits stock buying by general investors excluding "professional investors" and non-residents in Japan.**

## J-Adviser

**A J-Adviser investigates/confirms the listing eligibility of a company before listing instead of TSE. Also A J-Adviser supports timely disclosure after listing, and examines the status of compliance with requirements to maintain a listing.**

## Flexible Listing Requirements

**No set requirements for Minimum shareholders, Profit, Market capitalization etc. unlike the other markets.  
Listing Criteria judged by J-Adviser .**

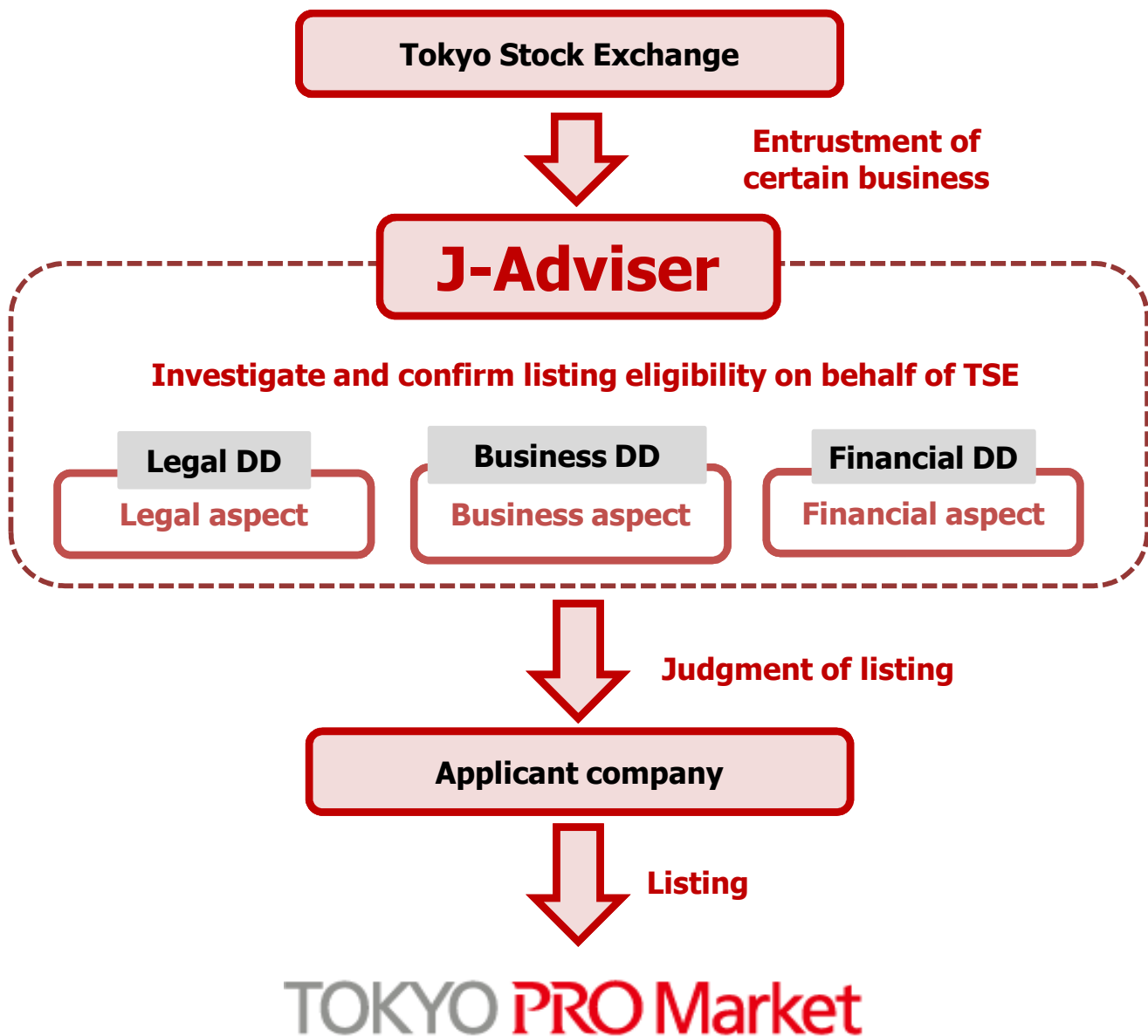
## English Disclosure

**Timely Disclosure materials and fiscal documents to be submitted to TSE can be prepared not only in Japanese but also in English.**

# Investors who can trade in TOKYO PRO Market

| Investor Segment                                       | Example   | Buy in TPM   | Sell in TSE |
|--|---|--|-------------|
| Specified Investors                                    | Qualified institutional investor (financial institutions, etc.), national government, Bank of Japan                                   | Possible   | Possible    |
| Specified investor (transferrable to general investor) | Listed company, stock company with capital of 500 million yen and more  | Possible   |             |
| General Investor (transferrable to specified investor) | <u>Stock company other than a specified investor</u><br>Individual with financial assets or net assets worth 300 million yen and more | Possible<br>(In case of transferring to Specified Investors) |             |
| Non-resident   | Individual who does not have an address or residence in Japan, corporation that does not have a principal place of business in Japan  | Possible   |             |
| General Investor                                       | Investors except the above investors  | Impossible   |             |

# J-Adviser System



## J-Adviser System

### ■ Role

- Company must retain a J-Adviser while listed on TOKYO PRO Market
- J-Adviser must evaluate the company and declare to the exchange that it is suitable for listing
- J-Adviser will continue to support and evaluate the company for the entire period it is on TOKYO PRO Market

### ■ Requirement

- J-Advisers are firms that have proven track record in corporate finance/IPO and have staff with expertise in respective areas (Majority of J-Advisers will be security firms)

## Current J-Nomads (alphabetical order)

- Daiwa Securities
  - Leading Securities
  - Mitsubishi UFJ Morgan Stanley Securities
  - Mizuho Securities
  - Nomura Securities
  - OKINAWA J-Adviser
  - Phillip Securities Japan
  - SMBC Nikko Securities
- (As of 31 Mar, 2015)

# Summary of Listing Requirements

|                                 | Other Markets in Japan  | TOKYO PRO Market  |
|---------------------------------|---|---|
| <b>Disclosure</b>               | Japanese  | Japanese or English   |
| <b>Accounting Standards</b>     | Japan GAAP, IFRS<br>(If the company has not disclosed financial statements in another country before) | <ul style="list-style-type: none"> <li>• Japan GAAP</li> <li>• IFRS</li> <li>• US GAAP</li> <li>• Other standards approved by J-Adviser or accountant</li> </ul>    |
| <b>Listing Criteria</b>         | Minimum shareholders, free float, profit, market capitalization, etc.                                 | <p>No set requirements</p> <p>*Criteria judged by J-Adviser</p>   |
| <b>Application Period</b>       | 2 - 4 months  | <p>Minimum 10 business days</p> <p>* J-Adviser expresses intent for a listing application within about 30 business days prior to the actual listing application</p> |
| <b>Auditor's report</b>         | The 2 most recent fiscal years  | The previous fiscal year only   |
| <b>Internal control reports</b> | Required  | Not required  |
| <b>Quarterly reports</b>        | Required  | Not required  |
| <b>Investors</b>                | No restrictions   | Professional investors and non-residents  |



# Listing Eligibility Requirements

The supervising J-Adviser investigates and confirms the listing eligibility of the applicant company based on the eligibility requirements specified by TSE in its regulations.

## (Listing Eligibility Requirements)

An initial listing applicant must satisfy the matters enumerated in each of the following items.

- (1) An initial listing applicant **does not damage the reputation of the market of the Exchange** and is a company that is suitable for listing on such market.
- (2) An initial listing applicant **conducts business fairly and in good faith.**
- (3) **The corporate governance and internal management structure of an initial listing applicant is appropriately developed in accordance with corporate scale and maturity, etc. and functions properly.**
- (4) An initial listing applicant **carries out disclosure of corporate content and risk information,** etc. appropriately and has developed a system and framework which enables it to fulfill its disclosure obligations based on the Special Regulations.
- (5) **No relations with anti-social forces** and other matters deemed necessary by the Exchange from the perspective of the public interest and investor protection.



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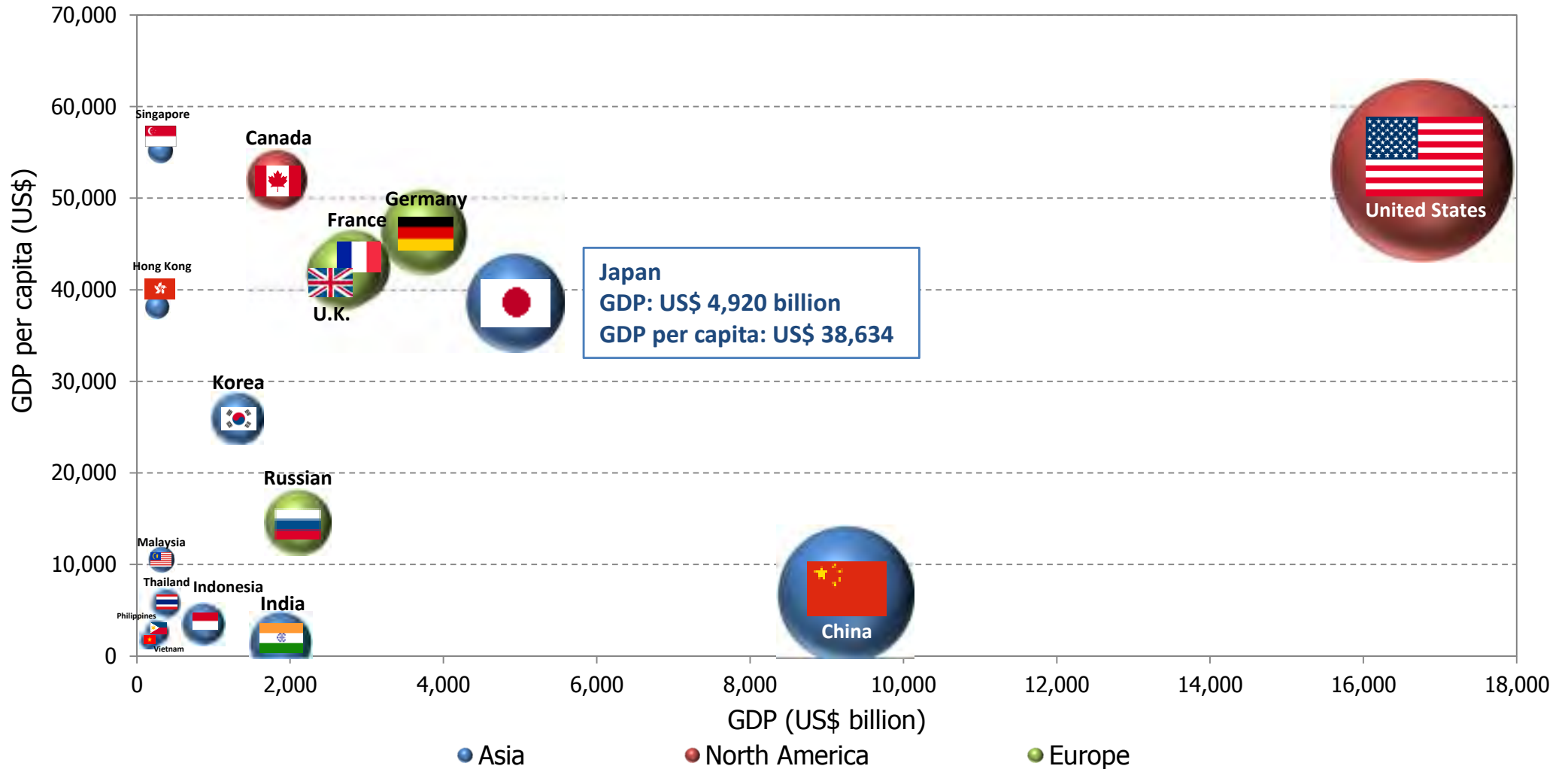
5. Listing on Tokyo Stock Exchange

A. TOKYO PRO Market

**B. Overview of the Japanese Financial Market**

# GDP and GDP per capita (2013)

Japan is a leading global economy with world-class GDP and per capita GDP.



Source: World Bank

Note: Circle size indicates relative GDP

# Deep and Diverse Investor Base

Participation by various types of investors in the TSE market creates fair and reliable valuations of its listed companies.

## 1 The World's Largest Institutional Investor

- Japan is the primary investment focus for the Government Pension Investment Fund, Japan (GPIF), the largest institutional investor in the world.
- Assets under management at GPIF was valued at US\$1.3 trillion<sup>1</sup> (Sep. 2014), an amount comparable to the GDP of South Korea (US\$ 1.3 trillion, 2013). GPIF's investments in foreign stocks accounted for 17.41% of its entire portfolio, an amount valued at US\$228 billion<sup>1</sup> (Sep. 2014).
- There are also other pension funds that manage huge amounts of funds.

## 2 High Net Worth Individuals

- Financial assets held by Japanese individuals stood at US\$15.68 trillion at the end of 2013<sup>1</sup>.
- This is comparable to 2.6 times Japan's GDP (US\$5.96 trillion, 2012 year end).

## 3 Accessibility to Japanese Markets for International Investors

- Foreign investors are the largest players in Japan. The increase in investments by foreign investors can be seen from their trading value, which reached US\$6.5 trillion<sup>1, 2</sup> in 2013.
- Globally reputable investors from many countries have shown interest in the Tokyo market. A TSE listing promises a company access to investment by international investors.

Source: GPIF web site, BOJ, World Bank

Note: 1 US\$= 100 JPY

2 Total amount of buy and sell

# Top 12 Pension Funds

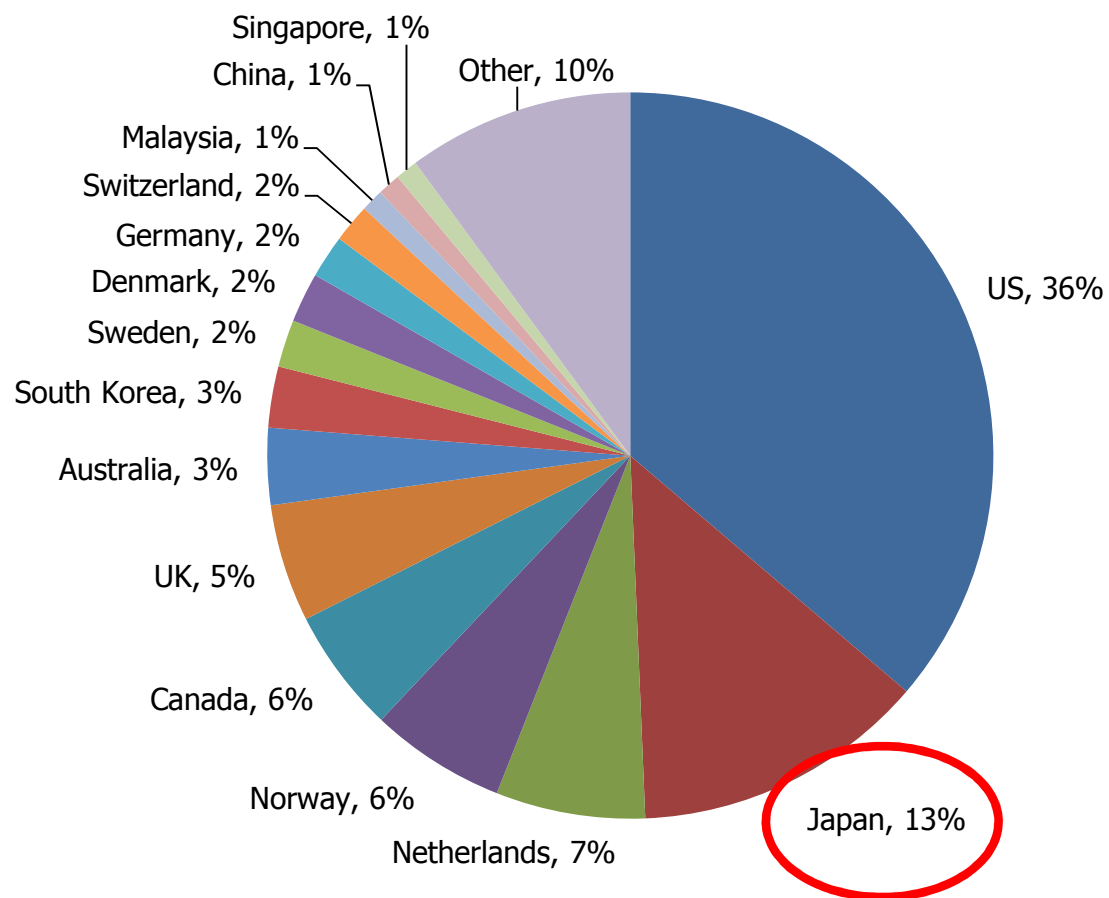
**GPIF (Government Pension Investment Fund) is the largest investor in the world.**

| Rank      | Fund                                     | Market       | Total Asset<br>(US\$ billion) |
|-----------|--|--------------|-------------------------------|
| <b>1</b>  | <b>Government Pension Investment</b>     | <b>Japan</b> | <b>1,292</b>                  |
| 2         | Government Pension Fund                  | Norway       | 713                           |
| 3         | ABP                                      | Netherlands  | 373                           |
| 4         | National Pension                         | South Korea  | 368                           |
| 5         | Federal Retirement Thrift                | U.S.         | 326                           |
| 6         | California Public Employees              | U.S.         | 245                           |
| 7         | Canada Pension                           | Canada       | 206                           |
| 8         | National Social Security                 | China        | 205                           |
| 9         | Central Provident Fund                   | Singapore    | 200                           |
| 10        | PFZW                                     | Netherlands  | 197                           |
| 11        | Employees Provident Fund                 | Malaysia     | 182                           |
| <b>12</b> | <b>Local Government OfficialsJapan\$</b> | <b>Japan</b> | <b>180</b>                    |

Source: P&I / TW Top 300 Pension Funds Analysis as at 2013 year end

# Total Value of Fund Assets

## Total Value of Fund Assets (Split by fund domicile)

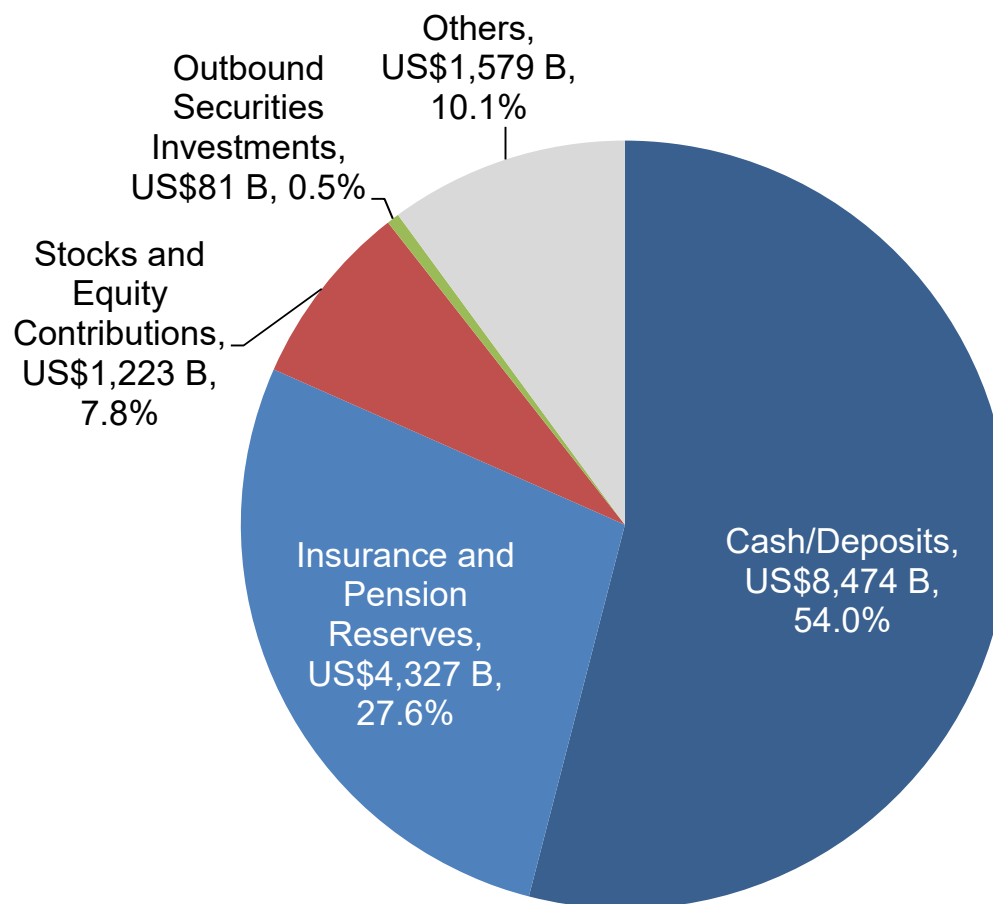


| #     | Country     | % of Total Value | No. funds |
|-------|-------------|------------------|-----------|
| 1     | US          | 36%              | 126       |
| 2     | Japan       | 13%              | 14        |
| 3     | Netherlands | 7%               | 13        |
| 4     | Norway      | 6%               | 1         |
| 5     | Canada      | 6%               | 19        |
| 6     | UK          | 5%               | 26        |
| 7     | Australia   | 3%               | 16        |
| 8     | South Korea | 3%               | 3         |
| 9     | Sweden      | 2%               | 7         |
| 10    | Denmark     | 2%               | 8         |
| 11    | Germany     | 2%               | 12        |
| 12    | Switzerland | 2%               | 10        |
| 13    | Malaysia    | 1%               | 2         |
| 14    | China       | 1%               | 1         |
| 15    | Singapore   | 1%               | 1         |
| 16    | Other       | 10%              | 41        |
| Total |             | 100%             | 300       |

Source: P&I / TW Top 300 Pension Funds Analysis as at 2013 year end

# High Net Worth Individuals

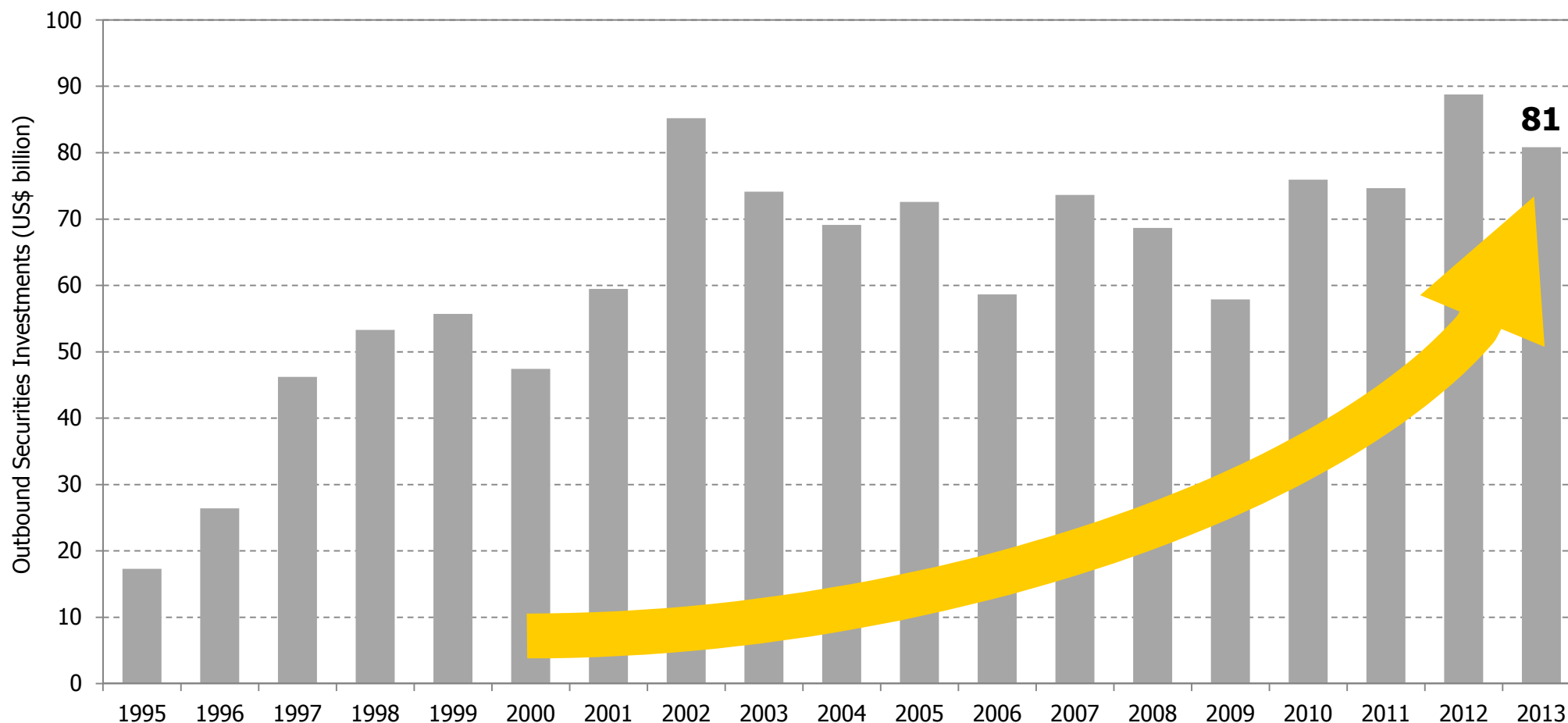
Financial assets held by Japanese individuals stood at US\$15.68 trillion at the end of 2013 and is comparable to 2.6 times of Japan's GDP. This is a very high level worldwide.



Source: Bank of Japan  
Note: US\$ = JPY 100

# Outbound Securities Investments

The value of outbound securities investments from household assets by Japanese individual investors shows a continued upward trend. Japanese investors also warmly welcome foreign stock listings on the TSE market.



Source: Bank of Japan  
Note: US\$ = JPY 100



## 【Contact】

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### **Atsushi Joden (Mr.)**

Account Manager, New Listings Dept.

## 【Important Information】

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