Determinants of IPO Valuation in Saudi Arabian Companies

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Abstract:

Pricing IPO is one of the most controversial topics in the Saudi stock market, which led many analysts and traders to demand that the CMA should issue rules that regulate the pricing of IPO. Therefore, this study addresses the determinants of IPO premium in the Saudi market by testing the impacts of some factors on the pricing of IPO. In specific, the study addresses the relationship between the premium and all of: (1) the book value of the issuing company; (2) profitability of the issuing company; (3) the debt ratio of the issuing company; (4) the external auditor of the issuing company.

The results indicate the absence of any effect of the carrying value of the premium. This result is contrary to the expectations and reverses the results of our literature reviews in this area. Concerning the relationship of earnings per share, the study finds a positive impact on the IPOs premium in the Saudi market. This result is consistent with previous studies which confirmed that the company's valuation and determined premium are significantly affected by the profitability of the firms.

With regard to the impact of the debt ratio, the study finds that IPOs premium is not affected by the debt ratio. Finally, it is clear from the study that there is an adverse effect of the external auditor on the IPOs premium in the Saudi market. This means that the premium value is reduced when the external auditor is one of the Big 4. This finding can be explained by the fact that large audit firms have professional commitments, which make them behave more conservative when auditing the financial statements of the issuing companies.

Determinants of IPO Premium in Saudi Companies

1. Aims and Motivation:

Pricing of IPO premium is one of the topics that gains much attention and discussion in the Saudi Stock Market by both traders and lawmakers. Nevertheless, and despite the huge number of researches and studies tackling the financial and accounting aspects of the Saudi Stock Exchange, this topic has been ignored and no study, till now, addresses the determinants of IPO premium or tries to explore the factors that affect pricing of IPO – IPO premium - in the Saudi market.

This study will try to document the factors that affect determination of the IPO premium in Saudi Arabia, aiming to contribute in enriching the academic knowledge through understanding the relation between book value, profitability, debt ratio and external auditor from one side and pricing of IPO shares of Saudi companies in public offerings.

The study aims, in particular, to address the impact of certain elements on pricing of shares in some companies during IPO. The study will concentrate on the relation between IPO premium and (1) the book value of the issuing company, (2) profitability of the issuing company, (3) debt ratio of the issuing company and (4) the external auditor.

The other parts of the study are divided into main sections: The conceptual framework of the study, literature review, study hypothesis, study methodology, results, conclusion and recommendations.

2. **The conceptual framework of the study:**

This research focuses on interpreting the changes in offer price at IPO of the Saudi companies. Offer price consists of two parts: the first is the face (par) value and the other is the premium. As the share par value for all Saudi companies is (10) SAR, this part of the offer price is not affected by any financial or structural changes in the company. For this reason the share par value has been excluded and concentration shall be only on the premium. The premium represents the amount which a company adds on its par value and therefore it differs from one company to another. The premium is affected by the financial and structural changes that occur in the company.

Based on the above, this study shall concentrate on the variances of premiums in Saudi companies. The premium is measured through establishing the difference between the offer price declared in a company prospectus and the amount of the face value of the share of that company, which is 10 SAR per share. Variations of IPO price in companies are controlled by certain financial and non-financial elements. This study tries to shed light on some of these elements in the Saudi market and in particular the elements, which are connected with the financial statements.

Due to the information asymmetry, between the issuing companies and investors, issuing companies, used to depend on an investment bank to assist in evaluating companies. Pricing of initial public offering starts simultaneously with the issuance registration. The first phase begins with submission of prospectus and the proposed price by the company. The prospectus includes all financial data of the company for the last five years with concentration on the description of the targeted markets, growth opportunities, and competitors. After that, the bank collects price offers from the licensed investment companies to determine the initial demand for the offer. A range for the offer price is determined before offering to the investors, which is expected to determine the offer price. The second step is what is called book – building, when the issuing company's administration meets with investment institutions to negotiate the price. This process is considered the base for determining the price. It shows the demand level and the indicators reflecting the needs and expectations of the potential investors in the market.

According to signaling theory, managers of companies going public, tend to present wanted and required information within prospectuses such as present and expected growth opportunities. They aim to emphasize the value of the company for outsiders and hence increase the share value, Certo (2001). This study will use signaling theory in addition to the theory of resources exploitation, which states that institutions are exploiting their resources to distinguish themselves from other competitors. This theory is considered as complementing theory for signaling theory, Daily (2005), as companies, try during book – building to convince investment institutions of the feasibility of investment in their shares.

Within the context of fair value valuation of the price of initial offering shares, the accounting model, presented by Ohlsen and Feltham, bridges the gap between a firm's real value and the available historical financial and accounting data of the firm. Ohlesn and Feltham model contributes also to establishing a proper conceptual framework of the studies about the relevance of accounting data and value. The results of the model testing can be used for assessing the impact of accounting information on the share real value, Richardson and Tinaiker (2004), Holthausen and Waths (2001). The model provides relevant information for the increase of the share real value against the book value, represented in assets valuation, which is not recognized in accounting.

3. Literature review

Researches and studies about valuation of IPO pricing appeared for the first time in the academic journals in the 1980s. Since that period, these studies have passed through three consecutive phases. The first phase includes the early studies during 1980s and early 1990s. These studies addressed the retained equity on IPO pricing. Most of these studies aimed to test Leland – Pyle model, which states that retention of equity by the main shareholders on post offering period, is a positive future signal for the issuing company.

The second phase includes the few studies, which appeared late 1990 and which stressed the importance of the value relevance of accounting data for IPO pricing.

The third phase includes the studies, which appeared in the latest period exploring the factors determining valuation of internet companies and studying valuation of IPO in general.

Due to the diversified nature of these studies this paper will cover the most important relevant studies, which belong mainly to the studies of the second phase, mentioned above.

While there have been numerous papers investigating the relevance of accounting information for pricing stocks in general, there are very few papers addressing the pricing of IPOs in particular. There are four notable studies in this context which are: Klein (1996), Kim and Ritter (1999), Beaty, Riffe and Thomson (2000) and Purnanandam and Swaminathan (2004).

In this context, Klein (1996) investigates the relation of the stock price (at the date of offering and on the first day of trading) with several variables for a sample consisting of 193 firms during 1980 -1991. The study concludes that the stock price is directly proportional with the earnings per share before IPO and the book value of share equity before IPO.

Kim and Ritter (1999) test the relation of price – earnings ratio (PE) at the level of the firm with the average ratio at the level of the industry in which the firm is operating. The study includes 190 firms during the period 1992-1993. They find that the two ratios have direct proportional relation, though the slope coefficient between the two ratios has a regression R2 of not more than 5%. They find that the explanatory variable (coefficient of determination) increases when taking forecasted earnings for the next year instead of taking pre IPO historical earnings. They conclude that historical earnings information at comparables have limited role in understanding IPO pricing mechanism.

Beatty, Riffe, and Thompson (2000), question Kim and Riffe conclusion regarding the low relevance of historical accounting information in the pricing of IPOs. As the researchers use only industry multiples in their regression, their model concentrates only on time and industry variation in pricing relations and does not consider the value relevance of firm-specific accounting information in each industry. Using a sample of 2,577 companies with positive pre-IPO income and positive book value of equity from the years 1987-1998, they find that the explanatory power of earnings, book value, and revenues for offer value is about 14%. Also, they find that when all the variables in their model are deflated by book value of equity or sales or when all variables are log-transformed, the model's explanatory power increases to reach about 60% to 80%.

In a new study, Purnanandam and Swaminathan (2004) compare the offer price to sales, and offer price to earnings of a sample of 2,288 companies during the period 1980-1997 with similar valuation ratios of industry. The study finds that using the above variables has lead to overvaluation of IPOs for companies having lower profitability, higher accruals, and higher growth forecasts by financial analysts.

In the context of IPO valuation, Aggarwal, Bhagat and Rangan (2009) in a study using a sample of 1,655 IPOs, in the American market, find that firms with more positive earnings have higher valuations.

For accounting studies, concern with the relation of accounting information with market value, the studies of Ohlsen (1995) and Feltham and Ohlsen (1995), are considered the pioneering studies in this regard, which address the value relevance of accounting information for market value of stocks. Though these studies do not deal directly with IPO pricing, but they depend on book value and accounting earnings in their model of valuation of stock fair value. Later on, many researchers use this model to test relevance of earnings and book value to equity in their valuation of stocks.

Our model in this study will depend on both the historical pre-IPO earnings and equity book value at the end of the year prior to IPO.

Collins et al (1997) is considered the first study to use the accounting model, presented by Ohlsen (1995), as a conceptual base for the relation of accounting information with stock prices. The study tests the variation in the relevance of accounting information – earnings and book value -. The study uses the coefficient of regression for stock prices and book value in the American market for a period of 40 years. The study concludes that there is a positive increase in the relevance of book value and earnings to the interpretation of stock value.

Concerning the relation of credit rating with IPO pricing, An and Chan (2008) studies the impact of credit rating on IPO pricing in the American market during the period of 1986-2004. The study concludes that companies which offer their shares in IPO and have credit rating, have lower underpricing compared with the companies, which have no credit rating . The study shows also that the level of credit rating has no impact on devaluation. The study finds that the presence of credit rating decreases ascertaining the company's value, which means that the concern is about the company's value and not the share value itself. The paper shows also that credit rating reduces price variations of the book- building process and price variations on the post IPO period. In general, the results prove that the credit rating bears important information, which leads to decreasing value of the issuing company. Moreover, credit rating decreases also information asymmetry in the IPOs markets.

Hogan (1997), in his attempt to assess the effect of the external auditor on IPOs pricing, states, in consistent with the results of Beaty (1998) and Balvers et al. (1988), that selection of an external auditor from the Big 4, leads to reduction of underpricing. The paper states that the firms, which offered their shares in IPO on the early 1990s have reduced underpricing of IPO, when used an external auditor from the Big 4.

In a study about the impact of the quality of the external auditor of the firm on the firm's post – IPO survival, Jain and Martin Jr. (2005) show that the quality of the external auditor has a significant relation with the post-IPO survival of the stock, especially if the underwriter (investment bank) has low reputation. The researchers assume that the company, which has no high risks and enjoys good potential, will invest in the use of high quality auditing to distinguish itself from companies having high risks and uncertain future.

Concerning the Saudi market, as far as we know, there is no study that addresses the topic of the determinants of the initial public offering premium, and therefore, this paper may be considered the first in this field.

4. Hypotheses Development:

The initial public offering process faces several problems with regards to determination of the price of the offering. This relates mainly to the uncertainty of the overall demand on the stocks and the quality of the issuing firm. Bensveniste and Spindt (1998) document that the issuing firms, usually present themselves to the investors in a manner better than their reality. What aggravates the problem more for the investors, is the absence of other similar firms for comparison with the issuing firm. The previous studies, which have been conducted in other countries, prove the existence of overvaluation or undervaluation of the IPO pricing, without explaining the real factors, upon which the IPO pricing is determined.

During the last decade, many trends have appeared in the studies in this field. Starting from the study of Kim and Ritter (1999), many papers have addressed the methods used in IPO pricing (see Purnanandam and Swaminathan (2004), Cassia, Paleari and Vismara (2004); Jaganathan and Gao (2005). These studies have come with a general result stating that the IPO firms are generally overpriced, comparing with the actually listed firms. There are other studies, which address the role of the financial analysts and their tendency to optimism and hence their estimations are usually greater than the actual figures of the firms (see Rajan and Servaes, 1997; Bravand and Lehavy, 2003).

The main question in this study, concentrates on the interpretation of the variations in offer prices of IPO of the firms in the Saudi market. The offer share price in Saudi market consists of two components: the first is the face value and the second is the IPO premium. As the face value for all Saudi companies is 10 SAR per share, this offer share value

component is not affected by any financial or structural variables in the firm. Therefore, this component is excluded and concentration will be only on premium. The premium is the amount added by a firm on its face value, and therefore this component of offering price differ from a firm to another and affected by the financial and structural variables.

This study will examine the variations in premiums between Saudi firms. The premium is measured by stating the difference between the offer price announced in the prospectus and the face value (10 SAR) per share. It is assumed that the premium is affected by a number of financial and non financial factors, and hence this study shall try to introduce some of these factors in the Saudi market.

4.1 IPO premium and book value

Ohlsen (1995) study, though not tackles the valuation of IPO stocks, is considered one of the most famous valuation studies. Ohlsen develops a model through which equity market value is estimated as a linear function for historical earnings and equity book value. The book value is one of the most important factors that should be considered in determining share price, whether by investors or by firms. Klein (1996) states that the share price has a direct relation with IPO's book value. This gives rise to the following hypothesis:

H1 Assuming that all other factors are controlled, whenever the book value increases, the IPO premium of Saudi firms will increase.

4.2 Premium and profitability (Earnings Per Share)

Earnings Per Share (EPS) is deemed as one of the most important factors that should be considered in determining the share price, whether by investors or by firms. Generally, most financial and accounting studies advocate for this assumption. Therefore, this study shall try to test the validity of this fact in the Saudi environment, especially after the increase of IPOs in the Kingdom. This not only for the purpose of improving the importance of the profitability variable in determining the value, but also to measure the degree of its impact on acceleration of IPO compared with other factors.

In continuation to what has been stated by Kim and Ritter (1999) regarding the effect of profitability on IPO pricing and what stated by Aggarwal, Bhagat and Rangan (2007) about the effect of profitability on pricing, this study expects that the IPO premium increases with the increase of the share profitability. This leads us to assume the following hypothesis to understand the impact of profitability on premium:

H2 Assuming that all other factors are controlled, whenever the earnings per share increases, the IPO premium of Saudi firms will increase.

4.3 Premium and debt

Theoretically, debt ratio is considered one of the factors that affect the share price to some extent. The effect of debt ratio is positive if such ratio is safe and helps the firm to make use of the leverage of financial surplus. Nevertheless, debt ratio may have negative impact if it increases to a level, exposing the firm to debt risks. Increase of debt ratio means increase of operational risks of the issuing firm as well as increase in state of uncertainty of earnings, An and Chan (2008).

This study, through including debt ratio in its test model, tries to explore the impact of this ratio on determination of IPO premium. Increase of debt ratio is expected to have a negative effect on determination of IPO premium. This leads to measuring the impact of debt ratio in the firms going public according to this hypothesis:

H3 Assuming that all other factors are controlled, whenever the debt ratio decreases, the IPO premium of Saudi firms will increase.

4.4 **The premium and the size of external auditor**:

Several researchers argue that the auditor quality is a signal of the credibility of the issuing firm regarding the disclosure of private information, through which investors can overcome bad selection. The studies of Titman and Trueman (1986) and Datar, Feltham and Huges (1991) confirm that owners of issuing firms chose auditors that suit the real value of their firms. Firms of high value choose high quality auditors and firm of low value choose low quality auditors. Hence this signal, quality of auditors, benefits the issuing firm through increase of offer price.

Underwriters, generally, affect the process of selection of auditors by the issuing firms, (Balvers, McDonald and Miller, 1988). Selection of high quality external auditor to audit the financial statements of a firm, gives underwriter confidence in the financial numbers, upon which the offer pricing depends, and their credibility (Menon and Williams 1991). Investors are likely will consider the quality of the auditor as a signal for the quality of the offering, which means that both issuing firms and investment banks will benefit from the increase in IPO premium.

The studies of Titman and Trueman (1986), Simunic (1989), Beaty and Stein (1987) confirm the existence of reverse relation between demand on auditors quality and IPO

risks. Based on these studies, this paper expects an existence of positive relation between the quality of auditors and the IPO price – premium.

H4 Assuming that all other factors are controlled, IPO premium of Saudi firms will increase when the size of the external auditor is big.

5. RESEARCH METHODOLOGY

The conceptual analysis of the study shows that the stock offer price in the capital market consists of two elements: the share face value and the IPO premium. And whereas, the share face value is a fixed amount for all IPOs (10 SAR per share), the variable which is affected by the financial and structural factors of a firm is the IPO premium. The theoretical study explains that the IPO premium may be affected by four main variables, which are: the book value, earnings per share, debt ratio and the size of external auditor. Based on this we can formulate the model regression for testing each one of the three variables of the IPO premium as follows:

$$P_{t,i} = a + \beta 1 BV_{t-1,i} + \beta 2 EPS_{t-1,i} + \beta 3 Debt_{t-1,i} + \beta 4 Auditor_{t-1,i} + e$$

Where:

$P_{t,i}$: Firm's premium (i) at IPO per year (t)

$BV_{t-1,i}$: Book value of the firm (i) per year (t-1).

$EPS_{t-1,i}$: Earnings Per Share of the firm (i) per year (t-1).

$Debt_{t-1,i}$: Debt ratio of the firm (i) per year (t-1).

$Auditor_{t-1,i}$: Size of external auditor of the firm (i) per year (t-1).

e: Regression residual or what is known as random error, which reflects the effects of unknown variables not included in the model.

B, a: Regression coefficients

5.1 Variables

All financial variables in this study have been formulated upon one unit. Variables are determined according to the method applied in prior studies as follows:

IPO premium:
The difference between offer price announced in the prospectus and the amount of par value (10 SAR).

Share book value:
Equity number divided by issued number of shares according to the last pre – IPO published balance sheet.

Earnings Per Share:
Number of earnings per share as appears in last pre-IPO published income statement.

Debt ratio:
Percentage of total liabilities to total assets.

Size of external auditor:
This variable is expressed in binary measure, as it gives number (1) if the auditor is one of the Big 4 or (0) if otherwise.

5.3 SAMPLE SELECTION

The study population represents 28 Saudi companies which have entered the IPO in the Saudi market with a premium during the period from 2005 to 2010. This sample of firms has been chosen after exclusion of Saudi companies, which offered their share in the IPO only with the face value. Annex 1 shows the names of these firms.

The sample covers a number of sectors: Communication, Industry, Insurance, Services, Food Industry, and Petrochemicals. Companies which offer their shares only at face value and companies, with financial statements, substantially changed during the pre IPO period are excluded from the sample.

6. Results

6-1 **Descriptive statistics**

Table No (1) shows a summary of the descriptive statistics for the most important variables of the study, included in the model. All variables are formulated on the base of Riyal unit.

Table No (1)

	Observations	**Mean**	**Standard deviation**	**Minimum**	**Maximum**
IPO premium	28	38.37	0.196	2.00	100.00
Book value	28	14.79	13.95	8.56	86.18
Earnings per share	28	3.85	4.58	029	24.68
Dept ratio	28	0.407	0.196	0.00	0.80

As shown in Table No (1) the average premium for the sample firms is (38.37), the standard deviation is (.0196) and the average book value is (14.79). The standard deviation of book value is (0.196), average book value is (14.79), the standard deviation is (4.58). Debt ratio for sample firms is (0.407) and the standard deviation for debt ratio is (0196).

6-2 Results

The statistical results of the study model show, in general, that the model is significant, and has explanatory power of 30%. This percentage is generally accepted in accounting researches. Table No (2) shows that regression model significance is accepted as (F) value of variance analysis is 4.17, with a significance value of (0.011) less than 5%. The results show also that the regression coefficient is 25.18 and the (t) test value is 2.08 at significance level of (0.048). This indicates, generally, that the model does not depend much on the variables and the constant has high value and significance level less than 5%. This indicates that there is a constant minimum level of IPO premium, not affected by other variables. This portion is less than 0.25.

The constant portion of the sample size means that most of the companies, that go public for the first time, have added a premium on the face value of the share price, regardless of the change value in the four variables (book value, EPS, debt ratio and foreign auditor). The researcher thinks that the constant part of the premium means that there is a constant book value for most of the firms, which makes the offer price greater than the face value. Moreover, the constant part indicates that there are no firms that offer their stocks with a value less than the par value and there are no cumulated losses in any company, which make the offer price less than the face value.

As regards the relation between the IPO premium with the four variables, subject of this study, Table No (2) shows the statistical results of the impact of these factors on IPO premium, as the results show that the multiple coefficient (Adjusted R-squared) of the firms, subject of this study, reaches 31%, and that the general test of the model (F) significant at a level less than (0.011).

Table No (2)

General Model

$P_{t,i} = a + \beta 1BV_{t-1,i} + \beta 2EPS_{t-1,i} + \beta 3Debt_{t-1,i} + \beta 4Auditor_{t-1,i} + e$

Variables	β Coefficients	T	Significance level
A	25.18	2.08	0.048
Book value	- 0.222	-0.43	-.668
EPS	3.637	2.39	0.025
Debt	9.14	0.48	0.6336
Auditor	-1.639	-0.20	0.843
Adjusted R2 = 0.30 Variance test analysis = 4.17F			

As the model results do not show any information about the significance level of each variable, below is an explanation of the results of the model variables test.

6-3 **Relation between the premium and the book value**

The results in Table No (2) shows that the coefficient of the book value effect on the premium is negative with a value of (- 0.222), which is not statistically significant as t test (-0.43) at significance of (0.668). This result is contrary to the research expectation; as the premium is expected to increase according to the increase in book value as per the literature review. To verify the relation, the researcher analyzes the simple regression between the book value and the premium and finds that the slope coefficient is positive and significant; but addition of the book value as one of the variables of the multiple regression model leads to the result shown on the previous table.

The multiple correlation analysis shown in Table No (2) explains this reverse results, as the book value has significant high relation with the earnings per share; and therefore, great portion of the variation of premium calculated in share profitability and excluded from book value.

6.4 Relation between premium and EPS

Results show that the EPS is the only significant variable of the study variables. Results show that the earnings per share test has a value of (2.39) with a significance of (0.025), which indicates that it has significance level.

This result is considered logical, as the relation between EPS with the share price is stable for a long time. The most important thing considered by an investor is the net profit of the company and earnings per share. Accordingly, valuation of a firm and determination of IPO premium will be affected greatly by the earnings per share gained at the end of the fiscal year before the IPO. On the other hand, the high correlation between earnings per share and the other variables makes these variables not significant.

6.5 Relation between IPO premium and debt ratio

The statistical test reflects no significance of the debt ratio variable. Statistical results show that the debt ratio test has a value of (0.48) with a degree of significance (0.636), which means that it has no significance level. This means that the Saudi market does not consider the debt ratio when evaluating the IPO shares. This result can be given different interpretations, the important of which is that the market has not reached enough level of maturity to understand the impact of financial leverage on the profitability and value of the company. The second interpretation may be linked to the Sharia opinion towards debts and their resulting interests. The great difference between debt ratio of the companies, which begins with zero percent (0%) to 80%, which leads to confusion in analyzing the variable; as the low percentage leads to the increase of value and the high value leads to decrease of value because of the high risks of debt.

6.6 Relation between the IPO premium and the external auditor

The results of the table show that size of auditor variable has reverse impact on the IPO premium with negative coefficient of 1.63. This means that the value of the premium decreases with the increase of auditor size. Nevertheless, the negative coefficient is not significant, which indicates its weak impact on the IPO premium.

The results on Table No (2) show that the size of the auditor variable has negative coefficient (-1.639) to the IPO premium, but it is insignificant as t value is (0.20-), which is not significant. The reverse impact on the IPO premium, means that the premium decreases with the increase of the size of the auditor. This result, despite its insignificance level, is contrary to the research expectations. What makes the interpretation more complex, is the fact that the auditor size has no significant relation with other variables, and particularly, with the significant variable – earnings per share – in order to refer the result to the impact shared by it and EPS. The accepted

interpretation is that the existence of the big auditors decreases IPO premium as the firms seek to have high IPO premium. Big auditors have punctual audit methods and bear great responsibility towards investors and legislative bodies. So, they do not accept exaggeration in IPO premium. This explains, the relation between low IPO premium and the big auditors. Moreover, the big auditors seek to adhere to their professional responsibility, and therefore apply more conservative method in auditing the financial statements upon which the premium is determined.

6.7 correlation

Table No (3) shows Person correlation coefficients for the relation of the study variables to the total sample. The table shows positive correlation (0.887) with significance level less than 1% between book value and earnings per share. This correlation shows that whenever the IPS increases the book value increases. This correlation may explain absence of impact of book value on IPO premium, as the tense positive correlation between the two variables results in mutual impact of the two variables on the IPO premium. As the multiple regression has statistical importance for the variables, if the multiple regression shows the shared impact, which causes variation of the variables, counted for the most significant variable (here EPS), it excludes the same impact of the less significant variable (book value).

Table No (3)

Person correlation coefficients

		Book value	EPS	Debt	Auditor
Book value	Correlation coefficient	1			
	Significance level	0			
EPS	Correlation coefficient	0.887	1		
	Significance level	0.00	0		
Debt	Correlation coefficient	-0.428	-0.418	1	
	Significance level	0.021	0.026	0	
Auditor	Correlation coefficient	-0.331	-0.268	0.269	1
	Significance level	0.080	0.160	0.158	0

7. Conclusion

The initial public offering premium and its valuation is the most challenging topic in the Saudi Stock Market, the thing, which led many analysts and traders to demand that CMA should set up a clear system establishing the bases for determining IPO premium. This study tackles the determinants of IPO premium in the Saudi market through testing the impacts of some factors on pricing of firms' stocks in initial public offering. The study addresses the relation between the premium and each of the following: (1) the book value of the issuing company; (2) the profitability of the issuing company; (3) debt ratio of the issuing company; (4) the external auditor.

The results of the study show no impact of the book value on the IPO premium. This result is contrary to the expectations of the researcher, and contrary to the results of the previous studies.

As concerning the relation of EPS with IPO premium, the study proves that there is a positive impact of EPS on the premium in the initial public offerings in the Saudi market. This result is in consistent with the previous studies, which confirm that the firm's valuation and determining of IPO premium are greatly affected by EPS. As for the impact of debt ratio on determining IPO premium, the study results show that the Saudi market does not put great importance on the debt ratio when evaluating the stocks of initial public offerings.

The fact that the book value and the debt ratio are not affecting the IPO premium can be interpreted by the existence of actual significant correlation between these two variables and EPS variable, which leads to this result.

Finally, the study shows the existence of a reverse impact of the auditor on the IPO premium in the Saudi market, which means that the premium decreases with the increase of auditor size. This can be explained by the fact that the big auditors have professional obligations, which oblige them to take more conservative methods when auditing the financial statements upon which the IPO premium is determined.

The results of this study is expected to help a number of parties in understanding the nature of the Saudi market interaction with the value of IPO premium. The results of the study will help, in particular, the legislative bodies – Ministry of Trade and Industry, Capital Market Authority (CMA) – to understand the structural and financial factors that affect the IPO premium in the Saudi market.

The results of this study are expected to open new horizons for the empirical researches on the IPO premium topics in the Kingdom of Saudi Arabia. Among the subjects, which

worth attention, and which may be tackled in the future studies, the investigation of the impact of the governance factors on determination of IPO premium and the impact of profit management on the value of initial offering.

Schedule (1)

Sample Companies

1. Alabdulateef Industrial Investment Company
2. Fawaz Abdulaziz Alkukair & Co
3. Albabtain for Power and Communication
4. Aldrais Petroleum Services and Transport
5. Almarai
6. Tawuniya Insurance Co (NCCI)
7. Red Sea Housing Services
8. Saudi International Petrochemical Company (CIPCHEM)
9. Saudi Paper Manufacturing Co
10. Saudi Printing and Packaging Co
11. Saudi Research and Marketing Co
12. Saudi Vitrified Clay Pipe Co
13. United International Transportation Company (BUDGET)
14. Saudi Advanced Industries Company
15. Al Khaleej Training and Education Co
16. Alsoryai Trade and Industry Group
17. Astra Industrial Group Company
18. Herfy Food Services Company
19. Middle East Specialized Cables Company (MESC)
20. Abdullah Al Othaim Markets Company
21. Al Hassan Ghazi Ibrahim Shaker Co
22. Abdullah Abdulmuhsen Al Khudari Sons Co
23. Methanol Chemical Company
24. Halawani Brothers Company
25. Al Muwasah Medical Services Company
26. Dar Alarkan Real Estate Development Company
27. Basic Chemical Industries Company
28. Moahmed Al-Mojil Group

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