Feasibility Study Report

Mauritius

Establishing Second Tier Market & Restructuring OTC Market

This report is an output from a project funded by FIRST Initiative (www.firstinitiative.org). The views expressed in it are not necessarily those of FIRST. This report is protected by the copyright and other applicable intellectual property rights owned by and/or licensed to FIRST Initiative.
CONTENTS

EXECUTIVE SUMMARY .................................................................................................................. 2
   OTC MARKET FINDINGS ................................................................................................... 2
   OTC MARKET RECOMMENDATIONS .................................................................................. 2
   NEW MARKET FINDINGS .................................................................................................. 3
   NEW MARKET RECOMMENDATIONS .................................................................................. 3
   NEXT STEPS AND TIMESCALES ...................................................................................... 3

INTRODUCTION ............................................................................................................................ 4

OTC MARKET .................................................................................................................................. 4
   HISTORY OF THE OTC MARKET IN MAURITIUS .......................................................... 4
   OTC TRADING RULES AND MARKET ACTIVITY .......................................................... 5
      Admission .......................................................................................................................... 5
      Trading and Trade Publication ....................................................................................... 5
      Market Activity .................................................................................................................. 6
   Regulation of the OTC Market ............................................................................................. 7
   RECOMMENDATIONS .......................................................................................................... 8
      The future of the OTC Market ......................................................................................... 8

NEW MARKET .................................................................................................................................. 11
   DEMAND FOR A NEW MARKET .......................................................................................... 11
   COST/BENEFIT ANALYSIS OF NEW MARKET .................................................................. 12
      Revenues ............................................................................................................................. 12
      Costs ....................................................................................................................................... 13
   STRUCTURE OF NEW MARKET ........................................................................................... 13
      The Business Aspects .......................................................................................................... 14
      The Regulatory Structure ................................................................................................. 14
      Operational Considerations ............................................................................................. 16
   ROLE OF INTERMEDIARIES ................................................................................................. 17
   PHASING OUT THE OTC MARKET ..................................................................................... 17
   INTRODUCTION OF MATCHED BARGAIN FACILITY ..................................................... 18
   TIME FRAME .......................................................................................................................... 18
   MOTIVATING AND ATTRACTING COMPANIES ............................................................... 19
   RESOURCES REQUIRED ...................................................................................................... 20
   RISK FACTORS ..................................................................................................................... 21
   NEXT STEPS ............................................................................................................................ 21

APPENDICES AND ATTACHMENTS ............................................................................................... 23
   APPENDIX 1 – CONCEPT PAPER ....................................................................................... 23
   APPENDIX 2 - LIST OF INTERVIEWEES ........................................................................... 26
   APPENDIX 3 - INITIAL THOUGHTS ON NEW MARKET RULES ...................................... 27
   ATTACHMENT 1 – COMPARATIVE STUDY ....................................................................... 28
EXECUTIVE SUMMARY

This feasibility study report has been commissioned to consider the future of the Over-The-Counter (OTC) Market in the light of the new Securities Bill and whether to establish a New Market. To support the recommendations, a comparative analysis of other second tier and OTC markets has been undertaken and detailed discussions have been held with 13 intermediaries (including brokers, investors and accountants) and 26 OTC companies.

OTC MARKET FINDINGS

- There are 78 companies on the OTC Market of which only just over a third traded more than, on average, once a week during 2004; about a fifth traded, on average, more than twice a week.
- Trading value on the OTC Market has increased significantly over the last six years to Rs 1.3 billion in 2004 compared with Rs 2.8 billion in the Official Market. However, two of those “trades” amounted to almost Rs 800 million of this value.
- The forthcoming Securities Act will lay upon the SEM greater responsibility for the regulation of its markets.
- The SEM will need to publish the information that it relies upon to admit securities to the OTC Market.
- Companies admitted to the OTC Market must make timely disclosure of material and periodic information.

OTC MARKET RECOMMENDATIONS

- The SEM should publish in hard copy and on its website information relating to the companies traded on the OTC Market.
- The website should be re-designed to segregate OTC Market information from Official Market data and should be made more user friendly.
- The rules should be amended to ensure that only “reporting issuers” or companies entering into a disclosure agreement with the SEM are traded on the OTC Market. Companies not entering into an agreement should be withdrawn from the OTC Market.
- The SEM should conclude an agreement with the Commission for the timely exchange and release of information received from reporting issuers traded on the OTC Market.
- Consideration should be given to charging OTC companies a fee commensurate with the amount of additional work involved in regulating the market.
- In the event that the Board of the SEM decides to launch a New Market, the OTC Market should close.
- Consideration should be given to establishing a match bargain facility whereby shareholders of unquoted companies can execute occasional transactions in a fair and transparent manner.
NEW MARKET FINDINGS

- There appears to be significant demand for a New Market from companies, brokers, investors and advisers.
- More work will be required by SEM, when the new Securities Bill is published, in order to quantify the demand more exactly.
- The success of the New market will depend on:
  - obtaining a critical mass of companies onto the market at the start
  - ensuring there are no company failures for at least the first few years
  - adequate resourcing
  - avoiding launching during a period of uncertainty
  - ensuring the appropriate training is completed prior to and after the launch.

NEW MARKET RECOMMENDATIONS

- The market should be open to all types of company and investor.
- The rules should build on the Securities Bill, be clearly differentiated from the Official Market and enable companies to grow whilst offering adequate protection for investors.
- The market should use the existing trading platform, have longer trading hours than the OTC, have transparent price reporting and a dedicated section of the website.
- The SEM should:
  - make available a dedicated resource for the New Market
  - try to create a “community” for the market
  - enter into partnerships with other market participants to promote the market
  - use the website to sell the market
  - enter a dialogue with the Government to investigate fiscal incentives.

NEXT STEPS AND TIMESCALES

- Further research by the SEM following publication of the Securities Bill
- Board decision – end February

If New Market approved:
- Draft Rules - March
- On-site assistance to SEM - April
  - Assist with marketing plan
  - Propose incentives
  - Advise on fees
  - Assist with action plan

Amend OTC Rules to comply with the Act - within 3 months of enactment
Launch of New Market - 4th quarter 2005
Closure of OTC Market - end October 2006
Introduction of Matched Bargain Facility - end October 2006

We would like to express our grateful thanks to the SEM and to all interviewees for their cooperation and assistance in conducting this study.
INTRODUCTION

This project is designed to consider whether the Stock Exchange of Mauritius (the SEM) should establish a New Market to address the drawbacks of the current Over-The-Counter (OTC) Market and to meet the requirements of the new Securities Bill, which is presently in draft form.

The project has included a desk based analysis of second tier and OTC market structures in a number of other countries, to assist in the development of an appropriate structure for the SEM. A copy of this analysis is attached for reference.

Detailed discussions have been held with the SEM and the Financial Services Commission (Commission) to establish their objectives for this market. The output from these discussions and from the comparative analysis of other second markets has been used to prepare a concept paper, which defined in generic terms, the main requirements and features of the New Market (a copy of the paper is attached as Appendix 1). This paper has been circulated to key stakeholders, including market intermediaries (brokers, analysts and investors) and potential companies (see Appendix 2 for details), with whom discussions have been held to determine the demand for a New Market and what structure such a market should adopt.

OTC MARKET

HISTORY OF THE OTC MARKET IN MAURITIUS

Since its formation in 1989, the SEM has had, as one of its main objectives, the creation of different market segments so that small and medium sized enterprises could use the stock market as a vehicle to raise capital and investors could benefit from a diversified range of risk profiles. Efforts were undertaken to establish, alongside the Official Market, a Second Tier Market for companies which could not comply fully with the stringent listing requirements of the Official Market. Rules governing the conditions of admission and trading of companies on the Second Market, which were less stringent than those applicable to companies on the Official Market, were drafted and included in the “Règlement Général de la Bourse de Maurice” in 1989. Furthermore, all the incentives available to companies on the Official Market i.e. reduced tax rate of 25%, tax free dividends for shareholders and no registration or stamp duties on transfers of shares, were extended to the Second Market. This initiative to set up a Second Market never came to fruition.

However, the SEM recognised that there was a need for a platform for trading in the shares of those public companies that were not traded on the Official Market and in 1990, developed an OTC Market with almost no disclosure requirements after admission.

The Regulations governing the OTC Market were made by the Minister under section 53 of the Stock Exchange Act 1998 on 2nd April 1990. The Stock Exchange (Operation of the Over-the-Counter Market) Rules made by the SEM govern access to the OTC Market.

Contrary to the belief of some, the OTC Market is not a growth market to enable companies to progress to a listing on the Official Market. Whilst it is true that nineteen OTC traded companies have progressed to the Official Market, only one (Caudan Development) has done so since the Official Market lost its privileged tax status in 2002. In addition, it is not fair to
say that the OTC Market has not been successful: quite the opposite, as can be seen from the trading volume statistics in figure 2.

**OTC Trading Rules and Market Activity**

**Admission**

The prerequisite requirements for companies to be admitted to the OTC Market are as follows:

- the company must be a public company;
- it must be a going concern;
- its issued shares must be freely transferable; and
- either its issued share capital must be not less than Rs 1 million, or
- the company must have at least 30 shareholders.

An application must be filed by an OTC trader¹ and signed by either the applicant OTC Trader or the Company Secretary. It must be accompanied by:

- a copy of the Company’s Certificate of Incorporation;
- copies of the Company’s audited Financial Statements for the previous two financial years; and
- a copy of the Memorandum and Articles of Association.

The application is considered by the OTC Review Committee and, if satisfied, it issues a one-off clearance visa. The OTC Review Committee has never found a reason to refuse to issue a clearance visa. Two companies are currently suspended on the OTC Market pending restructuring and two companies were, in the past, withdrawn from the OTC Market by the SEM because of restructuring. Companies cannot refuse to have their shares traded on the OTC Market. They can refuse to provide the information accompanying the application form but this can be obtained from other sources.

Although there is no contractual agreement between the SEM and the companies traded on the OTC Market, many of those companies provide the SEM with a copy of their announcements. Generally it works well but there have been some practical problems such as failure to provide a soft copy and the occasional problem over the timing of announcements. However, because companies do not need to comply with the listing rules, they do not need to report or present their accounts to the standards required of companies listed on the Official Market. In addition, there is no requirement to report directors and substantial shareholders dealings or report other information that is of a price sensitive nature. This will change with the passing of the new Securities Bill which introduces higher minimum disclosure requirements for all “reporting issuers” - most if not all of the companies whose securities are traded on the OTC Market will be “reporting issuers”.
Companies do not pay an annual listing fee to the SEM although they do pay a charge to CDS for its services of Rs 10,500 per annum.

**Trading and Trade Publication**

The trading procedures for the OTC Market are largely identical² to those for securities traded on the Official Market save that trading takes place only on a Tuesday and a Thursday.

---

¹ any dealer or any dealer/s representative as defined in the Stock Exchange Act 1988.

² generally they are the same but trading is on a different day.
and continuous trading is reduced to a forty minute session between 1.20 p.m. and 2.00 p.m. The OTC Market comprises the OTC Board and Crossings Board. There is no Odd Lot Board in the OTC Market and this can create problems when clients, who have traded in normal size, see other trades going through at materially different prices.

The SEM publishes information on trading and market statistics on its web-site and this is reproduced in printed form in the daily (twice weekly) list and in the Weekly Official Bulletin. The information is also passed to the press for publication in daily newspapers and in a weekly magazine. A summary of OTC Market activity is published in the Monthly Newsletter and annual Fact Book.

Market Activity

There are seventy eight companies whose securities are traded on the OTC Market. From its formation in 1990 to the present day, the number has varied between the current highest figure and a low of sixty five in 1996. Trading in most companies is infrequent as demonstrated by the following breakdown of the number of trades in each company during 2004:

*Figure 1*

<table>
<thead>
<tr>
<th>Number of Trades</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>501 plus</td>
<td>27%</td>
</tr>
<tr>
<td>201 to 500</td>
<td>9%</td>
</tr>
<tr>
<td>101 to 200</td>
<td>9%</td>
</tr>
<tr>
<td>51 to 100</td>
<td>16%</td>
</tr>
<tr>
<td>21 to 50</td>
<td>15%</td>
</tr>
<tr>
<td>11 to 20</td>
<td>21%</td>
</tr>
<tr>
<td>1 to 10</td>
<td>3%</td>
</tr>
</tbody>
</table>

This shows that only thirty seven percent of companies on the OTC Market traded more than fifty times (once a week) during 2004.

The value of trading on the OTC Market has increased considerably during the last five years as illustrated by the following graph:

---

2 There are minor differences e.g. the trading unit is different (which gives rise to the fact that there is no Odd Lot Board) and a difference in the price spread which is set at 20% (15% for the Official Market).
Although the majority of trading on the OTC Market appears to be normal buying and selling by investors, a small proportion of these trades are one-off deals in substantial size. These are corporate actions and are in fact brought as deals to the OTC Market in order to avoid the 13.2% transaction tax.

The OTC Market is an important market to the SEM as illustrated by the following graph which compares its growth in terms of trading volume over the last six years relative to the Official Market:

Regulation of the OTC Market

The Trading and Market Information Department is responsible for monitoring trading on both the Official and OTC Markets. This is done through a surveillance module attached to the trading system which can be configured to give alerts which assist in monitoring for instances of front running, market manipulation etc. It is also used in the analysis of market activity in cases of suspected insider dealing. The surveillance module is rudimentary but adequate given the current volume of trading on the SEM.
Apart from this, the OTC Market is largely unregulated because companies are not obliged to comply with any of the continuing disclose obligations that apply to companies listed on the Official Market.

RECOMMENDATIONS

The future of the OTC Market

Under the new Securities Bill, the SEM is required to have in place rules and procedures that are adequate to ensure, as far as is reasonably practicable, that the market will operate fairly, transparently and in an orderly way (section 12(2)(a)) and to have rules that make provision for:

- the terms and conditions for admission of securities for listing on the exchange (section 13(2)(b));
- the conditions under which securities are to be traded on the exchange (section 13(2)(c)); and
- disclosure of information about the exchange, and about listed securities and the issuers of those securities (section 13(2)(d)).

The objective of the Bill, which is designed to help develop Mauritius as a leading business and financial services centre in this part of the world, “is to establish a framework for the regulation of securities markets, market participants and self-regulatory organisations, the offering and trading of securities and other related matters, to ensure fair, efficient and transparent securities markets and to strike an appropriate balance between the protection of investors and the interests of the securities markets”.

It is clear therefore that the present structure of the OTC Market must change and the SEM must undertake greater responsibility for the admission and regulation of securities traded on its markets. The SEM, in addition to vetting companies to be admitted to the OTC Market, must ensure that:

1. the information it relies upon to admit securities to the OTC Market is published and made available to potential investors; and
2. companies admitted to the OTC Market:
   a. make timely disclosure to the SEM of material changes that occur in their affairs which is likely to have a significant influence on the value or market price of their securities; and
   b. make periodic disclosure to the SEM of quarterly financial statements and annual reports.

Point 1 above would be overcome by:

i. the production of a “Handbook for Companies Traded on the OTC Market” using the information taken from companies latest annual report and accounts; and

---

3 Extract from the Explanatory Memorandum to the new Securities Bill.
4 The SEM currently produces a “Handbook of Companies Listed on the SEM” which contains information on all listed companies compiled from their latest annual reports and accounts. The Handbook does not contain details of companies traded on the OTC Market.
ii. summary information derived from the annual report and accounts appearing on the SEM website. The website should also be redesigned so as to segregate announcements from companies traded on the OTC Market from those listed on the Official Market. In addition, there should be a search facility for both markets so that investors can call up all announcements, including quarterly financial statements, made by individual companies going back over a period of at least two years.

Point 2 above would be overcome by the SEM including in a memorandum of understanding with the Commission (under section 145 of the Securities Bill) the timely exchange and release of information received from reporting issuers that are traded on the OTC Market. The information, provided by the Commission, will avoid the need for the SEM to enter into individual agreements with all companies traded on the OTC Market. This would capture all companies that are reporting issuers which we believe to be the majority of OTC companies. The SEM is currently undertaking further analysis to determine those companies currently traded on the OTC Market that do not fall within the definition of reporting issuer. For those companies that are not reporting issuers, it will be necessary for the SEM to enter into an agreement with them for the disclosure by the companies of those matters that are in Part VI of the draft Securities Bill. In the event that the company is unwilling to sign such an agreement, the SEM would withdraw them from the OTC Market.

The Stock Exchange (Operation of the Over-the-Counter Market) Rules should therefore be amended, as follows (new wording underlined; deleted wording struck through), to ensure that only “reporting issuers” or companies entering into a disclosure agreement with the SEM are traded on the OTC Market:

A.(3) The Company, as described under A (1), above, must be a reporting issuer as defined by section 86 (1) of the Securities Act 2005 or have entered into an agreement to disclose to the SEM those matters contained in Part VI of the Securities Act 2005, public company, and such company’s stock held by a minimum of 30 shareholders or have a minimum issued capital of Rs 1 million.

In addition, the SEM should publish information about OTC traded securities as recommended earlier.

The SEM will monitor for compliance with the disclosure obligations of companies traded on the OTC Market. Any breach by a reporting issuer will be a breach of Law and dealt with according to the Act. A breach by a non-reporting issuer would be a breach of the agreement between the company and the SEM and will be dealt with by the SEM. If the company fails to put right that which is wrong, they should be publicly censured by the SEM. In the event of a continued breach, the company should be withdrawn from the OTC Market.

The transitional provisions within the Securities Bill require the SEM to submit rule changes to ensure conformity with the Act to the Commission within three months of the Act coming into force or such longer period as may be agreed with the Commission.

The procedures will be written after discussions have been held with the Commission on the release of information received from reporting issuers.
Thought is also being given to charging OTC companies a fee commensurate with the amount of additional work that the SEM will have to undertake in regulating the market. This could add further incentive to those companies considering a listing on the New Market to apply early and avoid the OTC fee. However, we are still considering the consequences if OTC companies refuse to pay the fee.

The longer term future of the OTC Market is discussed in the section of this report dealing with the New Market.
NEW MARKET

DEMAND FOR A NEW MARKET

Over 20 potential companies (focusing on existing OTC companies) were visited and asked for their views on the proposed New Market. The response was generally very positive, with most companies recognizing the benefits a regulated market would bring to their companies and accepting that the OTC Market could not carry on in its present form. The intermediaries and investors interviewed were all very concerned about the lack of companies on a regulated market, in which they could invest.

In addition, the proposed New Market generated significant interest from the accounting firms interviewed, who believed that a number of their unquoted client companies, who are often overgeared and entrepreneurs with ideas but no capital would also be interested in joining. Interviewees from some listed groups voiced the opinion that some of their subsidiaries may also be interested in the New Market and we were advised that Mauritius has a growing IT sector, which could also be targeted.

Comments received from interviewees suggest that the SEM should target companies from a wide group:

- Existing OTC companies (although the larger ones may wish to go direct to the Official Market, particularly if their competitors are there)
- The subsidiaries of listed companies
- Unquoted family owned companies (who could well be interested, provided the p/e ratios of companies on the market remain high)
- Venture capital companies seeking an exit for their investments
- Smaller Government privatisations

There is also a distinct possibility that some existing Official Market companies (particularly at the bottom end) may wish to move to the New Market. Although it would be difficult to stop this happening, it was generally felt that the purpose of the New Market should be to act as a stepping stone to the Official Market and not the other way round. Therefore, movement in this direction should not be encouraged and adequate listing rules should be put in place to ensure this is not a particularly attractive option (such as requiring a 75% vote and publication in the Press of the reasons).

However, the companies are unlikely to join the New Market of their own volition; the SEM will need to do much pro-active marketing to these potential companies to get as many as possible to join at the launch in order to form a critical mass at the outset and then to keep the pipeline full thereafter.

Although some interviewees felt that the New Market in Mauritius will always remain small and local, since the economy is simply not big enough to support anything larger, consideration should be given at a later stage to opening up the market to companies from the region.
COST/BENEFIT ANALYSIS OF NEW MARKET

Revenues

We have prepared for illustrative purposes only some initial estimates of revenues, which could accrue to a New Market.

The Board is asked to note the following matters in considering these figures:

- Only a small sample of companies (26 out of the 78 OTC companies and no unquoted companies) were interviewed, due to the time constraints of the project;
- The companies interviewed were only given limited information on the proposed entry and continuing obligations requirements, for the following reasons:
  - the requirements of the new Securities Bill have yet to be finalized and made public;
  - the objective of the interviews was to elicit from the companies without being prescriptive, which of the existing Official Market rules caused problems; and
  - the detailed rules are scheduled to be drafted in the next stage of the project.

Once the Securities Bill has been made public, the SEM should undertake a more intensive consultation with prospective companies, in order to gauge more accurately the likely demand for the New Market. In order to assist the SEM, some initial thoughts on a framework for the entry and continuing obligation rules for the New Market are attached as Appendix 3. However, experience dictates that true demand will not be known until the definitive rules are published.

On the basis of our very limited research, we believe as a conservative estimate that the following numbers of companies could, with appropriate rules and sufficient promotion by the SEM, be persuaded to join the New Market within the first three years of its operation:

<table>
<thead>
<tr>
<th></th>
<th>First Year</th>
<th>Second Year</th>
<th>Third Year</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>OTC Companies</td>
<td>15</td>
<td>8</td>
<td>Market Closed</td>
<td>23</td>
</tr>
<tr>
<td>Other companies</td>
<td>2</td>
<td>4</td>
<td>10</td>
<td>16</td>
</tr>
<tr>
<td>Total</td>
<td>17</td>
<td>12</td>
<td>10</td>
<td>39</td>
</tr>
</tbody>
</table>

Assumptions:
1. There are 25 companies on the OTC Market that traded more than 100 times during 2004. Two of those companies will apply to the Official Market. The remainder (23) will seek a listing on the New Market. Twice as many will apply in the first year as in the second. Seven companies will apply in the first six months.
2. Two new companies (not presently listed nor on the OTC Market) will seek a listing on the New Market in the first year; four in the second and six in the third. In addition four companies presently traded on the OTC Market will decide, after the market is closed, to seek a listing for their shares in the third year.

Discussion on fees and charges will be undertaken during phase three of the project. However, extrapolating the above numbers and making certain assumptions on fee levels (see below), the incremental income to the SEM will be:
<table>
<thead>
<tr>
<th></th>
<th>First Year</th>
<th>Second Year</th>
<th>Third Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Listing</td>
<td>500,000</td>
<td>600,000</td>
<td>500,000</td>
</tr>
<tr>
<td>Annual Listing</td>
<td>648,000</td>
<td>1,356,000</td>
<td>1,656,000</td>
</tr>
<tr>
<td>Total Listing fees</td>
<td>1,148,000</td>
<td>1,956,000</td>
<td>2,156,000</td>
</tr>
<tr>
<td>Increased Transaction Fees</td>
<td>77,000</td>
<td>98,000</td>
<td>133,000</td>
</tr>
<tr>
<td>Total</td>
<td>1,225,000</td>
<td>2,054,000</td>
<td>2,289,000</td>
</tr>
</tbody>
</table>

Assumptions:
1. There is a flat rate initial listing fee of Rs 50,000, which is waived for existing OTC companies joining in the first six months.
2. There are no listing fees for further issues of shares (this is consistent with the philosophy that the market should make it as easy as possible for companies to grow).
3. The annual listing fee is based on market capitalization and is set at fifty percent of the annual fee charged to companies listed on the Official Market; Non-OTC companies will have a market capitalisation of between Rs 50 million and Rs 100 million.
4. The number and value of transactions will increase by 20% for existing OTC companies due to the extra day’s trading and for new companies will be 60 trades per annum with an average transaction size of Rs 50,000.

No account has been taken of any listing or incremental trading income resulting from the two OTC companies, which are expected to move to the Official Market. There were also four very large trades in 2004 (totalling Rs 932 million) in OTC companies, which have not been included in the likely entrants to the New Market, as they did not trade frequently enough. However, it is believed that if similar transactions are undertaken in the future, the companies concerned will apply to join the New Market if the conditions and the potential savings are big enough. There will thus be minimal loss of trading income from closing the OTC market.

Costs

The costs of setting up the New Market would be marginal, as the SEM’s existing infrastructure (trading platform, staff etc.) could be largely used. However, we have identified the following additional start-up and ongoing costs:

<table>
<thead>
<tr>
<th>Cost type</th>
<th>Cost description</th>
<th>Cost Rs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Start-up</td>
<td>Website design and development</td>
<td>20,000</td>
</tr>
<tr>
<td></td>
<td>Training</td>
<td>50,000</td>
</tr>
<tr>
<td></td>
<td>Promotional advertising and launch expenses</td>
<td>300,000</td>
</tr>
<tr>
<td></td>
<td>Total start-up</td>
<td>370,000</td>
</tr>
<tr>
<td>Ongoing annual</td>
<td>Business development/relationship manager</td>
<td>450,000</td>
</tr>
<tr>
<td></td>
<td>Training</td>
<td>20,000</td>
</tr>
<tr>
<td></td>
<td>Promotional material</td>
<td>20,000</td>
</tr>
<tr>
<td></td>
<td>Total annual</td>
<td>490,000</td>
</tr>
</tbody>
</table>

**Structure of New Market**

The structure of the New Market has been considered from three perspectives: the business aspects, the regulatory structure and the operational considerations.
The Business Aspects

We believe that this project presents a wonderful opportunity to look at the structure of the financial markets in Mauritius afresh, rather than try to fit the structure of a New Market around the existing markets. In order to do this, it is necessary to be quite sure about the philosophy behind the New Market and indeed a number of interviewees stated that the New Market should have clear objectives and a well-defined purpose.

It is suggested that the broad principles underpinning the New Market should be that it:

- Is open to any company with a financial record of over one year
- Focuses initially on domestic companies and equity securities
- Targets all investor types (retail, professional, institutional, domestic and foreign)
- Requires frequent and timely disclosure of price sensitive information
- Has flexible, relevant regulation which allows companies to grow
- Is not tax driven

We believe that, to be successful, the New Market should seek to attract a wide range of companies from young, venture capital businesses to more established businesses including those that are family owned. It should not be restricted to companies, which are presently on the OTC Market. It should be seen as a market, which allows companies to grow and to become used to more accountability to shareholders, so that the market acts as a stepping-stone to the Official Market.

There was a mixed reaction as to whether the SEM should seek some form of tax incentives from the Government for the New Market. The past practice of giving tax incentives to Official Market companies, only to then make them available to all companies at a later date, was not seen as helpful. In general, interviewees felt that the market should not be predicated on tax incentives, but that never-the-less the SEM should initiate talks with Government to discuss stepped tax incentives for the equity markets as a whole.

Careful research should be undertaken to select an appropriate name for the New Market, as “second” market implies second division to some audiences. Similar markets in other countries have got around this problem by calling their markets “alternative” or “growth” markets. The market must have a clear identity of its own and not hide behind the Official Market. Many interviewees suggested that it should be emphasized that the market belongs to the SEM, who will have sole charge of regulating and operating it.

The Regulatory Structure

One of the questions we asked the intermediaries and the companies, was why few new companies have been coming to the Official Market recently and why OTC companies have not moved onto the Official Market. The common responses were that companies found it relatively easy to obtain financing from the banks (although this may change with the introduction of the new Basle requirements) and that the costs of complying with disclosure obligations for the Official Market were too onerous and cumbersome. Above all, companies wanted to be able to concentrate on running their businesses and not spend their time filling in forms.

The overriding principles for the New Market rules are that they should:

- Be clear and concise, with guidelines where appropriate
• Build on the new Securities Act
• Be clearly differentiated from the Official Market
• Create the right balance between facilitating the growth of companies and protecting investors
• Include the requirement for a risk warning for investors
• Ensure companies remain solvent for at least a year after joining the market

The rules of the New Market must be clearly differentiated from those of the Official Market and should not be formulated in a vacuum. This poses a problem, in so far as the rules of the Official Market are presently being revised, a process which will not be completed until later in the year. There are also the provisions of the new Securities Act to be considered, which will form the base level of regulation for the New Market.

In order to allow companies on the market to grow successfully, the New Market must have less stringent requirements than the Official Market, particularly those relating to acquisitions and disposals, which require an information circular to be sent to shareholders and the prior approval of their shareholders. However, there must be adequate protection for investors, particularly as the New Market will be attracting smaller companies, which by definition are likely to be riskier investments.

Companies would like the rules to remain reasonably constant and to be properly consulted on rule changes before they are implemented. It is worth considering a separate Consultative Committee for the New Market, which would assist in achieving buy-in from market participants and in creating a separate identity for the market.

The detailed draft rules for admission and continuing disclosure will be prepared under Phase 3 of the project (see Next Steps below). However, certain criteria were set out for discussion purposes in the concept paper circulated to interviewees and the responses, which will be used to formulate the detailed rules and which are reproduced below to assist the Board with their deliberations:

<table>
<thead>
<tr>
<th>Entry requirements</th>
<th>New Market</th>
<th>Official Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Min mkt cap</td>
<td>Rs 5m</td>
<td>Rs 50m</td>
</tr>
<tr>
<td>Min no. shareholders</td>
<td>100</td>
<td>200</td>
</tr>
<tr>
<td>Min % in public hands</td>
<td>10%</td>
<td>25%</td>
</tr>
<tr>
<td>Min financial record</td>
<td>1 year unqualified</td>
<td>3 years unqualified</td>
</tr>
<tr>
<td>Working capital statement</td>
<td>clean</td>
<td>clean</td>
</tr>
</tbody>
</table>

Interviewees were generally content with the proposed entry requirements although a number thought that the minimum percentage in public hands should be raised to 15% or even 20%. Most of the OTC companies interviewed comfortably met the above criteria.

As far as continuing obligations are concerned, many OTC companies believe that they are already making good disclosure, up to the level of the Official Market but that it is the procedures and processes of the Official Market, which they would find hard to comply with. Examples cited were the need to send circulars to shareholders, the need to get the consent of the Listing Committee, the pre-vetting of announcements and the fact that companies are not permitted to delist from the Official Market.
In recognition of the fact that most of the OTC companies have already been disclosing a considerable amount of information to their shareholders on a voluntary basis, it is proposed to offer these companies a simplified entry route. Providing these companies do not wish to raise capital when they join the New Market, they will be allowed to use their report and accounts with a short wrap as the introduction document rather than have to reproduce a full prospectus; this will also keep the costs of transferring from the OTC to the New Market at a reasonable level. It is proposed to develop a similar route for New Market companies, who wish to transfer after a period of time to the Official Market.

OTC companies wishing to raise finance and other companies joining the New Market will need to prepare a full listing document.

A listing agreement will be put into effect and the SEM will monitor and ensure compliance with its rules. A full range of sanctions will be available to the SEM in the event of a breach of rules.

**Operational Considerations**

The existing trading platform can be used for trading securities listed on the New Market and the same trading procedures should apply to both the Official and New Markets with the exception that the spread should initially be set at 20% and monitored to see if it should be brought into line with the Official Market’s 15%. The Boards should be the same as those in the Official Market. Some thought needs to be given to the odd lot board but this is a minor consideration.

Most interviewees would like to see the market open for trading for one hour on three days each week, preferably at a different time to the Official Market. If the hours were any longer or at the same time as the Official or OTC Markets, this would cause capacity problems for the brokers. We therefore suggest that the New Market trades initially on Monday, Wednesday and Friday on the same hours as the OTC Market (which will trade on Tuesday and Thursday). We anticipate however that there will be demand for more frequent and longer trading hours as the market develops.

There was also a lot of support for a separate index, although it was accepted that this may not be viable until the New Market had achieved sufficient critical mass.

There should be good transparency of trading, with prices reported in the Press on trading days and in the daily and weekly bulletins. The SEM’s website should also be developed with a new, separate section devoted to the New Market with links to the websites of the companies on the market.

Because of the fact that the New Market will operate on a marginal cost basis, it is recommended that it is treated as a revenue and not a profit centre.

The fee structures for listing and trading will be recommended during the phase 3 work. Resourcing has been considered under a separate heading below.
ROLE OF INTERMEDIARIES

Although there is a chapter of the Listing Rules devoted to sponsors’ qualifications and responsibilities, there is no mention of sponsors in the new Securities Act and sponsors have yet to be used to any great extent in Mauritius. This is partly due to the absence of any real recent corporate activity and partly due to the lack of resources and experience at the broking houses.

Brokers could be equipped to perform corporate finance work and the most logical of these are the broking arms of banks. However, a conflict can exist between the bank’s aim to lend money to its clients and the broker’s aim to raise equity for the same clients. There would also appear to a shortage of the requisite corporate finance experience in all brokerage firms, which means that they would need to recruit appropriate staff; and so at present the brokers’ role would probably be confined mainly to one of distributing the stock to their clients.

However, the firms of accountants who were interviewed appeared willing and able to perform many of the functions required in getting companies ready for the market, having already got dedicated corporate finance teams in place. They expressed a strong desire to assist the SEM with marketing the new market and helping with training.

Concern was also expressed about the capacity of the local legal firms to cope with the legal work involved with getting a number of companies onto the New Market.

There is no doubt that the SEM will need to undertake a considerable amount of training for the advisers before the launch of the New Market can take place.

PHASING OUT THE OTC MARKET

It is clear that in order for the New Market to be successful there must be a relatively wide gap between the obligations of the Official Market and those of the New Market. It is also clear that if those obligations are too onerous the New Market will not attract entrants. If, as is recommended, the obligations are placed at just above those for a ‘reporting issuer’, they will be at, or around, the level of the OTC Market and therefore companies would obviously stay on that market rather than pay a fee to be listed on the New Market. We therefore recommend that the SEM announce that the OTC Market will close on 30th October 2006. By announcing the date of the closure companies that are traded on the OTC Market will have a target date to aim at to make the transition to the New Market. We have chosen this date to allow those companies with a year end of 30th June (the vast majority of companies) a full year to make the transition and to use their latest report and accounts as the basis for the introduction document. This concession, which will greatly reduce the costs of a company seeking a listing on the New Market, will apply to all companies currently traded on the OTC Market.

Any new entrants to the OTC Market between now and the closure of the market would also be entitled to obtain the above concession. However, they must have been actively traded there for at least nine months. This will prevent representatives of companies from applying,

---

5 actively is defined as being at minimum one trade per week (on average 50 trades over a twelve month period).
at the last minute, to go onto the OTC Market with the objective of avoiding the production of a full introduction document to go onto the New Market.

**INTRODUCTION OF MATCHED BARGAIN FACILITY**

It is very possible that there will be some companies that are traded on the OTC Market that will decide not to go for a listing, particularly those companies in which there are very few transactions. Whilst this must be the decision of the companies themselves, having taken into consideration their duties and responsibilities to their shareholders, there was a concern expressed by a number of brokers to provide a facility whereby shareholders of such companies can execute occasional transactions in a fair and transparent manner. For this reason, we suggest that consideration be given to establishing a matched bargain facility whereby investors can arrange, through their broker, to buy and sell unlisted securities. These transactions would not be done on a Board but could be done on something akin to the Pink Sheets in the US.

The objective would be to avoid creating a “market” because this would require a greater degree of disclosure and regulation. In addition, it has to be distinctly different from the OTC Market. Each transaction would be approved by the SEM and there would be a requirement to ensure that both buyer and seller had been provided with information about the security in which they were about to deal. The rules of this “facility” (a term which comes within the meaning of “securities exchange” under the new Securities Bill) would only provide for the execution of occasional transactions and would stipulate that the SEM would refuse permission for a transaction if it was of the opinion that a market was starting to develop in the company’s shares. In such an event, we would expect the SEM to enter into direct discussions with the company with the objective of encouraging it to seek a listing on the New Market.

**TIME FRAME**

Interviewees believed that now was an excellent time to launch a New Market as in the past OTC companies had felt undervalued but the Official Market has had a good run recently, which has encouraged investors to return to the equity markets. However, the launch date for a New Market will be dependant on three principal factors. The first is the progress of the new Securities Act, which is now in final draft form and should go to Parliament in February. Once enacted, it has to be implemented within three months; the timing of this is clearly outside the control of the SEM.

The second factor is whether and how long it will take for the SEM and its Board to approve the establishment of the New Market. The project timelines agreed with FIRST Initiative allow for the project to be completed by early April; this is based on the SEM taking 2 weeks to review the recommendations contained in this report and a further 2 weeks in March to comment on draft rules and procedures.

The final factor is the impending election, which is scheduled to take place in the Autumn. It is generally felt that the New Market should not be launched until after the election has taken place which implies a launch during the fourth quarter of 2005.
Another consideration is the financial year end of the OTC companies, as it is expected many will wish to use the simplified entry route and come by way of Introduction, using their latest report and accounts as the entry document. If their accounts are not up to date, it is likely they will be required to produce a working capital and no material change statement, which could significantly add to the entry costs. A quick analysis of OTC companies shows that nearly half have a June year end and nearly a third a December year end; this would fit in well with a market launch date of the last quarter 2005.

As part of phase 3 of the project, we have undertaken to assist the SEM in the preparation of an action plan for the launch of the market.

**Motivating and Attracting Companies**

Under the project terms of reference agreed with FIRST Initiative, we have been asked to provide advice on **formulating a strategy** on how to motivate and attract companies to the New Market.

There are certain key principles, which should be followed when developing the SEM’s strategy:

- Try to create a New Market “community” amongst advisers, companies and investors
- Establish a dedicated resource for the market, whose role should be to establish and manage the relationship with the community
- Leverage off the advisors’ resources and facilities
- Market, sell and promote the New Market through the SEM’s website
- Create and monitor a 3 year business plan for the market
- Develop a package of incentives for the New Market and for companies progressing to the Official Market
- Open a dialogue with Government to discuss a stepped approach to possible incentives for the equity markets

The benefits for a company of joining a public market can be significant, but are often intangible; it will:

- Offer existing shareholders an increase in the value of their investment and provide an exit strategy and the chance to realize their investment if desired
- Provide an objective valuation for their business
- Allow a company to boost employee motivation by creating a share ownership scheme, for which the Government has recently announced proposals
- Enable a company to broaden its shareholder base
- Raise a company’s visibility and enhance its status with customers and suppliers at home and overseas
- Increase a company’s credibility with a high quality and broad range of investors
- Facilitate capital raising for funding organic growth and/or acquisitions
- Enable a company to make acquisitions using its shares as currency.

By joining the New Market, a company will derive all the above benefits plus it will:

- Become eligible without limit for Institutional funds
- Be able to attract foreign investors, without requiring approval from the Prime Minister’s Office under S. 3(3) of he Non Citizens (Property Restriction) Act

February 2005

19
• Receive exemption from the 13.2% transaction tax
• Allow investors to benefit from investment relief under S.36 of the Income Tax Act 1995
• Be able to use its shares as security for a loan.

The main attraction of the New Market over the Official Market, is that the processes of the New Market will be kept simple, so that companies can focus on running their businesses and in that way grow more quickly and more easily.

Although the SEM could impose a time or size limit on companies on the New Market to ensure progression to the Official Market, it is recommended that this is left to market forces. It is expected that some companies will migrate due to peer pressure, if their competitors are on, or move to, the Official Market. Others may make the move in order to be included in one of the Official Market indices, or to achieve greater visibility and thus attract more foreign investors. The SEM could also consider offering some incentives such as a simplified route to the market and a waiver of listing fees.

As regards fiscal incentives, although these should not be a primary motivator and this subject is really outside the remit of this project and is clearly outside the control of the SEM, it is recommended that the SEM opens up a dialogue with the Government, to reinstate some fiscal benefits for listed companies, which are graduated according to the level of regulation. It is understood that Government revenues from corporate taxes are very low, so that any new incentives will probably need to be tax neutral overall.

**RESOURCES REQUIRED**

As previously mentioned, it is recommended that the SEM hire a new Business Development/Relationship Manager for the New Market, whose role should be to create a separate identity for the New Market and form a new community from within the market participants.

There is also clearly a large amount of training, which will be required when the market is set up and on a continuing basis. It is suggested that seminars should be organized for:

• Advisors, who will need to understand the attributes of the New Market (so that they can promote it) and what is required of them in bringing companies to the market
• Company directors, who will need to understand fully their responsibilities as public company directors
• Investors, who will need to understand both the rewards of equity investment and the risks inherent in the New Market

Developing an equity culture within the retail sector where investors look at p/e ratios rather than yields, will strengthen the demand for the New Market and help to ensure its success. The Government can assist in this process, by refreshing its privatization policy.

The SEM should work together with other parties wherever possible to defray the costs and leverage on the resources of the other parties. The firms of Accountants interviewed have already expressed interest in teaming up with the SEM in this respect and it was also suggested that the SEM should work with the Development Bank of Mauritius and the Small
and Medium Enterprise Development Organisation, since it is the stated intention of the Government to promote small and medium enterprises through easier access to capital.

The SEM should also consider arranging more courses on the SEM and the equity markets at the University of Mauritius and spending more time educating and training journalists.

**RISK FACTORS**

The following key risk factors have been identified:

- Insufficient critical mass at the outset would seriously jeopardize the success of the market – the SEM believes at least 5-10 companies are required at the start
- The reputational risk to the SEM of a company failure within the first year of trading on the market
- Launching the market at a time of political or economic uncertainty
- Launching the market before adequate training has taken place
- Having insufficient dedicated resource at the SEM
- The New Market could in time overshadow the Official Market

Whilst many of the companies that will be listed on the New Market will be long established concerns that have many hundreds of small retail shareholders, the market is also intended for venture capital companies and other similar companies that are of much greater risk. Segmenting the market into high risk / low risk companies is not a practical solution. We therefore recommend that the following paragraph appears prominently and in bold on the first page of the listing document for any company with less than a three year track record that is admitted to the New Market:

> “The New Market is a market which caters for emerging or smaller companies to which a higher risk tends to be attached than to larger or more established companies. A prospective investor should be aware of the risks of investing in such companies and should make the decision to invest only after careful consideration and, if appropriate, consultation with a licensed investment dealer or investment adviser”.

Similar wording should, where appropriate, be applied to all client agreement letters and to New Market promotional material produced by the SEM.

The Official List could also have a separate section to identify the securities as only being suitable for sophisticated investors.

**NEXT STEPS**

The SEM to undertake follow up consultation with prospective companies on the likely demand for the New Market using as the basis for this our initial thoughts on a framework for the entry and continuing obligation rules as set out in Appendix 3.

Following this, the Board to decide whether or not to proceed with the establishment of the New Market.
On the assumption that the SEM decides to proceed with a New Market, we will:

- Prepare draft rules for the admission and continuing disclosure obligations of companies coming to and listed on the New Market.
- Prepare draft rules for the trading of companies listed on the New Market.
- Identify, at a high level, the areas to be covered by way of procedures governing the admission, surveillance, monitoring and enforcement of companies admitted to the New Market and of trading on the New Market.
- Review the work of the SEM in preparing those procedures.
- Assist the SEM in developing a marketing plan, including guidance on promotional materials and selection of a name for the New Market.
- Propose incentives for companies on the New Market to graduate to the Official Market.
- Advise on fees and charges to be imposed by the SEM.
- Assist the SEM in the preparation of an action plan for the establishment of the New Market. The action plan will include a plan for the launch of the New Market including testing of all systems and procedures.

Initial drafting of the marketing plan and rules will be done off-site and forwarded to the SEM for comment. Completion of these together with guidance on promotional material, incentives for companies and advice on fees, action plan etc. will be done in Mauritius, working together with the SEM.

The identification of the procedures, which will be derived from the draft rules, will be done off-site and forwarded to the SEM to complete. Whilst on-site during Phase 3 we will review the procedures prepared by the SEM to ensure thoroughness and completeness.

In terms of promoting the New Market, we suggest a public launch of the market; possibly in the form of a one day seminar with speakers from companies committed to joining the market, accountants, lawyers, the SEM, the Commission, FIRST Initiative, and the London Stock Exchange. We suggest that the Hon. Sushil K. C. Khushiram, Minister of Industry, Financial Services and Corporate Affairs, be asked to make the keynote opening address.
APPENDICES AND ATTACHMENTS

APPENDIX 1 – CONCEPT PAPER

Introduction
The purpose of this paper is to open up discussions with key stakeholders within the business community on a proposed new market framework, highlight the benefits the proposed New Market can generate and give an indication of the proposed structure of the New Market.

Proposed framework of the markets
The OTC market was initially set up to offer a trading facility for Mauritian companies and to enable companies to test the market before graduating to the Market. Although the first objective has been successfully achieved, few companies have graduated, due to the high step up to the requirements of the Official Market (particularly the requirement for 25% in public hands and the continuing obligations). However, those that have graduated have provided shareholders with handsome rewards, since the market as a whole has generated an annualized return exceeding 20% during the last 15 years.

The Stock Exchange of Mauritius (SEM) would like to consider whether it would be possible to create a market that would enable shareholders of companies outside the Official Market to benefit from the potential wealth-creating attributes of an organized and regulated market without having to comply with the stringent requirements of the Official Market.

The proposed framework of the markets also needs to be seen in the context of the new draft Securities Act. We believe that many OTC companies will fall within the definition of “reporting issuer” under the forthcoming Act. Reporting issuers will have to meet a number of obligations, including the timely disclosure of price-sensitive information as well as periodic disclosure, that is, quarterly financial statements and annual reports. The new Act will necessitate substantial change to the structure and rules of the OTC.

The SEM is therefore proposing to create a New Market for these reporting issuers, which are not already listed on the Official Market. Companies quoted on the OTC market, which will have to comply with the requirements of the Act as reporting issuers, will have the opportunity to step up onto a regulated market with requirements clearly distinct from those of the Official Market.

The New Market will also be open to companies whose securities are not yet publicly traded and which are incorporated in Mauritius or overseas.

Benefits of the New Market
The establishment of this New Market will enhance the healthy development of the capital market and will also complement the private equity sector, providing a viable exit strategy for venture capitalists and private equity funds.

The New Market will be in line with the Government’s initiative to develop Mauritius as a business and financial hub serving the region and beyond. It will enhance the objective of the Government to create a sound and conducive environment and an institutional and regulatory framework that is supportive of a new business model driven by sound management practices and wider stakeholder participation.
The main benefits for a company of joining the New Market are as follows:

- It has the potential to offer existing shareholders an increase in the value of their investment or provide an exit strategy and the chance to realise their investment;
- It will provide an objective market valuation for the business;
- It will allow a company to boost employee motivation by creating a share ownership scheme;
- It will enable a company to broaden its shareholder base;
- It will raise a company’s visibility and enhance its status with customers and suppliers at home and overseas;
- It will increase a company’s credibility with a high quality and broad range of investors;
- It will facilitate capital raising for funding organic growth and/or acquisitions; and
- It will enable a company to make acquisitions using its shares as currency.

**Proposed characteristics of the New Market**

The proposed entry requirements for the New Market will be less stringent than for the Official Market:

<table>
<thead>
<tr>
<th>Entry requirements:</th>
<th>New Market</th>
<th>Official Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Min mkt cap</td>
<td>Rs 5m</td>
<td>Rs 50m</td>
</tr>
<tr>
<td>Min no. shareholders</td>
<td>100</td>
<td>200</td>
</tr>
<tr>
<td>Min % in public hands</td>
<td>10%</td>
<td>25%</td>
</tr>
<tr>
<td>Min financial record</td>
<td>1 year unqualified</td>
<td>3 years unqualified</td>
</tr>
<tr>
<td>Working capital statement</td>
<td>clean</td>
<td>clean</td>
</tr>
</tbody>
</table>

In addition, the Official Market also has requirements relating to: trading record, continuity of management, the directors and controlling shareholders.

The main continuing obligation requirements for the New Market being proposed are: release price sensitive information promptly, have accounts prepared to International Standards on a quarterly and annual basis and to notify directors’ dealings promptly. In contrast, the Official Market has many additional detailed continuing obligation rules, contained in Chapters 11, 12 and 13 of the Listing Rules, many of which will not apply to the New Market.

**Admission requirements for the New Market**

It is proposed to allow a simplified entry route to the New Market for existing OTC companies, so that they will be able to gain admission using their latest accounts with a short wrap for an admission document, providing they join by way of Introduction (ie without a new issue of shares).

For companies not yet publicly traded, a fuller admission document will be required, but the disclosure standards will be lower than those applying to the Official Market.

It is also proposed to offer a simplified route from the New Market onto the Official Market to encourage those companies, which aspire to move to a full listing over time.

Consideration is being given to waiving the application fee in the case of OTC companies joining within the first months of the New Market and charging a lower annual fee than that
currently applicable to the Official Market. In addition, fees may be waived for further issues of shares on the New Market.

**Points for discussion**
The areas on which we would appreciate your views are:

- How do you think this market should be structured?
- How do you think SEM should reach out for companies?
- For companies: What have been the main reasons why your company has not as yet considered seeking a listing on the Official Market?
- For intermediaries: What value do you think the proposed New Market will add from your perspective?
APPENDIX 2 - LIST OF INTERVIEWEES

**Intermediaries**
- MCB Stockbrokers
- Asmo Securities & Investments
- General Brokerage
- First Brokers
- Newton Securities
- Associated Brokers
- SBM Securities
- Cavell Securities
- Compagnie des Agents de Change

**Investors**
- ACMS
- SIC/Port Louis Fund

**Accountants**
- Ernst & Young
- Deloitte Touche

**Companies**
- Naiade Resorts
- United Investments
- Medine Shareholdings/Medine S.E.
- Alma Investments/Black River Investment/EUDCOS
- IOIB
- Chemco/Bychemex
- CIEL Investment/Falaise Rouge/CIEL Textile/DRBC
- Livestock Feed/Moulins de la Concorde/G.Espitalier Noel/Tropical Paradise
- Casino
- Anglo Mauritius
- Constance Hotels Services/Constance S.E./Hotelest
- Flacq United Estates/FIDES/Union Flacq

**Others**
- SEM executives
- FSC
- Listing Committee members
APPENDIX 3 - INITIAL THOUGHTS ON NEW MARKET RULES

Contents of Wrap:
- Directors’ responsibility statement
- Latest annual accounts (3 years if applicable)
- Interims (if published since last y/e)
- Any prospectus, circular etc in last 12 months
- No material change statement
- Working capital statement (unless within 42 days of auditors ’ report)
- Date of listing
- Number, value, class & rights of shares
- Dividend date
- Documents on display

Entry criteria

<table>
<thead>
<tr>
<th>Entry requirements:</th>
<th>New Market</th>
<th>Official Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Min mkt cap</td>
<td>Rs 5m</td>
<td>Rs 50m</td>
</tr>
<tr>
<td>Min no. shareholders</td>
<td>100 [reporting issuer]</td>
<td>200</td>
</tr>
<tr>
<td>Min % in public hands</td>
<td>10% [possibly 15% ]</td>
<td>25%</td>
</tr>
<tr>
<td>Min financial record</td>
<td>1 year unqualified</td>
<td>3 years unqualified</td>
</tr>
<tr>
<td>Working capital statement</td>
<td>clean</td>
<td>clean</td>
</tr>
</tbody>
</table>

Continuing obligations
New Securities Act:
- General obligation of disclosure (psi – including 10% test)
- Notification of insiders’ (directors & 5% shareholders) dealings
- Quarterly reporting
- Time limits for publication of accounts

Additional:
- Substantial transactions (reverse takeover) – shareholder approval & circular at 100% (cf 50% for Official Market)
- Related party transactions – maybe higher threshold (30%) than Official Market (15%)
- Miscellaneous obligations (changes in capital, directors etc)
- Model code

Nb. Disclosable transactions caught by Act at 10% of assets (cf 15% on Official Market – also more tests)
ATTACHMENT 1 – COMPARATIVE STUDY

COMPARATIVE STUDY
OF
OTC and SECOND MARKETS

London
STOCK EXCHANGE

January 2005
Comparative study of OTC and second markets

Contents

<table>
<thead>
<tr>
<th>Purpose</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>1</td>
</tr>
<tr>
<td>Scope of study</td>
<td>1</td>
</tr>
<tr>
<td>Market structure</td>
<td>2</td>
</tr>
<tr>
<td>Admission rules</td>
<td>3 - 5</td>
</tr>
<tr>
<td>Operating/financial history</td>
<td></td>
</tr>
<tr>
<td>Profitability</td>
<td></td>
</tr>
<tr>
<td>Market value</td>
<td></td>
</tr>
<tr>
<td>Public float</td>
<td></td>
</tr>
<tr>
<td>Continuing obligation rules</td>
<td>5 - 7</td>
</tr>
<tr>
<td>Continuous disclosure</td>
<td></td>
</tr>
<tr>
<td>Major transactions</td>
<td></td>
</tr>
<tr>
<td>Directors’ dealings</td>
<td></td>
</tr>
<tr>
<td>Changes in major shareholding</td>
<td></td>
</tr>
<tr>
<td>Quarterly reporting</td>
<td></td>
</tr>
<tr>
<td>Corporate governance</td>
<td></td>
</tr>
<tr>
<td>Attachment</td>
<td>7</td>
</tr>
</tbody>
</table>
Comparative study of OTC and second markets

1. **Purpose**
The purpose of this study is to analyse the market structures of the major second and OTC markets in the world, in order to assist in restructuring the existing OTC market in Mauritius and to determine whether to establish a second tier market in Mauritius.

2. **Introduction**
The distinction between what constitutes an OTC and what constitutes a second market can be a bit blurred in some countries, but generally an OTC market has no business relationship with the companies quoted on it. As a consequence, companies traded on an OTC are therefore subject to very basic eligibility and continuing obligation requirements, unless they are also traded or listed on another market (which is generally not the case in the US). OTC trades are mainly conducted over the phone directly between two parties rather than on exchange.

We believe the largest OTC markets are the Pink Sheets and NASDAQ’s OTCBB in the US and the OTC in India, although statistical information on OTC markets is hard to come by.

There are over 35 second markets around the world, many having been set up in the mid to late 1990’s to catch the dotcom boom, although relatively few have attracted a sufficient number of companies to achieve any critical mass.

These markets are predominantly domestically focused, recognising that a good second market will provide a nursing ground for smaller growing companies, which can in time move on to the main market. The markets can make a significant contribution to domestic economies and some of the companies will become tomorrow’s leaders.

The establishment of good second markets is fundamental to the healthy development of capital markets and a strong second market will also complement the private equity sector, providing a viable exit strategy for venture capitalists and private equity funds.

3. **Scope of study**
This study analyses the market structures, admission and continuing obligation rules of OTC and second markets. It does not analyse fees, as the quantum of fees charged in a particular market will depend on the number of local factors including what the market will bear. It also does not cover prospectus disclosure as there is worldwide harmonisation to the IOSCO International disclosure standards (IDS), so that the disclosure standards for a new market should use the IOSCO IDS as a benchmark.

The principal criterion which has been used to select the OTC and second markets for this study is size, based on the number of companies traded or admitted at the end of 2002 and 2003 (statistics for 2004 are mostly not yet available).

NASDAQ, TSX-V, KOSDAQ and SESDAQ have been included for completeness, although they are not “second” markets as such and they tend to be rather more sectoral-based than markets specifically set up for smaller, growing companies.
Instead of creating separate, new markets, some exchanges have established new market segments for specific types of company such as the London Stock Exchange (the “Exchange”) has done with its “techMARK” and “techMARK mediscience” segments for technology and healthcare companies respectively. These markets are often referred to as “markets within markets” and usually have their own indices, which allow investors to track specific types of company; they have been excluded from this study.

<table>
<thead>
<tr>
<th>Market</th>
<th>Country</th>
<th>No. of Cos 2002</th>
<th>No. of Cos 2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>NASDAQ*</td>
<td>US</td>
<td>3,765</td>
<td>3,335</td>
</tr>
<tr>
<td>TSX-V</td>
<td>Canada</td>
<td>2,504</td>
<td>1,991</td>
</tr>
<tr>
<td>KOSDAQ</td>
<td>Korea</td>
<td>843</td>
<td>879</td>
</tr>
<tr>
<td>AIM</td>
<td>UK</td>
<td>704</td>
<td>754</td>
</tr>
<tr>
<td>GEM</td>
<td>Hong Kong</td>
<td>166</td>
<td>185</td>
</tr>
<tr>
<td>OFEX</td>
<td>UK</td>
<td>177</td>
<td>158</td>
</tr>
<tr>
<td>Nouveau Marché</td>
<td>France</td>
<td>153</td>
<td>131</td>
</tr>
<tr>
<td>SESDAQ</td>
<td>Singapore</td>
<td>116</td>
<td>138</td>
</tr>
<tr>
<td>Mothers</td>
<td>Japan</td>
<td>42</td>
<td>72</td>
</tr>
</tbody>
</table>

*National and SmallCap markets

Details of the date of establishment, the market capitalisation and the turnover of the second markets selected can be found in the attachment.

4. Market structure

The structure of the markets has been analysed as to who regulates both the market and the companies on the market and what type of trading system the market uses. The details are set out below:

<table>
<thead>
<tr>
<th>Market</th>
<th>Owner</th>
<th>Market regulator</th>
<th>Company regulator</th>
<th>Trading method</th>
</tr>
</thead>
<tbody>
<tr>
<td>NASDAQ*</td>
<td>NASDAQ</td>
<td>NASD</td>
<td>NASDAQ/SEC</td>
<td>Quote</td>
</tr>
<tr>
<td>TSX-V</td>
<td>TSX</td>
<td>RS</td>
<td>TSX</td>
<td>Order</td>
</tr>
<tr>
<td>KOSDAQ</td>
<td>KOSDAQ</td>
<td>KOSDAQ</td>
<td>KOSDAQ</td>
<td>?</td>
</tr>
<tr>
<td>AIM</td>
<td>LSE</td>
<td>LSE</td>
<td>LSE</td>
<td>Quote</td>
</tr>
<tr>
<td>GEM</td>
<td>HKEx</td>
<td>SFC/GEM</td>
<td>GEM/SFC</td>
<td>Order</td>
</tr>
<tr>
<td>OFEX</td>
<td>OFEX</td>
<td>OFEX</td>
<td>OFEX</td>
<td>Quote</td>
</tr>
<tr>
<td>Nouveau Marché</td>
<td>Euronext</td>
<td>AMF</td>
<td>AMF</td>
<td>Order</td>
</tr>
<tr>
<td>SESDAQ</td>
<td>SGX</td>
<td>SGX</td>
<td>SGX</td>
<td>Order</td>
</tr>
<tr>
<td>Mothers</td>
<td>TSE</td>
<td>SESC</td>
<td>TSE</td>
<td>Order</td>
</tr>
<tr>
<td>Pink sheets</td>
<td>Pink Sheets LLC</td>
<td>NASD</td>
<td>none</td>
<td>Quote</td>
</tr>
<tr>
<td>OTCBB</td>
<td>NASDAQ</td>
<td>NASD</td>
<td>SEC</td>
<td>Quote</td>
</tr>
<tr>
<td>OTCEI</td>
<td>OTCEI</td>
<td>SEBI</td>
<td>SEBI</td>
<td>Quote</td>
</tr>
</tbody>
</table>
Most markets regulate their own market participants; this is done either by a department of the market itself or by a separate SRO (eg NASD or RS). The market itself is usually regulated by the financial services regulator.

The companies traded on the markets also tend to be regulated by the market, although this function is sometimes shared with the financial services regulator.

Generally the less liquid the market, the more likely the trading system will be quote driven as in the case of the OTC markets, since no-one wants to see empty order books! In the UK, a consultation is presently underway, which proposes moving approximately 100 of the most liquid AIM securities onto a hybrid trading model based on an order book supported by continuous liquidity provision from committed market makers.

5. Admission rules

There are generally few admission rules for companies traded on OTC markets. To be quoted on the Pink Sheets, companies are not required to be registered with the SEC, nor be current in their reporting requirements nor even have their financial statements audited, although they must be drawn up according to generally accepted accounting standards.

For a quotation on the OTCBB, although there are no listing requirements per se, companies must be current with their filings with the SEC. The introduction of this eligibility rule in the late 1990s resulted in the removal of over 3,000 companies, halving the size of the market. The OTCEI however does have quite a number of admission rules, which makes the market more akin to a second market.

The four most usual criteria for admission to second markets are those relating to: operating/financial history, profitability, market value and public float. Each of these is analysed separately below:

a) Operating/financial history

<table>
<thead>
<tr>
<th>Market</th>
<th>Operating/financial history</th>
</tr>
</thead>
<tbody>
<tr>
<td>NASDAQ SmallCap</td>
<td>1 year or $50m (€ 37m) market cap</td>
</tr>
<tr>
<td>TSX-V</td>
<td>No requirement unless technology/industrial company (but sponsor report often required)</td>
</tr>
<tr>
<td>KOSDAQ</td>
<td>0-3 years depending on company type</td>
</tr>
<tr>
<td>AIM</td>
<td>None</td>
</tr>
<tr>
<td>GEM</td>
<td>2 years (1 year if certain extra requirements met)</td>
</tr>
<tr>
<td>OFEX</td>
<td>None</td>
</tr>
<tr>
<td>Nouveau Marché</td>
<td>3 years</td>
</tr>
<tr>
<td>SESDAQ</td>
<td>None (but projects must be fully researched and costed)</td>
</tr>
<tr>
<td>Mothers</td>
<td>Sales must have been: “recorded from an area of their business directly relating to their high growth potential” (NB 2 years financials required)</td>
</tr>
<tr>
<td>OTCEI</td>
<td>1 year (or Rs 5 crores – € 865k mkt cap)</td>
</tr>
</tbody>
</table>

The analysis presents a mixed picture: either no record or between 1 and 3 years’ record is required. Sometimes a sponsor’s or an expert’s report is required instead of an historical
record as a quid pro quo. In most cases, it is expected that the company’s prospectus will be able to demonstrate that the company has genuine prospects.

b) Profitability

<table>
<thead>
<tr>
<th>Market</th>
<th>Profitability</th>
</tr>
</thead>
<tbody>
<tr>
<td>NASDAQ SmallCap</td>
<td>$750k (€ 560k) net income from continuing operations (in latest fiscal year or 2 of last 3 years) or public float or market value requirements met</td>
</tr>
<tr>
<td>TSX-V</td>
<td>No requirement unless technology/industrial company, when Can $50k (€ 30.4k) + required</td>
</tr>
<tr>
<td>KOSDAQ</td>
<td>Usually none – but profit of 10% ROE required for some company types</td>
</tr>
<tr>
<td>AIM</td>
<td>None</td>
</tr>
<tr>
<td>GEM</td>
<td>None</td>
</tr>
<tr>
<td>OFEX</td>
<td>None</td>
</tr>
<tr>
<td>Nouveau Marché</td>
<td>Pretax profit for most recent year</td>
</tr>
<tr>
<td>SESDAQ</td>
<td>None, but expected to be viable and profitable, with prospects for future growth and expansion</td>
</tr>
<tr>
<td>Mothers</td>
<td>None (but unqualified audit report for most recent year)</td>
</tr>
<tr>
<td>OTCEI</td>
<td>Net income of Rs 0.25 crores – €43.4k (or minimum net assets or market cap)</td>
</tr>
</tbody>
</table>

Although it is quite rare to have any requirements relating to profitability levels, some markets (AIM, GEM and TSX-V) do have rules requiring companies to have sufficient working capital for at least the twelve months after their admission.

c) Market value

<table>
<thead>
<tr>
<th>Market</th>
<th>Market value</th>
</tr>
</thead>
<tbody>
<tr>
<td>NASDAQ SmallCap</td>
<td>$50m (€ 37.3m) or public float or profitability requirements met</td>
</tr>
<tr>
<td>TSX-V</td>
<td>None</td>
</tr>
<tr>
<td>KOSDAQ</td>
<td>None</td>
</tr>
<tr>
<td>AIM</td>
<td>None</td>
</tr>
<tr>
<td>GEM</td>
<td>HK$500m (€ 48m) if no trading record</td>
</tr>
<tr>
<td>OFEX</td>
<td>None</td>
</tr>
<tr>
<td>Nouveau Marché</td>
<td>€ 1.5m</td>
</tr>
<tr>
<td>SESDAQ</td>
<td>None</td>
</tr>
<tr>
<td>Mothers</td>
<td>JPY 1bn (€ 7.2m)</td>
</tr>
<tr>
<td>OTCEI</td>
<td>Rs 5 crores €865k (or minimum net assets or net income)</td>
</tr>
</tbody>
</table>

Only half of the markets reviewed set a minimum value, which in the case of the European markets was quite low at between €298k to €1.5m.
d) **Public float**

<table>
<thead>
<tr>
<th>Market</th>
<th>Public float</th>
</tr>
</thead>
<tbody>
<tr>
<td>NASDAQ SmallCap</td>
<td>1m valued at $5m (€ 3.7m) or market value or profitability requirements met</td>
</tr>
<tr>
<td>TSX-V</td>
<td>500k-1m shares publicly held (valued at Can $500k-1m – € 304-608k)</td>
</tr>
<tr>
<td>KOSDAQ</td>
<td>30% and 500 shareholders or IPO of 20% (10% of large company) of capital</td>
</tr>
<tr>
<td>AIM</td>
<td>None</td>
</tr>
<tr>
<td>GEM</td>
<td>25% (or 20% if market cap over HK$ 4bn – €384m) with spread of 100 shareholders owning HK$30m (€ 2.9m)</td>
</tr>
<tr>
<td>OFEX</td>
<td>“Sufficient” – not defined</td>
</tr>
<tr>
<td>Nouveau Marché</td>
<td>20% representing 100k shares valued at € 5m</td>
</tr>
<tr>
<td>SESDAQ</td>
<td>15% or 500k shares, whichever is greater (there are also distribution rules)</td>
</tr>
<tr>
<td>Mothers</td>
<td>Must create 300 new shareholders through IPO</td>
</tr>
<tr>
<td>OTCEI</td>
<td>25% and 1,000 shareholders owning 500k shares valued at Rs 2.5 crores – €433.5k</td>
</tr>
</tbody>
</table>

Most markets have rules relating to the minimum amount, which has to be in public hands and often go further to prescribe a minimum number or spread of shareholders, the notable exceptions being the two UK markets.

6. **Continuing obligation rules**

In the case of the US OTC markets there are very few continuing obligations. The Pink Sheets are required under SEC rules to notify the NASD at least 10 calendar days prior to the record date of any dividend or other distribution, stock split or rights offering.

Companies traded on the OTCBB have to register with the SEC and therefore must provide quarterly and annual financial information; they are also subject to many of the Sarbanes-Oxley Act provisions, including the certification requirements.

In contrast, the OTCEI requires its companies to continue to fulfil certain of the entry requirements relating to size and shareholding details for a period of 18 months after listing.

A general review of the continuing obligation rules in second markets is given below under the following headings: continuous disclosure obligations, disclosure of major transactions, director’s dealings, changes in major shareholdings, quarterly reporting and corporate governance. Accounting requirements have been ignored, as they tend to be mandated by country or regional law.

The rules have been analysed by country rather than market as in some cases, it is the national regulator (for example the SEC in the US), which sets the rules rather than the market operator.
a) **Continuous disclosure:** An over-arching requirement to disclose price sensitive information promptly exists in all the markets, although there are undoubtedly differences in application. The UK and Hong Kong achieve a high level of announcements, driven in part by demand from the sophisticated institutional investor base.

In contrast, until recently the emphasis in the US has been on quarterly reporting and the ad hoc disclosure of certain specific information such as the completion of major transactions, although the introduction of Regulation FD has brought the system closer to that pertaining in the UK.

b) **Major transactions:** Most of the markets surveyed required companies to disclose major transactions, with some setting specific thresholds (such as 10% in the case of the UK’s AIM) for determining what is regarded as major and others such as the US and Japan simply requiring material events or corporate changes to be disclosed.

Some countries (in particular the UK’s AIM and Hong Kong) also require disclosure of transactions with related parties.

c) **Directors’ dealings:** In the UK, the dealings of directors are seen as an active driver of retail investor behaviour, so that rules (known as “The Model Code”) have been developed over and above the national insider trading legislation. This system has also been adopted by Hong Kong, but otherwise is unique.

d) **Changes in major shareholdings:** Similarly, retail investors in the UK take an active interest in the dealings of major shareholders so that UK company law is more strict than European law.

e) **Quarterly reporting:** Quarterly reporting in the US is seen as a cornerstone of a transparent market, to the extent that it was long regarded as a substitute for continuous disclosure. However, a number of second markets (specifically Hong Kong and France) consider quarterly reporting as an important pre-requisite for markets concerned with fast growing companies.

f) **Corporate governance:** Corporate governance standards are imposed by a number of different routes: voluntary codes of practice, stock exchange rules, company law or national legislation. Although the UK has a highly developed corporate governance structure, its scope is restricted to listed companies so that unlisted (AIM and OFEX) companies fall outside the regime.

However, in the wake of the recent US corporate scandals, the US have enacted Sarbanes Oxley and the US exchanges have brought in corporate governance provisions, which are based on the UK model and apply to all companies on their markets.

In all cases, transparency is seen as the key to a liquid efficient capital market and in some cases (such as France and Hong Kong), the second markets are regulated more heavily than the main markets.
Second market capitalisation and turnover

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>NASDAQ**</td>
<td>US</td>
<td>1971</td>
<td>2.38 trillion</td>
<td>5,620</td>
</tr>
<tr>
<td>TSX-V</td>
<td>Canada</td>
<td>1999</td>
<td>18,070</td>
<td>3,820</td>
</tr>
<tr>
<td>KOSDAQ</td>
<td>Korea</td>
<td>1996</td>
<td>24,930</td>
<td>180</td>
</tr>
<tr>
<td>AIM</td>
<td>UK</td>
<td>1995</td>
<td>26,000</td>
<td>9,380</td>
</tr>
<tr>
<td>GEM</td>
<td>Hong Kong</td>
<td>1999</td>
<td>7,200</td>
<td>3,910</td>
</tr>
<tr>
<td>OFEX</td>
<td>UK</td>
<td>1995</td>
<td>2,430</td>
<td>230</td>
</tr>
<tr>
<td>Nouveau Marche</td>
<td>France</td>
<td>1996</td>
<td>8,040</td>
<td>240</td>
</tr>
<tr>
<td>SESDAQ</td>
<td>Singapore</td>
<td>1987</td>
<td>2,840</td>
<td>4,050</td>
</tr>
<tr>
<td>Mothers</td>
<td>Japan</td>
<td>1999</td>
<td>11,540</td>
<td>16,500</td>
</tr>
</tbody>
</table>

* Million € (unless otherwise indicated)
** National and SmallCap markets