In public interest

Since the IPO hype will probably only increase, you need to screen new issues even more carefully

Prithvi Haldea

One of the stories of this bull run has been the fabulous returns from IPOs (initial public offerings). Behind these huge gains are several factors like too many investors chasing too few issues, most issues being made by companies with good businesses, generally reasonable pricing and a buoyant secondary market. Going forward, though, all this might not be a given.

History shows that IPOs in bull markets have a cycle. The early phase is characterised by good issuers and reasonable pricing. As investor demand increases, most issues get 'probably overpriced' and, eventually, become 'positively overpriced'. even as the percentage of mediocre and rank-bad issuers increases. So far, hardly any IPOs have been made for greenfield projects -- building a business from scratch. That's the case even in the list of upcoming issues. But this could change as hype builds and draws unscrupulous promoters to the market.

There could be a temptation to chase every new offering, as huge oversubscriptions in the issues so far has meant zero or small allotments coming your way. Resist that temptation. The pipeline of public issues is large enough. What's important is you pick out good issues, as IPO investing is the riskiest investment – you can double your money in a minute, you can also lose half of it in the same time. Each issue is unique; and contrary to what some media reports might lead you to believe, Sebi neither 'approves' these issues nor their offer prices. You have to decide for yourself. Here are some essential parameters to base your decision on.

The issue

Regrettably, most investors still invest in public issues for reasons that have nothing to do with the company's fundamentals. It's true that making informed decisions is difficult: the abridged prospectus is very investor-unfriendly. Moreover, as a prospectus is a seller's document, each one tries to project the issue as an opportunity of a lifetime. In most cases, the good information is highlighted, the damaging revelations are not disclosed, buried, sugar coated or ambiguously worded. But it's still an important document about the company. Do go through at least the portions that matter -- promoters, performance, business, issue objectives and risk factors.

Promoter. Look at the promoter's track record, experience in the industry, performance of the company and other group companies, related party transactions, record of shareholder rewards and investor complaints. It's important these facts give a sense of comfort. Be wary of promoters/companies that have broken laws. Look for evidence of defaults in the 'risk factors' or web resources like www.watchoutinvestors.com.

Objectives. Gone are the days when almost all issues were made to finance projects. Companies now make issues to build a cash chest for acquisitions, to retire debt, to meet working capital needs, to facilitate divestment by promoters or venture capital funds, among other things. Whatever the reason, it should make sense in the company's scheme of things.

Performance. It's amazing how almost every company turns in an extraordinary performance in the year and quarter preceding its issue. In reality, many might have window dressed their accounts by reporting huge 'other income' or making huge sales on credit, the payment for which may not come.

Price. At a high price, even a good company becomes a bad investment. As issuers look to milk this market, aggressive pricing might not be far away, even from PSUs. Don't look at the state of the Sensex or market sentiment or oversubscription numbers. Look for value. Analyse the issue price in the context of the expected earnings growth of the company.

Also, differentiate between IPOs and FPOs (follow-on public offerings). In an FPO, the secondary market price serves as a price benchmark. Since there is no real price discovery involved, listing gains or losses are only marginal. Even if the discount offered to the market price is substantial, see whether the valuations make a case for investment. Often, share prices rise in the lead up to an issue, so check out the price movement in the past six months.

Lead managers. Some merchant bankers manage only poor quality issues. Make a note of merchant bankers to the good and bad issues, and use it as a point of reference.

The process

When you find an issue worthy of investing, keep these three factors in mind.

Bid price. If you don't have the resources to determine the fair price for an issue and don't want to lose out on allotment, bid at the 'cut-off price' -- the price that is decided by the issuer.

Application size. In every issue, 35 per cent of the shares on offer are reserved for small investors -- defined as applications of up to Rs 1 lakh. Keep your application within this amount. If you want more shares, apply in the names of family members.

IPO financing. Today, Financiers are more than willing to lend you money to invest in public issues. It might look cheap, but it is not always. Understand that you pay interest on the number of shares applied for, but your gains, if any, are on the number of shares allotted. In issues that are heavily oversubscribed, borrowing can turn out to be expensive.

BOX

DUE DILIGENCE

- Have a valid demat account, with correct address
- Fill the application form in capital letters and legibly
- Keep a photocopy of the filled application form and cheque
- Applicant names should match those in the demat account
- Quote PAN in applications above Rs 50,000; no need for MAPIN
- Take acknowledgement slip while depositing the application form
- When filing a complaint, list important details
- Send complaints to registrars, copy to Sebi