Press ‘I’ for IPOS

Can the current upbeat stockmarket sentiments turn into euphoria? In the past two months, the Union government, along with capital market regulator Securities and Exchange Board of India (Sebi), has announced a raft of reforms measures, many of them involving the primary market, that is issue of fresh shares by a company, to make them more accessible and attractive for retail investors. This, along with other reform announcements, have led to a major bounce in the Indian stockmarket. The optimism could undergo metamorphosis into euphoria if the currently moribund primary market could get revived with successful initial public offerings (IPOs) and follow-on public offers (FPOs).

According to Prime Database, a capital market database company, only 19 fresh issues have hit the market in 2012 and raised a mere ₹770 crore. Many companies cancelled their plans of floating IPOs this year. Says Jagannadham Thunuguntla, head-research, SMC Global Securities: “Because of unfavourable market conditions, as many as 20 companies, including Reid & Taylor, Micromax Informatics, Embassy Property Developments, Joyalukkas and Tata AutoComp Systems, had called off their IPO plans totalling nearly ₹9,000 crore this year.” Retail participation and interest in IPOs has also been low for the last few years. Hira Sadhak, advisor, PricewaterhouseCoopers (PwC), and former managing director, LIC Pension Fund, quotes a 2011 study by National Council of Applied Economic Research. “Only 10 per cent of 24.48 million equity investors participated in IPOs,” it says. Investor interest has also been low...
To revive retail investor sentiment. Retail investors have lost money in the market and are unwilling to come back.

To revive the capital markets. The equity markets have been on a rollercoaster ride deterring investments from domestic as well as foreign investors.

To divert funds going to non productive assets like gold. Gold, which has given stellar returns of over 15 per cent this year, is attracting a large number of investors.

To attract investment from abroad. Foreign Institutional Investors (FII) are waiting for market sentiments to improve so that they can deploy money in India.

To bridge the widening fiscal deficit. India’s fiscal deficit is in a bad shape and the government is trying to use the disinvestment proceeds of PSUs to steer out of it.

The Centre has to raise ₹30,000 crore in the five short months left in financial year 2012-13 to meet its target. And it desperately needs the money. Says Sunil Jain, head-equity research, Nirmal Bang Securities: “An upsurge in IPO market will hinge upon two factors—the environment in the overall equity market and the pricing of the issues.” But the question is: Will the IPO party happen at all? Further, if it does, would it present opportunities to individual investors like you? And should you reach out to them?

While successful PSU IPOs and FPOs are critical for the primary market party to start, the government’s IPO pricing hasn’t been consistently robust. For a success like Coal India in November 2010, there have been hiccups like the ONGC FPO in early 2012 and the recent RINL FPO debacle. Says Dara J. Kalyaniwala, vice president-investment banking, Prabhudas Liladher Capital Markets: “PSU IPOs would trigger investor interest only if the valuations are attractive.” If promoters price their stocks in a way that does not leave any room for investors to make a profit, it kills the IPO market.

Adds Arun Jethmalani, CEO, Valuenotes: “It is important to bridge the gap between what the promoters want and what would interest the investors.” Of course, too steep a discount would also hurt the divestment process.

Certainly the government will be wary of failure. Says Jagannadham Thunuguntla, head-research, SMC Global Securities: “The stockmarket has already priced in the government disinvestment plan and any failure would disappoint the market.” Adds Ashutosh Maheshvari, CEO, Motilal Oswal Investment Advisors: “In case of RINL, the valuations offered by the merchant bankers were much below company’s book value, which was not acceptable to the promoters.” There is a lot riding on the success of PSU offerings.
Cover Story

IPOS TO WATCH FOR

- **NTPC**
  - ₹10,000-15,000 crore
- **Nalco**
  - ₹2,000-3,000 crore
- **Bharti Infratel**
  - ₹5,000 crore
- **BSE**
  - ₹1,000-2,000 crore
- **Just dial**
  - ₹700 crore
- **RINL**
  - ₹2,500 crore

Says PwC’s Sadhak: “PSU disinvestment, if successful, will be an inducement to the private sector to come out with IPOs; many are waiting to see the market response.”

**Reforms advantage.** To get the ball rolling, the first of the recent reform measures involved introducing the IPO safety net for retail investors. The draft measures suggest IPO issuers would be required to buy back up to 5 per cent of the issue size, in case the prices of the shares fall by more than 20 per cent (over and above the market index) within three months of listing. This mechanism would be available to all resident retail investors who make an application of up to ₹50,000. Maheshvari says “the safety net mechanism seeks to prevent price rigging by promoters” and retail investors making big losses after IPO shares get listed.

In a price performance analysis by Sebi of the shares listed between 2008 and 2011, it was found that out of 117 shares listed, 72 (around 62 per cent of the issues) were trading below their issue price after six months from the date of listing. Says Daljeet Kohli, head-research, IndiaNivesh Securities: “Many newly-listed stocks saw huge volatile movements in the initial days of listing.” This is mainly because of the hype created around an IPO. While the efficacy of the safety net is debatable (see Retrograde In Spirit, 31 October), Sebi clearly wants to be seen protecting retail investors. This puts the onus on companies to price issues better.

To protect investors, Sebi has also announced steps to control the quality of IPO issues by bringing in stricter rules. For instance, it has created a framework for rejecting offer documents. It would not clear them if it finds that the quality of disclosures are inadequate, promoters unidentifiable, and proceeds intended to be used for loan repayments. The result would also be rejection if the business model is exaggerated, complex or misleading. Sebi finds the business highly risky or discovers sudden growth in the company’s financials in the pre-issue filing stage. It has also put stringent rules on who can float IPOs and how they can be issued.

Says Ajay Puri, president, LSI Financial Services: “Through these measures Sebi has sent a clear signal to both the issuers and the merchant bankers that it would be unwilling to tolerate either window dressing of the issuers’ financials or ambiguity about the purpose of floating the issue.” Experts feel that the quality of IPO issues now. “(Henceforth,) corporates with a track record and sound business plan are likely to access the market and, in the long run, it is likely to create a healthy and sound primary capital market.” adds Puri.

Among the long-standing grouses of retail investors has been that they aren’t allotted shares. Sebi has tried to also address this with norms that require each individual investor to be allotted a minimum lot of shares. Says Alex Mathews, head-research, Geojit BNP Paribas Financial Services: “Previously, investors wouldn’t know how many shares they were allotted, but now the norms are clear.”

**WHY NEW ISSUES COULD BE RISKY PROPOSITIONS**

Assessing a company in the secondary market is simple because the finances of the company are readily available and the market is quick to price the shares right based on the information available. Investing in the primary market is, however, risky because:

- **Minimal information is available to assess a firm**
- **A lot of hype is created by intermediaries to sell an IPO**
- **Disclosures for ‘to be listed’ firms are less stringent**
- **Usually IPOs are aggressively priced and can be misleading**
- **Past issues have witnessed drop in prices after the initial flurry**
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HOW TO APPLY FOR SHARES IN AN IPO

Fill up the ASBA form
Submit the ASBA form at a Self Certified Syndicate Bank (SCSB) or apply online
Ask the bank to block the application amount in your bank account or specify while applying online
The application gets uploaded during the bidding process
Get the order number
Your application amount continues to earn interest till the allotment is done

will get if they applied in an IPO.” It doesn’t stop at this. There are many other measures that Sebi has announced, such as those related availability of a blocked amount for IPO application in your bank savings account which will make sure that your money earns interest till allotment. Says Thunuguntla: “The regulator has also announced various steps for enhancing the distribution network, bidding through electronic IPO platforms and incentives for brokers.” This will ensure that IPOs and FPOs remain accessible to a large number of new and existing stock investors.

IPO star attractions. If the stockmarket sentiments improve, you can expect several IPOs to hit the market with the major PSU offerings being Nalco, Hindustan Copper, Oil India and Hindustan Aeronautics. Says Maheshvari: “The biggest disinvestment for the financial year is likely to be that of National Thermal Power Corporation (NTPC), (which is) expected to rake in more than ₹10,000 crore for the government.” If these are successful, you could expect a host of other private sector IPOs—Just Dial, BSE, NSE, PC Jewellers and Bharti Infratel. “The Bharti Infratel IPO is most likely to generate public interest and be worth considering,” he adds.

Tread with caution. A revival of the IPO market could bring back the popular misconception—a relic of the time when there was no free pricing of IPOs—that allotment itself is enough for make gains on listing in IPOs. So, despite Sebi’s primary market reforms, the risk of investing in IPOs remains greater than investing in listed companies, which are, typically, better researched. That lets you invest in them not only with greater conviction, but also to review performance effectively. The ‘image building’ of a company before an IPO typically distracts the investor. Finally, there is the biggest risk of all—issue mispricing.

What to do... Before investing in an IPO, you need to ask yourself whether you are in it for the long-term, or for listing gains. If it is the second, investing big doesn’t work since the risks are too many and you should exit the stock on listing. However, if you are in it for the long-term, the process broadly mirrors investing in a listed companies. To begin with, read and understand the offer document. If you cannot, get expert advice. IPO grading will tell you whether the financials are sound, but not help you understand the price. Try to understand the business and look for company-specific risks over above the usual business risks such as interest rates. Investigate whether the company’s management is worthy of your trust and money. Find out the purpose for which the money is being raised. If it is to make the business and shareholder wealth grow in a viable manner, the IPO plunge merits consideration. Lastly, compare the company with similar ones on different parameters, such as size. This will give you an idea whether you are being overcharged.

...And what not to. The don’t dos list starts with you not following the crowd. IPOs and FPOs are usually floated when markets are euphoric and, consequently, valuations of companies are stretched. Unless the promoters and merchant bankers leave sufficient gains on the table, retail investors shouldn’t invest in IPOs. Totally ignore oversubscription figures. And, of course, don’t ever borrow to invest in an IPO. There is rarely easy money in the stockmarket, no matter what anyone says. The key to good investments is getting credible information. That truth remains unchanged even with the new optimism.

How to apply for shares in an IPO

Submit the ASBA form at a Self Certified Syndicate Bank (SCSB) or apply online
Ask the bank to block the application amount in your bank account or specify while applying online
The application gets uploaded during the bidding process
Get the order number
Your application amount continues to earn interest till the allotment is done

ASHTUOH MAHESHHVARI
CEO, Motilal Oswal Investment Advisors

“The Sebi’s moves will only be able to address quality issues to enter the market and enable productive use of investor money”

AJAY PURI
President, LSI Financial Services

“Pricing is the key. The success of any equity issue depends on getting the issue pricing right”

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