Lessons from the past

He's lived the worst of IPO investing over the past three decades. Today's investors have much to learn from his travails

In every new issue boom, he applied in IPOs blindly. At one time, he held 650 stocks, of which, 400 were not even traded

Prithvi Haldea

Some things never change. I have been interacting with investors for many years. I find, as a collective set, their hopes and concerns remain the same. Their responses to market happenings remain the same. Within that set, there are some who learn from bad experiences to become wiser investors. Then, there are some like my compulsive IPO investor friend -- let's call him 'X' -- who simply stumble from one crisis to another, never learning their lessons.

Hope floats

X got interested in the capital market in 1977, when the government forced multinationals to offload shares to domestic investors. His first investment was Pond's, at Rs 20 a share. Back then, issue pricing was fixed not by the company or its merchant banker, but by a government body called the Controller of Capital Issues (CCI), through a formula. Since not many people knew about shares back then, X was allotted all the 400 shares he applied for. Pond's got listed at Rs 100, and kept climbing.

Kicked, X applied in every multinational IPO that followed -- about 100-odd. By then, more investors had caught on to the fantastic potential of these IPOs (initial public offerings), and allotment became a lottery. X got shares of only a handful of companies -- all bluechips, at low prices. He didn't sell a single share. His stocks soared, which convinced him he understood stocks and that a buy-and-hold strategy was the way to go.

When the next IPO boom happened, from 1984-1986, X went on an application spree again. He applied for hundreds of IPOs, many of which were leasing companies. He generally applied for 100 shares. But desperate for allotment, X also started applying in his wife's name. Sometimes, when he got impressed with a company's ads, he applied for 500 shares. He got an allotment in three out of four issues. Most of them listed above their issue price, but X didn't sell a single share. When the euphoria vanished, so did many of these companies. His portfolio gains turned to losses. But he held on, hoping another bull run would set things right. "Why should I sell at a loss? The market is cyclical and, some day soon, the tide will turn to bring all my holdings into profits."

When the next IPO boom came in the late-80s, X decided to be more cautious. But when he saw the big gains from the first set of new issues and the turnaround in some stocks in his portfolio, he couldn't resist. He still believed the CCI pricing guaranteed profits. Again, he got big allotments. Again, he didn't sell a single share. "I don't need the money," he said.

Then came 1992 and Harshad Mehta. X didn't buy. But he didn't sell either, despite the fact that many dud stocks in his IPO portfolio had rebounded. One such scrip was Mazda Leasing, which was languishing at Rs 5 a share. When Mehta bought this company, its soared to Rs 50. X asked me what to do with his 500 Mazda Leasing shares. I advised him to sell. He agreed.

The next day, the stock had gone up to Rs 80. X held on, as the 'market buzz' was it was poised for greater heights. It hit Rs 2,000. All along, I kept saying sell, giving the additional logic that those gains would improve his portfolio value. X smiled and held firm, as the buzz now was Rs 10,000 in a month. When Mehta's game was called, X rushed to sell his Mazda Leasing shares -- his first sell order – but there were no buyers. The stock, eventually, tanked to Rs 2.

Back to basics

In June 1992, the CCI was abolished and companies were given a free hand to price their issues. X didn't grasp the magnitude of this change. For him, an IPO was an IPO -- it had nothing to do with a company, or its business prospects, or the price at which it was issuing shares! Between 1992 and 1996, a record 3,911 issues hit the market, many of them from two-bit companies. X applied in about 1,100 and got allotment in about 500. Again, the same pattern. Most of his stocks listed above issue price, he didn't sell, prices crashed. Many of these companies disappeared or their promoters siphoned of money. He made losses in four of the five issues. Shell-shocked, he swore off IPOs and swore at Sebi.

But come 1999, X was back, furiously logging on to new IT issues. I recall the day when he was applying in a company called Shriram Multitech. I asked him what the company did. "IT, of course, it's evident from its name," he shot back. It was a packaging company. X got shares in 30 companies. When they listed above issue price, he felt he was back in business. But he didn't sell. The Nasdaq crashed, Ketan Parekh got busted, IT shares went into a tailspin. X lost money again. At that time, he was holding shares of about 650 companies. Unfortunately, about 400 weren't traded at all.

When the current IPO boom started in May 2003, X sought me out. I told him two things. One, be an investor, not an applier. Apply only in good issues -- not every IPO is good. Two, set a sell target and exit when it's hit. X has made decent money this time around, he's even sold off some of his old holdings. Of course, he's been helped by the fact that the quality of new issues has been good. But as the market heats up, and more companies approach it, quality could suffer. And it could be yesterday, once more.

IPO rules

- Apply only in good issues: credible promoters, promising business, fair pricing
- If an exuberant market showers extraordinary gains on you, take it and run -- don’t wait for more
- Holding on to a losing investment is futile. Would you buy that stock today? If not, you shouldn’t even hold it
- Making profits in a few issues doesn’t mean you know all there is to know about stock investing
- Don’t read anything into glossy ads and TV commercials -- they often blow up the real picture