Indian IPOs: Back in Action !

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The global market turmoil and a subsequent crash in Indian secondary market threatened to play spoilsport to the great Indian IPO rush. But this was only temporary as the market sentiment has begun to turn positive.

Primary market plays an impor tant role in accumulation of seed capital required for any upcoming project. In fact, the last few years have witnessed many corporate entities raising easy capital from the primary market.

The year 2008, has also started with a bang with high-profile launch of Reliance Power IPO. The initial public offering of Anil Ambani's Reliance Power stock was oversubscribed more than 72 times as the investors across the world placed bids worth a whopping $200 billion or Rs. 8,00,000 crore for its shares worth $2.9 billion on offer.

This created India's new IPO record by toppling the public sector oil giant ONGC's 2004 IPO record of Rs. 9500 crore. Even the Future Capital Holdings Ltd. – the financial services arm of Kishore Biyani's Future Group, which went public in January, had also raised about Rs. 490 crore through its IPO and surged nearly 19% over its issue price on debut trade at the bourses.

But subsequently, as the global markets crashed and the Indian secondary market, collapsed, the earlier euphoria has somewhat waned and the market has corrected itself. The market has even seen issuers reducing the issue price by more than 20% to attract the investors. Even postponement of listing dates could not stop the withdrawal of big IPOs such as Wockhardt Hospitals, Emmar MGF and SVEC Constructions.

The RPower IPO, had also crashed on its first day of trading in the Bombay Stock Exchange. The shares of the much-hyped power-generation startup company closed at Rs. 372.50 each after its first day trading, 17% below its issue price of Rs. 450. But, since then, as the global markets turnedvolatile on the fears of impending recession in US, the Indian secondary market has also started skimming off the froth and so has been the case with Indian primary market. Suddenly, liquidity evaporated and investors have become risk averse, thereby giving tepid response to primary issues.

However, these were only temporary adjustments and in fact fundamentally there was nothing wrong with the Indian primary market. Now, again the investors have started crowding the Indian primary market.

Backed by the applications from a string of government banks and financial institutions (FIIs), state-owned Rural Electrification Corporation (REC), got full subscription within 27 minutes of opening. Even the Kerala-based V-Guard Industries, engaged in the manufacturing and marketing of electrical and electronic products, has received thumping response from all kinds of investors.

These recent developments only indicate that investors were temporarily in hibernation and now they are coming out again which really bodes well for the IPOs that are in the pipeline.

Whatsoever, the recent developments have highlighted the fact that market sentiment can take a volte-face in a moment and no stock, in a broad sense, no country can be insulated from a change in investors' sentiment. However, the bottom line is that, through the current drubbing, the investors have become more suspicious and are taking thoughtful decisions.

Liquidity matters

A section of the experts hold the view that the R-Power traded-price debacle has led to a liquidity problem and an acute downturn in the market. Even individual investors had been staying away from the market for some time now taking a cue from institution investors and seemed to have lost their hunger for IPOs. That is the reason IPO applications from retail investors too tend to pour in on the last couple of days during the offer period. However, presently, the larger worry for the Indian investors and the market, in general, is the extremely lukewarm response from QIBs (qualified institutional bidders).

The institutional investors disregarding high profile names such as Wockhardt and Emaar which was billed as the second largest IPO in the realty sector only after DLF and favoring a slew of lesser known names in recent times, tells a lot about recent market apathy.

This clearly hints at genuine waning of liquidity and appetite for risk, at the global level. And when it comes to liquidity, India's primary market, much like its secondary counterpart, depends heavily on the whims of the global investors. In the IPO-boom phase i.e., till the launch of R-Power IPO, a good number of retail investors, were in the game mainly to make killings through big listing gains. However, now the present state of sluggishness in the secondary market makes huge listing gains difficult; those waiting in the wings may prefer to remain on the sideline until the buying frenzy starts again.

INTERVIEW

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1. How do you see the recent trend in IPO market in India?

With the start of 2008, we have definitely seen lot of IPOs flowing in. However, with the recent failure of good companies like Wockhardt and Emaar MGF to raise funds from the market reflect the reluctance of investors, in investing in IPOs in a sentiment driven market. When the dust of sub-prime issues and US economic crisis settles down we expect a good number of IPOs coming in again.

2. What is your outlook on the Indian IPO market in 2008?

It is most certainly clear that investors hesitate in putting money in a volatile market. Especially with more of B1 and B2 category stocks (representing higher risk) coming up with IPOs. However, this hesitation as per our view is short lived. With a clearer market, showing an uptrend we expect the IPO inflows to continue in 2008.

3. What is your take on the IPO activities in the emerging markets?

In emerging markets the need for Infrastructure, Banking & Financial Services, Power, and Telecom lies at the macro level. So money ploughing will continue and IPOs will also generate a more favourable response in these sectors. In the IPO market established players will have a upper hand in raising funds.

Our primary markets are simply mirroring the happenings in the global secondary markets. However, this is not a cause for concern as Indian economy is structurally strong and is likely to remain so with short-term disruptions caused by external factors.

In case of listing at discount, HNI's, trading with leverage money for listing gains; incur massive losses in the form of discount price as well as interest to be paid on the leveraged money.

4. Any other comments?

- A provision for establishing control over the valuations of IPOs is required, especially while valuating non-profit making companies. For example a condition of the stock P/ E not exceeding the index P/E can be arranged.

- While valuating some IPOs the future earning potential of the companies are considered while the risks faced by the companies are not taken into consideration. This leads to over-valuation of the stock, which then becomes unacceptable to the investors.

The recent withdrawal of IPOs is also due to over valuation along with negative sentiments running in the market. The poor opening of Reliance Power on listing reinforces the fact that the stocks are overvalued for short-term.

- We also suggest that reservations for retail investors in IPOs should continue. IPOs are basically a way by which small investors participate in the capital markets. The investors in IPO markets are usually the conservative kinds and thus are impacted by valuations given to the scrip.

- A segregation of short term (listing gain traders) and long term investors while allotting the shares can be considered such that, short term investors pay a premium price than the price paid by long term investors.

This would encourage investments in the real sense. For instance in case of listing of Reliance power investors would have got the scrip at a price of Rs. 350 for say two years lock in period (The investors will get the option of selling before the completion of lock in period under certain restrictions like selling only to the company at a pre-determined price that may be Rs 350 plus bank interest rate). Short term investors may get the same scrip at a price of approx Rs 500 vs. Rs 430.

Though the market sentiment has for sure became weak and played a big role in the present subdued mood, most market pundits point at grossly overrated valuations, based on projected earnings of many years in the future.

For example, in R-Power case, the company's plan includes setting up power plants, wherein majority of the projects would start fetching revenues and profits only from the year 2013 onwards.

Moreover when compared with listed peers such as NTPC and Tata Power, R-Power IPO looks over priced. Even Wockhardt Hospitals' IPO was highly over priced, almost 10 times costlier than rival Apollo Hospitals. Besides this, Mumbai-based IRB Infrastructure had solicited almost double the P/E than its Mumbai-based peer L&T. The same has been the case with Emaar MGF in comparison to its real estate peer DLF. However, experts anticipate that the forthcoming IPOs would not be overpriced like their earlier ones and thereby, they would again attract investors' attention. The recent success of REC and V-Guard vindicates the fact that though the liquidity has some what evaporated, it has not completely dried out.

INTERVIEW

Padmalatha Suresh
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1. How do you see the recent trend in IPO market in India?

Probably mid February 2008 is not the right time to be talking about a 'surge' in the primary market, when highly publicised and heavyweight IPOs are being withdrawn or postponed due to poor investor response! However, the last four years have seen amounts ranging between Rs 22000 to Rs 25000 crore being mopped up from markets that have been unnervingly choppy at times. Yet when stock prices start rallying, as they eventually would, investors would again start snapping up shares in newly listed companies.

2. What is your outlook on the Indian IPO market in 2008?

From January 3, 2008, to February 1, 2008, seven issues were listed. Of these, 3 were listed at prices below the issue price. Of the 14 issues closed and awaiting listing, with the glaring exception of Reliance Power, retail investors have contributed to very little offtake. Even in the case of Reliance Power investors wait with bated breath to see at what price the issue would list.

All of which returns the retail investor to the enigmatic question- is it safer to invest in the primary or secondary market? In the primary market there is a scramble for select issues, of which the investor would end up with a miniscule holding if he is lucky. Further, though terms like 'investor protection, 'IPO grading' and others started making the rounds, there has not been much progress.

At 90% of GDP, the size of India's equity markets is comparable to other emerging economies, though still small compared to other developed markets. Hence, there is a huge potential for growth in equity markets, provided sustained economic growth and market friendly capital reforms can be ensured. However, if the economy slows down, as some estimates indicate, the trend may decelerate slightly in 2008.

3. What is your take on the IPO activities in the emerging markets?

IPO investment in emerging markets is seen to be quite risky. A survey done on IPOs in China and other emerging economies during 2001-2005 has shown that the share prices are lower than the initial subscription price in 50% of the companies after just one year. Another study estimates that in India too, about 50% of companies trade below their listing price after one year. A study by McKinsey notes that while only 18% of the listed companies on the NSE are owned by retail investors, they account for an estimated 85% of the trading volume, suggesting that retail investors tend to speculate rather than invest for long term benefit. Against the backdrop of a so called 'boom', a joint survey by SEBI and NCAER in 2003 found that a mere 7% of Indian households invested in the capital markets. Even with the subsequent economic expansion, this percentage is unlikely to have increased substantially. Hence, there is huge potential for IPO activities in emerging markets if the risks can be addressed, and investors sufficiently educated, protected and encouraged to invest for long term benefits.

Back to basics

However, the truth is that the recent turmoil in Indian market was waiting and bound to happen. Even some experts argue that it would have been better if this had occurred a few months ago.

The inherent resilience and the strong macro fundamentals of the Indian economy had temporarily prevented the IPO bloodbath for a while. Now with global turmoil and the bigshot R-Power floatation sucking the liquidity from the system, the crisis had come to the fore. And even a few months ago, several companies with fragile fundamentals, had raised thousands of crore of rupees just in the names of the promoters. That time investors supporting such weak IPOs showed a complete disregard to the principle of investing and an apparent victory of herd mentality. In fact, for quite some time, Indian capital market had become an island of dreams fetching superlative returns to the investors.

However, the recent stasis has brought to the fore a very basic issue, that of our heavy over-dependence on the foreign investors. Even a meager sell-off by them can lead to market crash in India. A tiny Rs 5,821 crore sell-off by FIIs over five days in January, which accounts for only 0.08% of the total market cap, has brought down a Rs 75 lakh crore market by whopping 30%.

This reveals that there is clearly a need for greater development of domestic institutional investors, pension funds, mutual funds and insurance companies. However, there is no denying the fact that the recent market crash has eroded investors' confidence, particularly that of first time investors. And in these circumstances, gullible investors badly need to reframe their IPO strategy. They should go back and evaluate offers on the basis of business fundamentals rather than on potential listing gains. Investors should also make a cost-benefit analysis of the opportunity cost of tying up their money with an IPO, with investing in the bluechips in the secondary market.