

# Understanding South African **Financial Markets**

## Chapter 12: The equity market



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### Study outcomes

The objective of this chapter is to provide an overview of the concepts, instruments, and participants in the equity market in South Africa.


***When you have studied this chapter you should be able to***

- understand the capital market as a source of longterm financing for companies
- define equity and discuss the different classes of shares
- differentiate between debt and equity
- discuss the equity market and its components



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## Study outcomes

- 
- describe the various equity market participants
  - explain the mechanics of the equity market in terms of listing, valuing and trading shares
  - describe published equity market information.

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## Introduction

### *Overview*

- 
- Equity market terminology
  - Equity market instruments
  - The equity market defined
  - Market participants
  - Mechanics of the market
  - Published market information

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**Table 12.1 Size of the global capital market (in USD billion) (Textbook page 368)**

Markets	Global			South Africa			South Africa market share	
	2012	2011	% change	2012	2011	% change	2012	2011
<i>USD billion</i>								
Equity *	54 672	47 538	15,0%	908	789	15,0%	1,7%	1,7%
Private equity **	2 332	2 029	14,9%	15	14	5,0%	0,6%	0,7%
Bonds and long-term debt ***	100 392	96 835	3,7%	273	247	10,6%	0,3%	0,3%
Capital markets	157 396	146 402	7,5%	1 196	1 050	13,8%	0,8%	0,7%

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## Equity market terminology

### Box 12.1 The uses of retained earnings

Businesses can use retained earnings in two ways:

- *Buy real or financial assets.* As long as these assets are productive, their acquisition will increase the company's future earnings and the price of its shares.
- *Buy the company's shares in the equity market.* Such a share buyback will reduce the number of shares in issue and, as long as the company is profitable, will increase future per-share earnings and dividends. This will have a positive impact on the price of the company's shares.

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## Equity market instruments

### *Equity*

- Equity defined [\(Box 12.2\)](#)
- Equity versus debt
  - Debt
  - Ordinary shares
  - Preference shares
- Debt, preference shares and ordinary shares compared  
[Table 12.2 Debt, preference shares and ordinary shares compared](#)  
[\(Textbook page 372\)](#)

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## Equity market instruments

### *Private equity*

### *Depository receipts*

### *Exchange-traded funds*

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## The equity market defined



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## Market participants

*Issuers*

*Investment banks*

*Venture capitalists*

*Investors*

*Members of the JSE*



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## Mechanics of the market

### Issuing shares

- JSE listing requirements
- Choice of board or market

[Table 12.3 Listing requirements for different equity boards \(Textbook page 378\)](#)

- Methods of listing shares

[Table 12.4 Methods of bringing shares to listing \(Textbook page 379\)](#)

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## Mechanics of the market

### Valuing shares

[Table 12.5 Approaches to equity valuation \(Textbook page 382\)](#)

Relative valuation	Discounted cash-flow valuation
<ul style="list-style-type: none"> <li>• Earnings yield</li> <li>• Dividend yield</li> <li>• Price/earnings ratio</li> <li>• Price/book value ratio</li> </ul>	<ul style="list-style-type: none"> <li>• Present value of dividends</li> <li>• Present value of free cash flow to equity</li> </ul>

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- **Relative valuation**
  - Dividend yield
  - Earnings yield
  - Price/earnings ratio

[F.12.1](#)

[F.12.2](#)

- Market (price) to book value

[F.12.3](#)

[F.12.4](#)



## **Discounted cash-flow valuation**

- **Dividend discount models**

[F.12.5](#)

- Gordon growth model [F.12.6](#)

- Two-stage model [F.12.7](#)

[Table 12.6 EPS and DPS calculations \(Textbook page 385\)](#)

- Three-stage model [F.12.8](#)

[Figure 12.1 Expected growth rate and dividend payout in the three-stage DDM \(Textbook page 386\)](#)

[Table 12.7 Value of the share using the three-stage DDM \(Textbook page 387\)](#)

- **Free cash flow to equity (FCFE) models**

[F.12.9](#)



## *Valuing private equity*

## *Trading listed shares*

- Market and limit orders
- Stop loss order
- Short selling and securities lending



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## Published market information

[Table 12.8 Published market information for shares \(Textbook page 391\)](#)

[Table 12.9 Market information for Aspen shares \(Textbook page 392\)](#)



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