The Rs 1,40,000 crore question

The stock market might be cracking and recent issues barely scraped through. Still, don't write the epitaph of the primary market just yet

Issuers will adjust to new market realities: conservative pricing, better timing and other capital-raising options

Prithvi Haldea

One of the eagerly-tracked stories in the market's recent savage fall was the fate of the four new issues that week -- Air Deccan, Gangotri Textiles, Rathi Udyog and Unity Infraprojects. Caught in a maelstrom in which all investors and brokers wanted to do was jump ship, these four issues eventually made it ashore -- but just. They didn't have the luck of, say, Reliance Petroleum: the Sensex and the share price of the promoter company – Reliance Industries - rose and rose during the 35-day period from its IPO announcement to listing, only to collapse the next day!

The issues

Had those four issues devolved or been cancelled, investor sentiment for new issues would have taken a beating. In these early days, investor interest in new issues seems to be waning, but it's not the end. If anything, this shows how much distance the primary market has travelled since the manic 1990s. This is borne out by events of the past fortnight -- for example, around 55,000 retail investors applied to the Air Deccan issue. It is also borne out by new issues announced after the crash -- Prime Focus and Allcargo Global Logistics are in the market, Blueplast has announced its IPOs. These might not garner huge oversubscriptions, but should sail through.

That said, the primary market is healthier than ever before. Entry norms are more stringent, there are fewer merchant bankers, issues are vetted better and there is strong institutional participation. In this IPO boom, we have had fewer but better quality issues. Most have been from established companies, with hardly any IPOs for new projects from new promoters. Just seven of the 162 issues have been below Rs 10 crore.

The Rs 1,40,000 crore question -- the size of the current new issue pipeline -- now is: will the good times continue? Based on the stage at which these issues are, they can be classified into three:

Have Sebi clearance. 13 companies, planning to raise Rs 1,963 crore. Among issuers, these would be the most anxious. Most of them, especially large ones like Parsvanath, may announce their opening dates only when some stability returns to the market.

Awaiting clearance. 48 companies, planning to raise Rs 16,517 crore. This list includes DLF Universal (the largest-ever IPO in India) and five others that have filed after the crash. They have about a month -- the time it will take for Sebi clearance to come through -- to decide what to do.

Plans to file. About 500 companies, planning to raise Rs 1,20,000 crore, they might wait for the market to settle down. Unlike the past, when most IPOs were project related and issue funds were a critical component of project implementation, most issuers are now in no big hurry to enter the market. Most of the issues are for objectives that can typically wait: like working capital needs, expansion, debt repayment, acquisitions, and exit option for the venture capitalist.

The answers

For a healthy stream of IPOs, we don't necessarily need a buoyant or a rising secondary market. What we need is the absence of huge volatility.But, if the market continues to slide or remains volatile, many issuers will defer their issues, as they woundn't want to dilute at a lower valuation or live inanxiety. They would rather hold on to their plans until the market sees some stability, as is expected in the coming months.

Clearly, the IPO market is not dead; it is only experiencing some anxiety, which might be a good thing for it in the long run. Until recently, when the entire market was working on forward multiples, IPOs got priced similarly. So, if the PE of its listed peers went up from, say, 10 to 20, an aspiring company would bump up its issue price PE from, say, 10 to 14. Pricing may now get more conservative. Companies will want to see their issue through and merchant bankers would not want issues to devolve or languish below issue price.

That's not to say that pricing has been overly aggressive so far -- of the 162 issues in the past three years, only two have never quoted above offer price. In other words, 160 out of those 162 IPOs allowed investors to exit at a profit. Of the 30-odd new listings this year, about 20 are quoting above their offer prices, the best at a marginal discount. Besides better prices, over-subscription levels might drop, improving an investor's chances of getting an allotment.

Not so good news for FPOs (follow-on public offerings), though. Their pricing is pegged to the recent market price of their respective stocks. If that discount vanishes overnight, so will investor interest. Instead of FPOs, issuers may now opt for the qualified institutional placement (QIP). We may also see a rise in pre-IPO placements, as private equity funds are sitting on loads of cash.

Hopefully, the crash would foster policy changes. The IPO pricing and reservation system needs to introduce auctions for QIBs and fixed price offerings for retail. Besides allocation for domestic investors needs to be raised, largely to act as a counter force to FIIs.