

Capital Market Update

the quarterly newsletter of the Capital Markets Development Authority

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Stock market cycles – The key is “time” in the market

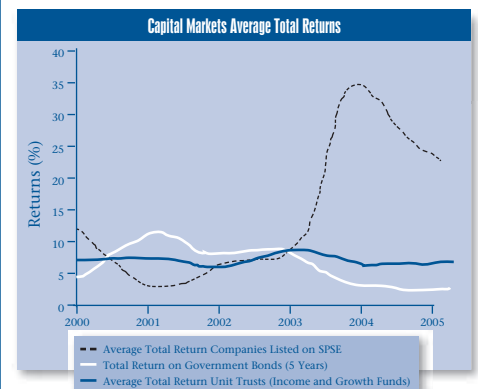
Understanding how the stock market cycles affect you as an investor is important, especially when reviewing your investment plans and strategy during a falling market. A falling market is generally when the market trend for prices are falling. Markets rise and fall for a variety of reasons, some conditions encourage optimism and investment which may drive prices up, whilst others may dampen and discourage investment and prices may fall. In general, a growing economy with a stable political climate provides a conducive environment in which stock and real estate markets can gain value. A period of political and economic uncertainty, may drive money into short-term cash equivalent investments, as people feel uncomfortable investing for the long term.

Cyclical patterns can be tracked in all asset class markets: the stock market, unit trust market, bond market, money market, and real estate market; and in all the subclasses, or smaller segments of those markets. For example, the local stock market performed strongly in 2003, with almost all of the shares quoted on the SPSE recording positive total returns for that year, and only four of the fifteen listed companies' generated negative total returns. This was attributed to Fiji's economy performing well for that year, after recording growth for the third consecutive year. The economy was estimated to have expanded by 5 percent in 2003, due mostly to buoyant consumer spending and rising investment, as well as the impetus provided by the South Pacific Games. During the period 2001-

2003 the interest rates were very low. This allowed people and companies to borrow more from commercial banks. In 2003, the level of credit growth by commercial banks and credit institutions rose by 20 percent and 22 percent respectively from the previous year. Increase credit to companies, allows companies to expand and in turn increases overall returns. In addition, investment as a percent of GDP increased from 15 percent to 16 percent in 2003.

How does a share investor gauge whether the local stock market is rising or falling? In Fiji, the Kontiki South Pacific Stock Exchange Index, or KSPX Index is a share price index composed of the market-weighted average of the market value of all listed companies on the South Pacific Stock Exchange (SPSE). The KSPX tracks the performance of all the companies listed on the SPSE. If an investor owns more than a few stocks, it is difficult to follow each share individually to determine the composite performance of the portfolio (collection of shares). Therefore, if the overall market rises as measured by the index, then there is a probability that the value of most investors' shares will also rise. When the stock market, measured by the market index, continues to gain value over a period of time, it's known as a bull market. But when the market drops 20% or more from its most recent high, it's considered a bear market.

Some investors will react to volatile markets by abandoning their investments when they see prices fall. The problem with this strategy is that selling an



investment while its price is at the bottom, can sometimes be the worst possible response, because it results in losses. Investors could for example, miss out on the opportunity to achieve better returns when the market recovers. Studies have shown that the returns on shares investments, have over the longer term out performed other asset classes like cash and bonds. The lesson for investors is that you should stick to your investment strategy, if it closely reflects your attitude to risk and investment needs. Selling out at the slightest downturn, when values fall may mean losing out twice, once by accepting a reduced price for the asset or stock, then again when prices eventually rise. Many believe that investing is not about “timing” the market – but rather achieving long term growth through your “time” in the market. Investors are recommended to seek investment advice from a licensed broker or investment adviser.

Incentives needed for capital market development

The Interim Minister of Finance in his 2007 mini-budget address in March, announced that the Interim Government will remove the tax exemptions on dividends and capital gains on investments in Fijian Holdings Property Trust Fund (FHPT) and Colonial First State Income Fund (CFSIF) as well as Colonial First State Income and Growth Fund (CFSI&GF). This announcement came as a surprise to those in the capital markets industry, particularly because of the potential implications it can cause for the industry. For a start many investors, particularly the “mums and dads” who have invested their hard earned savings in these unit trusts, will find that their returns will no longer enjoy the tax free returns they had anticipated when they first invested in these unit trusts. The

decision had also indirectly created an uneven playing field in the unit trust market, and may impede future growth in the unit trust market given that the Unit Trust of Fiji (UTOF) and Fijian Holdings Unit Trust, now have a competitive edge by continuing to enjoy its current tax exemption status.

Unit trusts or managed funds have been around for over 29 years in Fiji, following the enactment of the Unit Trust Act (Cap 258) in 1976. Following this the Unit Trust of Fiji was set up by the Government in 1978, with the intent of providing an investment vehicle for “the man on the street”. At the end of 2006 there were approximately 14,351 investors and over \$165.3 million dollars invested in seven licensed unit trusts in

Fiji. This has been a tremendous growth, considering that only ten years ago, funds under management was \$18 million and there was only one licensed unit trust fund. One of the major contributing factors to the growth and success of the unit trust market has been the attractive returns, and up until recently these dividend and capital gains were tax free. Other reasons that have contributed to their success in the market are because they are fairly easy to understand and the investor has access to a professional manager to make investment decisions.

The unit trusts companies have contributed immensely to the economic growth and prosperity of Fiji. They have provided an attractive investment option for the public to invest and grow their wealth. Many have

benefited from them as testimonies from individuals, villagers and rural dwellers show that they have been able to develop and upgrade schools, community halls, provide rural electrification and educate their children through the good returns from their investments in unit trusts. On the other hand, the fund managers have created employment opportunities, not only within their own companies, but also to other companies they have invested in. The unit trust market is one component of Fiji's capital markets, which also include the stock market and

the bonds market. The development of Fiji's capital markets is essential if the private sector is to be the engine room of economic growth and would strike a favourable balance to the bank dominated financial industry. Although not widely appreciated, studies have shown that there is a high correlation between economic growth and the level of development of the stock market.

If Fiji is to fully develop its fledgling capital markets, policy makers must be mindful that as in the case with all developing

countries with emerging markets, tax policies must play a particularly a balancing role, where the tax system should raise revenue in ways that are equitable, and minimize its disincentive effects on economic activities. As an incentive to encourage more investors, tax exemptions on FHPT and CFSI is a good way to entice saving and investing in the capital markets especially when the unit trust is a stepping stone in investing for new investors, before moving to the more complicated shares market. ●

Understanding Employee Share Scheme(s)

What is an Employee share scheme (ESS)?

An Employee Share Scheme (ESS) or Employee Share Ownership Schemes (ESOSs) is one way of aligning employee's performance with the company's financial and business objectives by encouraging them to invest in the business they work in. Under these schemes, employers give gift shares to employees (for example as performance payments) or they can sell the shares to the employees at a discount. Studies show that employees who are shareholders of the company in which they work are presumed to be motivated, and may benefit from additional performance incentives and wealth creation. The basic idea behind any ESS is that common stocks (or convertible preferred stock) are distributed to the accounts of employees and eventually passed on to them at retirement or when they leave the firm (assuming vesting has taken place).

What is the difference between the two schemes?

Under an ESS, the company's shares are offered to employees, normally at a discount to the current market price (if it is listed on a stock exchange) or current value. Sometimes the company may offer the employee a "low-interest" or "no-interest" loan to assist them purchase the shares. In some cases, loan repayments can be met by the dividends paid on the shares. Quite often, the loan is non-recourse. This means that if the shares are sold off and used to repay the loan, any balance on the loan outstanding is written off. On the other hand, under an ESOS, employees are offered options to purchase shares in the company at a fixed price, which they can exercise sometime in the future on certain conditions. If granted an option, the employee does not own a share of the company immediately but only a right to have a share issued to them by the company sometime in the future. The employee has the right, but not the obligation, to buy the shares.

Once the employee exercises the option, the company is obliged to issue the shares to them. A trustee can be used to administer the ESOS for the employees. Employees will typically exercise their options if the exercise price is lower than the current market price of shares.

What are some of the key features of an ESS?

All of the stock in ESS is held in trust. The company can contribute cash to the ESS to buy shares, or the ESS can borrow money to buy shares, and then the company makes cash contributions to the plan, which the ESS then use to pay back the loan. An ESS is the only kind of employee benefit program that can borrow money. Shares can be allocated using a variety of factors, such as seniority and pay scale. Usually only full-time employees may buy shares. Dividends are paid to employees in the form of cash or increased value of the stock.

What are some of the benefits of an ESS?

A company could benefit from an ESS or an ESOS in the following ways:

- **Positive incentive for employees to increase profitability** – As shareholders, employees will share in the company's profits and therefore can be expected to be strongly motivated to increase company profitability.
- **Attract and retain key employees** – The company may have invested considerable resources in attracting key staff and their retention could be critical to company success. Owning some of the company's shares could prevent them from joining competitors.
- **Conserve cash and reduce the cost of performance bonuses** – Share ownership schemes can work as an alternative to paying employees cash bonuses. This extra cash can be used by the company to expand its operations.

- **Improve employee loyalty** – Attractive employee share schemes could mean that employees remain with the company for a longer period. Such loyalty could contribute positively towards the company's growth and profitability.
- **Improved morale** – Employee participation in share ownership schemes could enhance relationship between the company, as employer, and employees for long-term mutual benefit. This could deter any possible industrial conflicts in future.

What are some of the problems associated with an ESS?

Falling share prices for reasons unconnected to the employees' performance can result in a negative reaction from employees and could cause embarrassment if the outstanding loan for shares exceeds their market value. Conflicts can also arise when the interests of outside shareholders and employee shareholders do not always coincide. Another problem that can arise involves 'insider trading' laws which prevent employees, particularly senior ones, from selling their shares at any time. In most cases companies must repurchase the shares when an employee leaves and this may mean huge cash outlays. ESS can also be expensive to set up. Stock ownership also becomes diluted whenever new stock is issued.

What are the requirements for approval of an ESS or ESOS in Fiji?

If your company would like to establish an ESS or ESOS, it will need to submit a proposal to the Capital Markets Development Authority (CMDA). The CMDA will examine the proposal and may allow it to become effective on certain terms and conditions. The CMDA Rules 1997 allow companies listed on a

DID YOU KNOW...

that a share market index is an average representation of price movements of a sample of shares and it provides an overview of the level of a share market and not merely the share price of any one individual stock.

stock exchange to operate ESS or ESOS provided the scheme has been approved by CMDA. An offer of shares to employees may be considered a “public offer” if its sole purpose is to raise funds for the company, and if so the company will need to prepare a prospectus making important disclosures about the company. It is for this reason that most companies may prefer to introduce an ESS or ESOS when they are undertaking a “public offering” or if they are already a listed company. If the purpose of the ESS or ESOS is to enable employees to participate in the ownership of the company, then some relief from full disclosures may be available.

What are the tax incentives for qualifying ESS or ESOS?

Under the Fiji Income Tax Act, if an employee acquires a share or an option under an employee share scheme, any discount received is included in the employee’s total taxable income. The Income Tax Act (Cap. 201) defines an “employee share scheme as a scheme under which an employee may acquire shares or options to acquire shares in the employer in respect of, or for or in relation directly or indirectly to, the taxpayer’s employment.” To promote the establishment of more ESS or ESOS, the Government has provided a tax benefit

for employees under qualifying schemes of companies listed on a stock exchange. Employees can deduct up to \$1,000 of benefits from their total taxable income in respect of shares or options acquired in a qualifying scheme.

To be eligible for tax incentives, an ESS or ESOS in Fiji must meet the following requirements:

- The shares or options acquired under the scheme must relate to ordinary shares;
- All employees, whether full-time or part-time employees, who have at least one year’s service must be allowed to participate in the scheme;
- Any financial assistance provided by the employer to its employees to assist in the acquisition shall be provided on a non-discriminatory basis, and
- The employee may not sell or dispose of the acquired shares or options for a period of two years, except upon ceasing employment.

Whilst the terms ESS or ESOS refer primarily to employees, the definition under the Income Tax Act also includes directors and any persons providing personal services to an employer. Therefore, directors or senior management are also eligible to participate in share schemes.

Meet a Unit Trust Rep



Ms. Reema Chand, Approved Unit Trust Rep

Getting Started: Reema is a Management Accountant with the Unit Trust of Fiji (Management) Limited (UTOF). She holds a Bachelor of Arts (BA) degree majoring in Accounting & Financial Management and Management & Public Administration from the University of the South Pacific. She has also completed the Fiji Securities Licensing Examination Course through the Financial Services Institute of Australasia (FINSIA). The idea to create investment awareness amongst grassroots people, helping them to save for their future and contributing to the economy as a whole attracted her to join UTOF.

The Clients: Reema’s clients are from all ethnic groups and include individuals, clubs, mataqali’s etc who invest with UTOF with the objective to maximize their returns with a minimum level of risk. “These clients or “unit holders” take full advantage of the six monthly tax free dividends, payable in June and December. Apart from this, they can also have a capital growth to their initial investment in the medium to long term depending upon the overall performance of the Trust’s investments.

The Job: As a Unit Trust Rep, Reema’s main role is to advise prospective and current unit holders about UTOF and the benefits and risks associated with their investment in line with the approved guidelines as required under her license. The experienced employees at UTOF offered her a very good learning platform in terms of her professional development in the Capital Market Industry.

Biggest Challenge: “My biggest challenge is reaching “grassroots” people who are unaware of investment opportunities available in the Unit Trust market and assisting them to develop an investment objective. Another challenge is to help UTOF in increasing the size of its fund and the number of unit holders.”

Best Investor: “One who knows his investment objectives, goes for medium to long term investment, keeps increasing their funds and has updated information about UTOF’s performance”.

Best Thing about the Job: “There are so many good things about the job. I get to utilize my skills and knowledge to assist people in planning and investing for their future. I also get the chance of interacting with lots of people from all walks of life and contribute towards building our company and the nation”.

Regulatory Matters

On regulatory matters, during the quarter, the CMDA received no complaint and undertook four inquiries into potential breaches of the CMDA Act, Regulation and Rules. Two cases have been resolved.

The CMDA granted approval to:

- Ms Nijeshni Wati to act as a Licensed Broker representative for Kontiki Stockbroking Limited (KSB) from 17 April 2007 to 16 April 2008.
- Mr. Meli Verebalavu to act as an approved Broker/Dealer representative for FHL Securities Limited (FHLS) from 25 April 2007 to 24 April 2008.
- Mr. Griffon Emose to act as an approved Investment Adviser representative for Kontiki Capital Limited (KCL) from 19 March 2007 to 18 March 2008.
- Mr. Jaoji Koroi to act as a Licensed Investment Adviser representative for FHL Securities Limited (FHLS) from 27 March 2007 to 26 March 2008.
- Mr. Sowani Tuidrola to act as an approved Unit Trust representative for Fijian Holdings Trust Management Limited (FHTML) from 12 May 2007 to 11 May 2008.
- Ms Raghni Khatri to act as a licensed Broker/Dealer representative for Kontiki Stockbroking limited (KSB) from 7 March 2007 to 6 March 2008.
- Mr. Nitesh Kumar to act as a licensed Broker representative for FijiStock
- Brokers Limited (FSB) from 30 April 2007 to 29 April 2008.
- Mr. Sanjay Dewan to act as a licensed Broker representative for Kontiki Stockbroking limited (KSB) from 16 May 2007 to 15 May 2008.
- Mr. Nadeem Ali to act as an approved Investment Adviser for Kontiki Capital Limited (KCL) from 16 May 2007 to 15 May 2008.
- Mr. John Ridgway to act as a Licensed Investment Adviser from 14 February 2007 to 13 February 2008.
- Mr. Brendan Harrison to act as a Unit Trust representative for Colonial First State Investments (Fiji) Limited (CFSI) from 16 May 2007 to 15 May 2008.
- Mr. Sowani Tuidrola to act as a approved Unit Trust representative for Fijian Holdings Property Trust (FHPT) from 30 May 2007 to 29 May 2008.
- Ms Rowena Fong to act as an approved Unit Trust representative for Fijian Holdings Property Trust (FHPT) from 30 May 2007 to 29 May 2008.
- Fijian Holdings Property Trust to conduct the business of a Unit Trust from 30 May 2007 to 29 May 2008.

Unit Trust of Fiji

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News in Brief

- Fijian Holdings Limited (FHL) announced the payment of its interim dividend for the six months ended 31 December 2007 totaling \$2.046m. This dividend is based on 10 cents per share for A-class shares and five cents per share for B-class shares and is the same for December 2005. The Company recorded a net profit after tax of \$2.262 m for the first six months of 2007. FHL also announced that the Fiji Independent Commission Against Corruption (FICAC) entered the FHL property under search warrant acting on allegations lodged with them. FHL were not given a copy of the allegations which they suspect was to do with their shareholding base. FHL while pleading for stakeholders to remain calm, have co-operated with the FICAC team.
- Pacific Green Industries (PGI) announced that the Company has returned to profitability after recording a profit of \$155,620 in the first four months of this year.
- Kontiki Growth Fund Ltd (KGF) announced that the net asset backing per share of the KGF was 96.23 cents per share as at 31st May 2007. This compares with 96.80 cents a share as at the date of listing 16 December 2004 on the SPSE.
- Flour Mills of Fiji (FMF) announced that the interim dividend for the year 2006-2007 has been declared at 1.2 cents per share. The share transfer books would be closed on 25 June 2007 and the dividends would be payable to shareholders as at that date.
- Amalgamated Telecom Holdings Ltd (ATH) announced a Group consolidated net profit after tax and minority interest of \$41.5 m for its financial year ended 31 March 2007. This was an increase of 18.9% over the previous financial year, in which a Group consolidated net profit after tax and minority interest of \$34.9 m was recorded. The Company also announced a \$77 m capital expenditure program for the 2007/2008 financial year. The Board of Directors proposed a final dividend of three cents per share, or \$12.7m, for the year. This is in addition to an interim dividend of three cents per share paid on 28 February and will bring the total dividend for the year to six cents per share or \$25.3m, the same as the previous year. The Company earlier announced that in line with the rules on restricted trading under the Code of Corporate Governance Principles, all Directors and staff of ATH and its group companies are to refrain from trading (buying or selling) ATH shares on the SPSE during the restricted period from 28th of May to the 27th of July 2007.
- R B Patel Group Limited (RBG) announced a final year-end profit after tax of \$3.4m for the year ended 31 March 2007. This compares with \$2.95m for the same period last year and equates to an increase of 16.13%. This is the eight year of year-on-year growth. The Company also announced a second interim dividend for the twelve months ended 31 March 2007. The Board of Directors proposed a final dividend of six cents per share, or \$1.8m for the year.
- Fosters Group Pacific Ltd (FGP) announced the resignation of Mr. Robert Rogers as Director of the Company effective from 29th May 2007. The Directors of the Company have duly endorsed the appointment of Mr. Anthony Neil Davie, Managing Director of Foster's Asia, New Zealand and Pacific from 30th May 2007. The company also announced an interim dividend of 20 cents per share or \$2.08m for the 10 months ended 30th April 2007.
- Fijicare Insurance Ltd (FIL) announced a consolidated profit of \$370,699 as at 31 December 2006. Total assets had increased to \$8.03m, whilst Net Assets [Shareholder's Equity] had increased up to \$2.98m over the past year.
- Yaqara Group Limited (YGL) announced that total profit and loss expenses (operating, administration and finance costs) have been reduced by \$1.38m, from \$2.591m to \$1.21m, which represents a reduction of 53.36%. The net asset position of the Company is reported at \$22.34m.

Quarter 2 2007 Trading on the South Pacific Stock Exchange

Company	Total No. of Shares Traded	Total Value of Shares Traded (\$)	No. of Trades	Last Price Traded this Qtr (\$)	Qtr 2- Qtr 1 % change	Earnings Per Share (cents)	Price/Earnings Ratio (times)	Dividend Yield (%)	Market Capitalisation (\$m)
Atlantic & Pacific Packaging	-	-	-	1.19	-	3.80	31.29	2.94	9.52
Amalgamated Telecom Holdings	67,079	53,177	25	0.79	(5.95)	9.84	8.03	7.59	333.46
Communications (Fiji)	-	-	-	1.84	-	0.36	507.34	1.63	6.55
Fosters Group Pacific	961	17,209	8	17.50	(3.85)	83.00	21.09	2.29	182.14
FijiCare Insurance	284,629	176,567	8	0.70	-	6.44	10.87	-	4.03
Flour Mills of Fiji	50,000	42,500	1	0.85	(1.16)	n/a	n/a	1.41	127.50
Fiji Sugar Corporation	2,400	850	2	0.35	(2.78)	n/a	n/a	-	15.54
Fiji Television	3,635	16,405	8	4.50	(3.64)	34.95	12.88	4.00	46.35
Kontiki Growth Fund	3,000	2,880	2	0.96	(4.95)	1.36	70.51	2.08	3.40
Pacific Green Industries	-	-	-	2.25	-	n/a	n/a	-	17.14
R B Patel Group	22,504	34,881	6	1.55	(4.91)	11.41	13.59	6.45	46.50
The Rice Company of Fiji	1,000	3,000	1	3.00	-	28.98	10.35	4.50	18.00
Toyota Tsusho	3,849	7,886	3	2.00	(4.76)	19.68	10.16	3.00	28.06
VB Holdings	9,500	27,650	3	2.95	5.36	27.33	10.79	4.41	4.51
Yaqara Group	1,000	1,180	2	1.18	(11.28)	n/a	n/a	-	17.99
Fijian Holdings	21,292	79,963	90	3.50	(13.15)	89.32	3.92	5.71	36.63
TOTAL	470,849	464,148	159	Market Capitalisation as at 30 June 2007					897.32