

INITIAL PUBLIC OFFERING /IPO/ IN MONGOLIA

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Хураангуй: Судлаачид, компаниуд яагаад, хэзээ нээлттэй болж байгаа талаар янз бүрийн судалгаа хийсэн байдаг. Энэ хоёр асуултад хариулахад тулгарч буй үндсэн бэрхшээл нь тохирох судалгааны аргачлал олоход хэцүү болон шаардлагатай аргачлалыг хэрэглэхэд компаниудын мэдээлэл хомс байгаатай холбоотой.

Бид энэхүү судалгааны ажлаар компаниуд эдийн засгийн нөхцөл байдалтай уялдуулж IPO хийдэг үү гэдгийг судалсан. Өөрөөр хэлбэл, зах зээлийн нөхцөл сайн буюу эдийн засаг өсөлттэй байх үед компаниуд IPO хийх нь нэмэгддэг нь судалгааны ажлын үр дүнгээр гарч байна. Мөн компаниуд салбарын дундаж гүйцэтгэлийг дагадаг болохыг харууллаа.

Харин эсрэгээр компаниуд эдийн засаг уналттай үед IPO хийж хөрөнгө татахаас илүүтэй компанийн санхүүгийн байдлыг хамгаалах, түүнчлэн бууруулахгүй байх эрмэлзэлтэй байдаг нь олон улсын судлаачдын судалгааны ажилд дурьдагсан байна.

Уг илтгэл нь хураангуй, оршил, судлагдсан байдал, онолын болон судалгааны хэсэг, дүгнэлт, ашигласан материал зэрэг хэсгүүдээс бүрдэнэ.

Түлхүүр үгс: IPO-н давалгаа, IPO-н тохиромжтой цаг үе

Abstract: Researchers have made various studies on why and when they shall publicly offered. The main difficulty in responding to these two questions due to identity of appropriate methodology and the lack of information by the companies to use the methodology.

In this study, we investigate whether companies are doing IPOs in line with economic conditions. In other words, companies do IPOs when market conditions are good or the economy grows. If the market performance is insufficient, companies are keen to protect the financial situation of the company, rather to attract IPOs during the downturn.

This paper comprises summary, introduction, theoretical and research sections, conclusions and reference.

Keywords: IPO waves and IPO timing /MSE/

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INTRODUCTION

Initial public offering /IPO/ is the one of the appropriate ways for companies to finance projects and expanding its operations.

IPOs³ can be made by a company whose business has stabilized and business is growing as well as a new company with a project that is likely to have high profitability.

The public offering of shares is a classic investment tool that allows companies to fundraise cost-effectively in long term and offers several advantages for the company.

The importance and benefits of IPO⁴:

- ✓ Provide cheap and long-term financial resources.
- ✓ Increased reputation, improved corporate governance and improved liquidity. Market value is determined more realistic.
- ✓ Creation of competent personnel and good management team.
- ✓ Increased opportunity to attract investors from foreign markets.

Companies need assistance of professional advisors, intermediaries, mainly underwriters⁵ and investment advisors in issuing IPOs, and intermediaries provide professional services to security issuers in order to anticipate the difficulties that may be encountered in order to succeed in the IPO.

An issuer of security can be listed on several stock exchanges and can trade securities on a foreign stock exchange by dual listing or issuing depository receipt on the securities listed on the primary market.

However, the companies confront several challenges regarding IPO. First of all, company managers need to pay close attention to the process of issuing IPO because it requires a large amount of capital, manpower and time, but in some circumstances, their focus on main operating activities likely to weaken or deteriorate. Second, it is prohibited to conduct marketing activities and other activities that may affect the financial position of the company during the preparation of the IPO. Third, if a company is listed on a stock exchange, its internal affairs such as filing reports, announcing and holding meetings, making decisions etc. need to disclosed

³ [18] Article 4.1.21. "Public offering" (IPO) means to inform to the public through media that the company is going to sell its securities to more than 50 investors in accordance with the regulations set by the Financial Regulatory Commission.

⁴ [15]

⁵ The underwriting is to provide professional services for the IPO issuer to offer the securities to the public on the basis of the agreement and to buy the remaining securities sold in the primary securities market in accordance with the underwriting contract.

in accordance with the laws and regulations. Fourth, depending on the number and size of the shares, the company may lose control over management to its shareholders as well as to its competitors or third parties inadvertently.

Comparative analysis, summarizing, and sampling methods are used in this research paper⁶.

BACKGROUND

Although scientists are keenly interested the IPOs as it is popular in international markets, the concept on the process of decision-making to become public company is still complex and limited.⁷

Zingales (1995) considered the IPO as the result of decision bringing company value to the highest, making company owners' investment realistic. He has developed a model that demonstrates the potential strategy of such owners. For example, whether to buy a public company, in that case you buy, what part of the ownership will be kept. The researcher stated that the owners optimize ownership structure to maximize their total sales revenue. For example, by defining the control and cash flow rights before negotiating with prospective buyers. IPO is the one way of implementing it.⁸

Pagano, Panetta and Zingales (1998) studied 2,181 Italian companies in between 1982 and 1992. To answer the question of why firms become public, compared the characteristics of companies stayed closed and public companies before and after IPO and estimated the probability to become public by probit model. Italian companies were becoming public to balance their asset structure. The researchers found that the IPOs are likely to increase when the company size is the same and/or has the average the ratio of market/booking price.

With rapid change of technology, primary companies of emerging markets have chosen to finance through equity.

Fischer (2000) explains why companies related to the technology growth are becoming public in Germany. He found that the share of intangible assets, research and development, investment and preliminary growth have increased as the IPO rises. In addition, concluded that the issuers of IPO listed at Neur Markt in German are funding for future investments not just to withdraw cash.

Companies listed at other market segments of Frankfurt Stock Exchange had become public to being economically and financially favorable rather than needing

⁶ Statistical method which selects sample members from a population.

⁷ [19]

⁸ By issuing IPOs to shareholders, the owner makes maximum cash income using its cash flow sales. By making direct trading with potential buyers, maximise its cash by using sales of control rights.

the capital.

Andrew Worthington's research work on "IPO's pricing and performance of IPO's for small and medium sized performance" in 2001, studied the stock performance against the small and medium sized companies listed at the exchange in Thailand and discussed average abnormal returns. The survey concludes that the market-what-stock performance³ follows the market except during downturns.

Boehmer and Ljungqvist (2004) examined the information of 330 companies in Germany who had announced their willingness to become public in between 1984 and 1995. In the IPO, a general economic condition or an opportunity to acquire investment, and the return on equity markets that are positively associated with the company's value are essential. When sales, income growth and profit margin of the company are relatively higher compare to other companies in the same industry and are willing to become public, increases the likelihood of becoming public.

Brau, Ryan and DeGraw (2005) have surveyed executives of 438 companies which are issued an IPO during 1996 and 2002 in the USA. The most important reason for becoming public was financing growth of both domestic and foreign — external internal as respondents and repelled that the IPO is the tool for optimizing asset structure for holders. Their research also supported the theory of market timing. For example, the majority of respondents concluded that the IPO timing coincides with the favorable market conditions.

Brau and Fawcett et al (2006) classified the reason to become public into four categories. These include:

1. Reduce capital costs;
2. Allow internal employees or participants to withdraw cash
3. Activating the procurement process;
4. Strategic transition.

Traditionally, the IPO has considered an important stage of a company for growth and development. In other words, companies become public when it reaches specific stage.

The research on "A theory of IPO waves", 2016, of Ping He, a professor at the University of Chicago, has conducted factors that may affect to the IPO, and the market factors are the key factors mostly influenced to the IPO.

The study on "The IPO Waves: How market performance influences the market timing of IPO?" by Firas Batnini, Moe Hammami's, 2015, evaluated the market factors influenced to the number of IPO by regression model. The results show that when the market is booming or hot, the number of IPO increases and valued highly. When the market is down or cold, the IPO declines and have correlation.

In summary, companies issue IPO to:

1. To reduce capital costs;
2. Activating procurements;
3. When the company reaches its particular development stage, it is automatically public;
4. When the main owners want to sell part of their shares to diversify portfolio;
5. Determine the balance of rights and control of your cash flows before negotiating with potential buyers;
6. Independent entities to balance the assets structure;
7. The entrepreneur who requires foreign financing to finance the project will raise money by selling risk averse venture capitals;
8. Companies do IPOs when economy is favorable but not for the need of capital.

Risks to take into account while issuing IPO:

- Unsuccessful IPO
- Losing control over management
- Implementation of corporate governance principles
- Business sector and economic risks
- Risks associated with competitors
- Financial risk
- Technical or technological risks
- Risks related to shareholders
- Risks from IPO counterparts and their employees involved in IPO.

IPO timing

Many studies have shown that issuers of IPO are sensitive to the market timing and IPO activity increases in some particular time. In other words, companies go for public using “windows of opportunity” when the economic condition is favorable. Studies have defined market IPO timing differently.

Some researchers emphasize that the investor’s intention to the company play major role, while others focus on the ability of the company to issue stocks. Companies consider the market trend, return and valuation factors when making decision to issue IPO.⁹

Current situation of IPO at MSE

IPO issuance at MSE is not many compare to other similar countries. 18

⁹ It is still debated whether the market capitalization of the stock, certain specific sectors, or comparison of companies, or the recently released IPO companies is the most relevant

companies issued IPO during 2005-2018 (Appendix) which is only 7.6% of total listed companies at MSE.

Therefore, this paper investigates the current situation of IPO for the companies and determines the appropriate time for successful IPO at MSE.

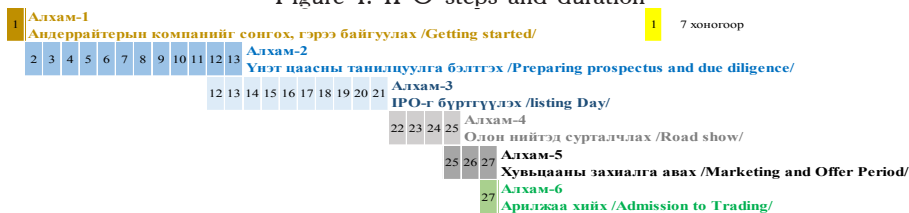
LISTING AT MSE

Different stock exchanges around the world have different boards with different criteria. **For example**, Hongkong (HKSE) Stock Exchange has **Mainboard** and **GEM** for companies with high growth. HKSE has listing specific procedures, however, there are instances where some criteria are not applied depending on the project's nature. Listing process takes up to 4 months.

IPO process at Mongolian Stock Exchange /MSE/

Listing stage of a stock is legalized under the “Law of Securities Market”, “Procedures for listing” of MSE and “Securities Registration procedure” of Financial Regulatory Commission /FRC/ and registers on the one main menu.

Figure 1. IPO steps and duration



Source: Own calculation and MSE

Step 1: Choose an underwriter and enter into an agreement for cooperation. The underwriters have an important role to play in providing valuable advice on the success of IPO.

Step 2: The underwriters will be able to analyze the financial and other conditions of the issuer and prepare and introduce prospectus of the company to investors, and handles the registering criteria to meet the authorizing organizations (FRC and MSE). These include:

- An independent audit report on financial statements
- Business and asset valuation by an independent, professional valuation company and obtain a report
- An independent law firms to make report on company's legal documents
- Obtain report from underwriting company.

Step 3: Submit an IPO request to the FRC and MSE, who will conduct

audits in accordance with relevant laws and regulations and make decision whether to trade the security.

Step 4: Perform road show for foreign and domestic investors.

Step 5: Receive buy orders from investors through brokerage companies.

Step 6: Organize trading and raise the fund for the company's investment.

The above steps take an average of 6 months. Companies planning to issue an IPO shall consider the methodological and legal recommendations and need to meet the criterias.

MSE classes and their criteria

MSE registers new shares of companies in three classes and lists in the class that meet the criteria. Table below shows the classes and criteria.

Table 1. MSE classes and criteria

Criteria	I class	II class	III class
1. Market cap	>10,0b ₺s	>1,0b ₺s	<1b ₺s
2. Public offering	25%	15%	-
3. Time of withdrawal	2 years	-	-
4. Years of operation	More than 3	Not less than 2	Not less than 1
5. Sales revenue	More than 10b ₺	More than 1b ₺	-
6. Profitability indicators	More than 1b ₺	Be profitable	-
7. Underwriters	Yes	Yes	Yes
8. Prospectus	Need to prepare	Need to prepare	Need to prepare
9. Principles of corporate governance	Yes	Yes (if no, describe)	Yes (if no, describe)
10. Financial reporting	Submitted to the FRC for the last 3 years and must be audited.	Submitted to the FRC for the last 2 years and must be audited.	-
11. Liability	Must not have overdue debt	-	-

Source: MSE

THE COST OF IPO ISSUENCE

We investigated the cost of IPO insueance by comparing with the bank lending.

The company that has been approved by the MSE and the FRC to issue their stocks will have the following costs during and after the registration process.

Table 2. Cost of IPO /tugrugs/

N°	Type of cost	Amount	Description		
1	Underwriting cost / Underwriting company/	3-5%	Percent of fund raising from security market and regulated by contract. Advertising costs associated with the sale of securities are included in underwriting fees.		
2	Valuation /Valuation company/	1%	In practice, approximately 10-30 million tugrugs		
3	Auditing /Auditing company/	10-30 million	Regulated by contract		
4	Law Report /Law firms/	10-30 million	Regulated by contract		
5	Marketing expenses		Negotiation with marketing company		
6	Fee of Regulatory organizations	0.68%	Fixed amount is set in accordance with regulations		
7	MSE service fee				
1	Application and analyzing service fee	2 million ₮	Before application to register		
			I class	II class	III class
2	Security registration service fee	Within 3 days after successful IPO	50 million -500 million	25 million-250 million	5 million-50 million
3	Annual service fee ¹	Within 1 quarter	1,2 million-50 million		500 thousand-25 million
	FRC service fee				
	Registration of new security	Each time	500,000.00		

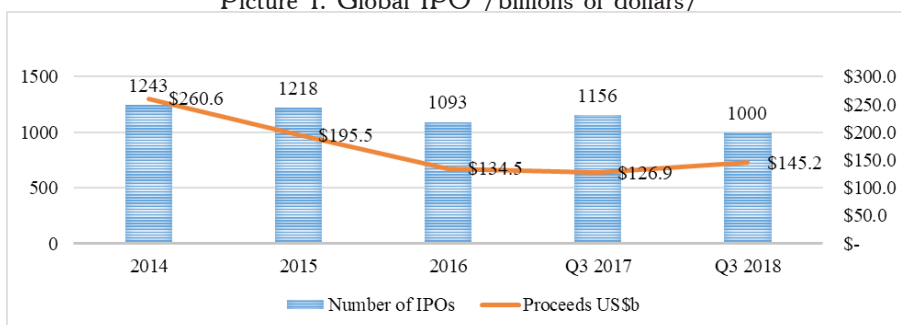
Source: Mongolian Stock Exchange, Financial Regulatory Commission & “BDSec” JSC

RESEARCH:

➤ GLOBAL TREND OF IPO ISSUANCE

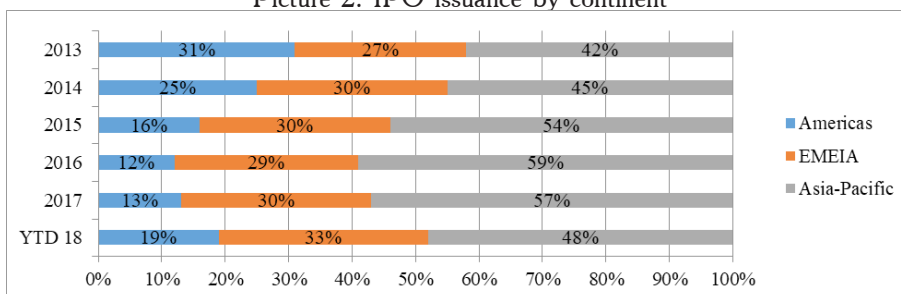
Despite ongoing geopolitical uncertainties and trade issues, IPO activity levels in the first nine months of 2018 (YTD 2018) are significantly above the 10-year median in volume and proceeds. In a historically quiet quarter, Q3 2018 **global IPO activity was notably lower than Q2 2018** and significantly down from Q3 2017 volumes. However, an increase in unicorn IPOs in Q3 2018 pushed YTD 2018 global IPO proceeds 9% above YTD 2017.

Picture 1. Global IPO /billions of dollars/



Source: Global IPO trends: Q3 2018

Picture 2. IPO issuance by continent



Source: Global IPO trends: Q3 2018

Asia is leading by its number of IPO however the figure was lowered compare to previous year in the third quarter of 2018.

The high yielding IPO is aimed at stabilizing the securities market and creating a stronger economy. Here's an example of China's overwhelming advantage over the number of deals made by the IPO, suggesting that the economy is sustainable and that the securities market is growing.

Top countries by number of IPO in 2018:

✓ China	(23)	✓ US	(6)	✓ Denmark	(3)
✓ Singapore	(14)	✓ Israel	(3)	✓ Malaysia	(3)
✓ UK	(9)	✓ Ireland	(3)		

Top stock exchanges by number of IPO:

• NASDAQ	(24)	• Hong Kong	(16)	• Sweden	(6)
• London	(10)	• NYSE	(17)		

IPO by industry:

- 1. Technology 66 IPO, \$9.5 b
- 2. Manufacturing 45 IPO, \$3.2 b
- 3. Health 40 IPO, \$5.6 b

Technology, industrials and health care sectors have been the most prolific producers of IPOs globally in YTD 2018, suggesting that investors are striking a balance between new innovation and sticking with the basics.

CURRENT SITUATION AND PROSPECT OF IPO ISSUANCE AT MSE

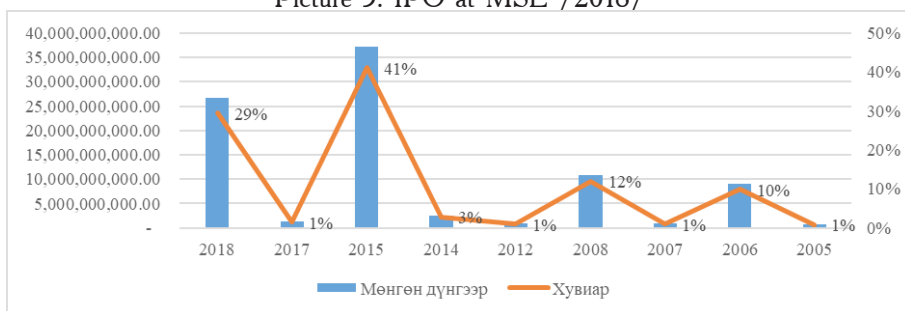
The following Appendix indicates that the IPO issuance, the key factor to the Mongolian capital market development is not sufficient.

Globally in 2018, technology companies have made IPOs at most, while most of the companies registered at the Mongolian stock exchange are technological and financial firms.

From the results of studies stated in the background section and IPOs at MSE investigation, the companies finance investment needs by issuing security-IPO relative to the period which the economic condition is fair. For instance, IPOs were active in the short run before 2008, but in the years with the economic downturn, there has been a sharp decline in Mongolia.

However, during the economic recovery in 2017-2018, 6 companies issued IPOs and financed successfully.

Picture 3. IPO at MSE /2018/

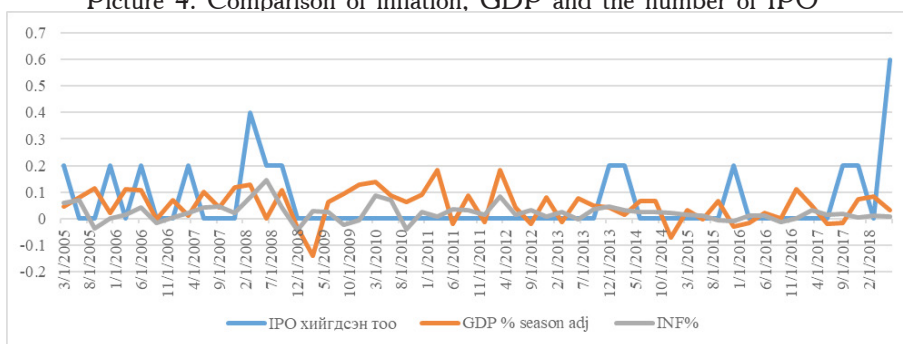


Source: Mongolian Stock Exchange

Let's look at the relationship between companies issued IPO and the macroeconomic factors. We observed the number of IPO, inflation, GDP growth which removed its seasonal effects. The results show that inflation and GDP have

impact on the number of IPOs with one quarter lag, ie. IPO increases at the next quarter which GDP has grown.

Picture 4. Comparison of inflation, GDP and the number of IPO¹⁰



Source: Own calculation, Mongolbank & Mongolian Stock Exchange

In 2007, GDP grew by 10.1%, which was unprecedented in the last three years, with 4 IPOs in 2008. However, in the next four years after the 2008 financial crisis, there was not any IPO and the GDP was -1.3% decline, and as in the international studies, the average number of IPOs in the post-crisis period of 3-4 years after the economic downturn had been reduced. In conclusion, the decision to issue an IPO depends on the GDP growth of the previous quarter in some circumstances.

In 2018, a total of 5 IPOs have been made, reflecting the recovery of Mongolia's economy or 6.3 percent of GDP growth.

The World Bank predicted that the Mongolia's GDP growth will be 6% has influenced-boosted the IPO.

Unlike IPO wave in 2008, inflation rate is low at this time. IPO wave was not efficient due to inflation and GDP growth in 2008. In recent years, inflation is observed to go has opposite-reversed direction with the number of IPO and the number IPO is expected to increase in the future.

Let us estimate the effect of industry average to the IPO decision.

¹⁰ [6]

Table 4. Industry classification of companies

Industry	Selected companies	Companies of the industry
Construction	Mereks, Remicon	Arig gal, Moninjbar, UB buk, Gan Hiits
Processing industry	Khukh Gan, Nako fuel, High B oil	Ulaanbaatar hivs, Darkhan huns, Juulchin duty, Nehmeliin uildver, Mongol savhi
Whole and retail sales	Hermes centre	Material impex, State Department store

Source: Mongolian Stock Exchange

The IPOs are comparable to the average growth of the industry, and our assumptions are based on $H_0: \mu_i = \mu_s$, $H_1: \mu_i \neq \mu_s$, and that it is significant to the confidence level of 95% using T criteria. As a result, a total of 60 results were achieved according to Table-5, of which 55 or 91.17% accepted the hypothesis. It is statistically unacceptable that IPOs do follow the industry's average performance. In other words, the IPO companies follow the industry average for 2.5 years.

Table 5. Hypothesis on comparison of companies issued IPO and industry average¹¹

Symbol		1	2	3	4	5	6	7	8	9	10	overall
RMC	start month	5/21/2008	8/21/2008	11/21/2008	2/21/2009	5/21/2009	8/21/2009	11/21/2009	2/21/2010	5/21/2010	8/21/2010	h0
	Accepted hypothesis	h1	h0	h0	h0	h0	h1	h0	h1	h0	h0	h0
MRX	start month	4/21/2014	7/21/2014	10/21/2014	1/21/2015	4/21/2015	7/21/2015	10/21/2015	1/21/2016	4/21/2016	7/21/2016	h0
	Accepted hypothesis	h0	h0	h0	h0	h0	h0	h0	h0	h0	h0	h0
HBO	start month	5/3/2007	8/3/2007	11/3/2007	2/3/2008	5/3/2008	8/3/2008	11/3/2008	2/3/2009	5/3/2009	8/3/2009	h0
	Accepted hypothesis	h0	h0	h0	h0	h0	h0	h0	h0	h0	h0	h0
NKT	start month	6/25/2008	9/25/2008	12/25/2008	3/25/2009	6/25/2009	9/25/2009	12/25/2009	3/25/2010	6/25/2010	9/25/2010	h0
	Accepted hypothesis	h0	h0	h0	h0	h0	h0	h0	h0	h0	h0	h0
HGN	start month	8/1/2008	11/1/2008	2/1/2009	5/1/2009	8/1/2009	11/1/2009	2/1/2010	5/1/2010	8/1/2010	11/1/2010	h0
	Accepted hypothesis	h0	h0	h0	h0	h0	h0	h0	h0	h0	h0	h0
HRM	start month	5/19/2008	8/19/2008	11/19/2008	2/19/2009	5/19/2009	8/19/2009	11/19/2009	2/19/2010	5/19/2010	8/19/2010	h0
	Accepted hypothesis	h0	h0	h0	h0	h0	h1	h0	h1	h0	h0	h0

Source: Authors' estimation

As shown in Table 5, Remicon did not follow the industry average. The reasons include the economic crisis in 2008, that year election has organized and because when issuing IPO, there were not enough trading and did not traded at secondary market. Other companies followed the industry average. As a result, most of the Mongolian companies follow the industry average in issuing IPOS coinciding with international studies.

¹¹ [5]

Conclusion

- ✓ While the companies in developing or developed countries prefer to become from limited to public companies through security market. Since privatization, 125 public companies became LLC, meaning Mongolia is in opposite direction compare to emerging markets.
- ✓ The international study shows that IPO optimizes asset structure and creates new opportunities for business development.
- ✓ IPO process takes place up to 6 months (slower) at MSE but up to 4 months at HKEX. Market capitalization of Mongolian companies are lower making difficult to attract large amounts of financial resources.
- ✓ Need to explore new markets for small and medium-sized companies at MSE, and tailor requirements adapting to the country situations.
- ✓ The result of the study overlapped with international studies, in other words, Mongolian companies issued IPOs when the market is recovering. Mongolian economy is growing lately so issuing IPO may be the best way of financing for the companies at the moment.
- ✓ Research findings show that the company's value follows the industry average and companies may consider the findings.

The study shows that, although the cost of issuing IPOs has decreased significantly in recent years, the duration of listing at MSE is longer compare to other countries.

Global IPO trend shows that the number of IPO issuance follow the overall economic outlook as well as the trend in the majority of countries. For example, the number of technological companies which issued IPO successfully has increased in the worldwide, whereas Mongolian financial and technological companies have issued IPO successfully in 2018.

There are 18 IPOs have listed at MSE today and 4 of 6 companies which listed between 2017 to 2018, were technological and financial companies, indicating that global trends also affect our country. Finally, the results show that companies are likely to success in IPO when the global market rebounds and when the domestic companies are growing.

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Appendix. Public companies offered its shares

N°	Symbol	Company name	Type of Industry	Registered Date	Raised amount	
					Number of stocks	Total amount / tug.s/
1	AIC	“Ard Daatgal” LC	Finance	2018-06-13	7,500,000	5,250,000,000
2	MNDL	“Mandal Daatgal” LC	Finance	2018-05-07	1,560,754	7,491,619,200
3	ERDN	“Erdene resource Development Corporation” LC	Mining	2018-04-04	3,898,000	2,494,720,000
4	MBW	“Mongol Bazalt” LC	Manufacturing	2018-04-05	16,925,100	6,431,538,000
5	LEND	“Lendmn NBFO” LC	Finance and Technology	2018-01-26	200,000,000	5,000,000,000
6	ITLS	“Itools” LC	Technology	2017-09-27	13,387,980	1,338,798,000
7	MIK	“MIC holdong” LC	Manufacturing	2015-12-21	3,106,398	37,276,776,000
8	MRX	“Merex” LC	Manufacturing	2014-01-14	26,000,000	2,600,000,000
9	ETR	“E-Trans Logostics” LC	Transportation	2012-04-09	7,700,000	924,000,000
10	HGN	“Khukh Gan” LC	Manufacturing	2008-07-30	30,395,272	3,195,456,280
11	NKT	“Naco tulsh” LC	Manufacturing	2008-06-24	2,743,000	274,300,000
12	RMC	“Remicon” LC	Manufacturing	2008-05-19	50,480,202	5,048,820,200
13	HRM	“Hermes center” LC	Manufacturing	2008-05-16	23,562,900	2,356,290,000
14	OLL	“Olloo” LC	Technology	2007-09-12	5,820,299	582,029,900
15	HBO	“High B oil” LC	Manufacturing	2007-05-02	4,000,000	400,000,000
16	BDS	“BDSec” LC	Finance	2006-06-22	7,500,000	750,000,000
17	JTB	“Genco Tour Bureau” LC	Tourism	2006-01-17	78,895,885	8,259,239,676
18	MSH	“Mongol shiltgeen” LC	Tourism	2005-05-25	1,000,000	800,000,000

Source: Mongolian Stock Exchange