IPOs: HOW LONG WILL THE DREAM RUN LAST?

A raft of new share sales boosted first-half IPO numbers. But, there are red flags

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MUMBAI

Until March, the market for initial share sales in India had been moribund this year and badly in need of stimulus to come back to life.

It took a condom maker to revive the sagging market for initial public offerings (IPOs). Mankind Pharma Ltd, the New Delhi-based maker of the Manforce brand of male contraceptives, raised ₹4,326 crore in a blockbuster IPO in April, almost seven times the entire amount raised by three companies that went public in the first three months.

Until Mankind Pharma, which commands 30% of condom sales in the world's most populous nation and also makes over-the-counter consumer products like sanitizers and Gas-O-Fast antacids, breathed life into the primary market, IPOs raised just ₹633 crore in the January-to-March period, a drop of 92% from ₹7,819 crore a year ago, according to Prime Database.

The initial stock sale attracted demand for more than 15 times the shares up for sale, and the price surged by nearly one-third to ₹1,422.30 apiece on its debut. It has since risen to ₹1,799.45 on the National Stock Exchange on Friday, compared to a 7.6% return offered by the benchmark Nifty 50 in the same period.

True, Mankind has credentials that are refreshingly different from those of other companies, mainly tech-oriented ones, that were deemed overvalued and underperforming, which have tapped investors in the past couple of years.

Its issue size was large, but not overly so, at ₹4,326 crore, and the valuation judged reasonable. Plus, the company's financials were robust, unlike those of tech companies such as Zomato Ltd, PB Fintech Ltd and One 97 Communications Ltd (Paytm) that hit the market in 2021. The tech

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Not surprisingly, Mankind Pharma's stellar performance set the stage for a raft of new share sales by companies. IPOs were back on the radar of investors by June and July, followed by an uptick in August and a bumper September.

Overall, in the April-September period, or the first half of fiscal year 2023-24, the number of IPOs was 31, the highest since the same period in 2007-08. Companies have raised ₹26,281 crore, with September alone contributing a share of as much as 55%.

The pharmaceuticals and drugs sector, travel-related companies and cable and wire makers raised nearly 23%, 17% and 8% of the proceeds, respectively, in the first half of this fiscal year.

"Mankind Pharma changed the fortunes of the IPO market in 2023. Its success went a long way in boosting the confidence of merchant bankers to proceed (with initial share sales)," says Nitin Rao, founder of investment blog alphaideas.in.

Now, the question uppermost in the minds of investors and analysts who track the stock markets is this: Will this run persist into the second half of the year?

Rao expects it to have enough steam left to last a few more months at least; the optimism is offset by reasons for investors to exercise caution.

THE FUEL

Among other factors, experts point towards a moderation in the valuations of companies seeking a public listing as an attractive enticement for investors.

Of course, it also helped that the Indian stock markets have soared this year. So far in calendar year 2023, the Sensex has gained 8.5%, matching the Nifty, which scaled a new peak of 20,000 points in early September for the first time. Last month, domestic liquidity was relatively more robust at ₹20,311 crore, according to National Securities Depository Ltd data.

Typically, IPO market activity levels depend on the gains in recent listings and the state of the secondary market, especially the broader indices.

"When these turn favourable, IPO markets become hot and oversubscription levels rise—a situation we have seen in September in India. The grey market becomes active at such times and based on the grey market premium, investors apply for IPOs, expecting them to list at such premiums," says Deepak Jasani, head of retail research at HDFC Securities Ltd.

"As long as the IPOs list at a good premium (irrespective of their valuations), investors will be tempted to keep applying," he adds.

On their respective listing dates, the top five companies (Mankind, JSW Infrastructure Ltd, RR Kabel Ltd, Concord Biotech Ltd, Samhi Hotels Ltd) by issue size rose in the range of 14-32% from their issue prices.

Expectedly, subscriptions for IPOs have zoomed this year, especially from retail investors. According to Prime Database, the average number of applications from individual investors increased to 1.002 million in the first half, compared to 757,000 in the same period last year.

Retail investors applied for shares worth ₹55,516 crore, which is 118% higher than the total amount raised through IPOs. In comparison, this measure was 33% lower in the first half the last financial year.

What stands out here is that the total allocation to retail investors in the first half of this year was 26% of the total funds raised through IPOs, according to Prime Database. In simple terms, this indicates that a higher number of retail investors were willing to apply for IPOs and wanted greater allocation but were unsuccessful in buying as many shares as they wished to.

After a strong September, when as many as 14 IPOs were launched, investors are looking earnestly at what the rest of the year has in store. As of 22 September, 28 companies had approval (which was still valid) from the Securities and Exchange Board of India (Sebi), the market regulator, for IPOs with an estimated aggregate sale of ₹38,440 crore.

SMALL IS BEAUTIFUL

The increased quest for higher listing gains amid a sharp outperformance by mid-caps and small-caps has opened the doors for a flood of IPOs by small and medium enterprises, or SMEs, this year.

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For perspective, take a gander at this: The Nifty Midcap 150 and Nifty Smallcap 250 indices have risen by nearly 27% and 30%, respectively, so far in this calendar year compared to the 8.5% gain in Nifty 50. Against this backdrop, the September reading for SME IPOs touched a record with 37 companies raising about ₹1,006 crore.

During the current fiscal year's first half, 97 SME IPOs collected a total of ₹2,732 crore, 140% higher than ₹1,137 crore gleaned from 63 IPOs in the same period last year.

"Apart from ample liquidity, another reason why SME IPOs have fared well is their relatively reasonable valuation compared to a mainboard listing (large IPO issue size)," says Abhijit Tare, managing director and CEO at Motilal Oswal Investment Advisors. "Investors want to find a margin of safety through IPOs."

For instance, instead of buying HDFC Bank, one will buy a better-valued NBFC, or non-banking financial company, like Utkarsh Small Finance Bank Ltd, he says.

TIGHTER SCRUTINY

Some SME IPOs have also received a positive rub-off from higher traction in the Indian manufacturing sector. For now, this could mean impressive earnings/order inflows for manufacturing-focused SMEs, but whether this sustains requires closer tracking.

"SMEs are expected to declare results once in six months. When they raise funds through IPOs in September, there could be a lag in reporting earnings and this poses a problem as a profitable SME could well become a loss-making one in a short span of time," says Arun Kejriwal, founder of Kejriwal Research and Information Services.

"Here, it would be helpful if the stock exchanges are more attentive," Kejriwal adds.

In any case, mid- and small-cap stocks are considered relatively riskier than large-caps. SME stock prices tend to undergo brutal corrections when market sentiment is subdued. At such times, forget the large external risks, even an internal regulatory change can upset the apple cart for SME stocks.

For instance, in a bid to curb speculative trading and protect investors from volatility, Indian stock exchanges recently said some SME stocks will come under the Additional Surveillance Measures framework, which entails closer scrutiny and regulation of certain shares, and trade-to-trade settlement that requires compulsory delivery of shares.

In the last one month, the BSE SME IPO Index has declined by 6%. In comparison to the gains of 53% seen in this calendar year so far, this correction may seem marginal. Even so, with the market regulator tightening the screws on trading in these counters, any expectations of superlative returns may be dashed going ahead.

Moreover, when too much optimism prevails in the equity markets, more often than not, "a rising tide lifts all boats" scenario plays out. The latest regulatory tightening comes amid uncertainty in the global economy and at a time that central banks across the world are fighting to tame inflation by raising interest rates.

There are other risks as well. According to Jasani, the quality of the companies and corporate governance may not be quite up to the mark. So their stock prices could soon come under pressure, resulting in losses for investors in some of these IPOs.

Compared to a mainboard IPO, for SME share sales, the disclosure norms are not as stringent. Yet, after much-hyped large IPOs such as those by Life Insurance Corporation of India and Paytm disappointed investors, perhaps some are willing to overlook risks that come with SME IPOs.

"The ongoing euphoria in the SME IPO segment suggests that these have become more like a speculative vehicle rather than an investment vehicle with some counters seeing a sharp spike in volumes on the first trading day," says Rao.

IPOS LAG

Coming to mainboards, while IPO activity may have revived in the first half, it is worth noting that the funds raised are still 26% lower than the proceeds from the amount mopped up in the same period of the last fiscal year.

Sure, one could argue that the mammoth share sale by Life Insurance Corporation of India drove last year's numbers. Even so, overall first-half numbers of 2022-23 are lower by 32% year-on-year.

This trend is not unique to India. Globally too, IPO activity has been slow this year. A recent Global IPO Trends report by EY, the accounting and research firm formerly known as Ernst & Young, points out that in the first nine months of 2023, the number of global IPOs and proceeds were down 5% and 32%, respectively, versus the same period last year.

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Broadly, emerging markets have been resilient. "Collectively, emerging markets have made up 77% of the global share by number and 75% by value in the first three quarters of 2023 and sustained their dominance despite the slowed momentum from Mainland China," says the EY report.

NOT JUST IPOS

Overall public equity fundraising in India was solid in the first half of 2023-24. And apart from IPOs, companies are exploring other fund-raising avenues as well. For instance, qualified institutional placements (QIPs) surged 358% from a year ago with 20 companies mobilizing ₹18,443 crore, according to Prime Database.

QIPs were dominated by financial services and power generation companies, which accounted for 70% of the overall amount. The rush for fundraising came in the backdrop of the government's increased thrust on infrastructure development that is expected to translate into higher capital expenditure by companies.

WHAT NEXT?

Like Nitin Rao, founder of investment blog alphaideas, many market participants are betting that IPO activity will remain robust at least for the next few months.

Yet, two factors are worth watching out for in the near term. One, foreign portfolio investor, or FPI, flows need closer tracking. In September, flows turned negative after being in the positive territory for six straight months.

"This is a risk to the broader market sentiment and puts potential IPO candidates in a wait-and-watch mode as they look for stability or improvement in flows," says Rao.

Two, in the run-up to state and parliamentary elections, caution may prevail among investors in general.

"Eventually, nervousness will creep in since the general election is a mega event. This election is relatively more crucial because the economy is on a strong growth path and any disruption in political stability would dampen investor sentiment on stock market outlook," says Yatin Singh, head of investment banking at Emkay Global Financial Services.

After touching highs, Nifty is now at 19,653.50 points.

For now, Mankind's investors are not complaining. From its sale price, the stock has gained almost 67% in a spectacular outperformance.

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NEXT

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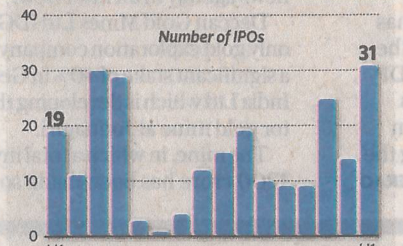
HOT CAKES

The number of IPO issues that hit Indian stock market in H1FY24 was at a multi-year high

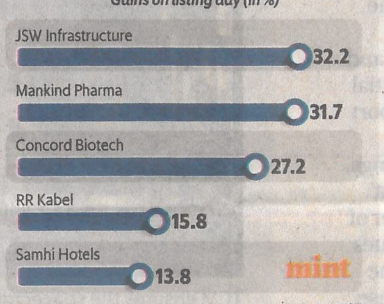


Data for mainboard IPOs; H1 of each financial year refers to April-September

Source: primedatabase.com

Good returns

Top-five companies by issue size in H1FY24 saw their shares rise meaningfully on their respective listing dates



Source: NSE

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