SME IPO frenzy: The red flags that investors should heed

While investors are making bumper listing gains, one never knows when the tide will turn

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SME IPOs are selling like hotcakes with dramatic oversubscriptions even as Sebi's warnings about malpractices in some listed companies raise red flags.

Resourceful Automobile's IPO, for instance, attracted ₹4,800 crore in bids for a ₹12 crore issue, and Travels & Rentals offer received ₹7,075 crore for a ₹12.2 crore issue. HOAC Foods India and Magenta Lifecare saw 1,963 and 1,002 times oversubscription earlier this year, even as their issue size was just ₹5.10 crore and ₹6.64 crore, respectively.

While investors are making bumper listing gains, one never knows when the tide will turn.

In FY25, 104 companies raised ₹3,396 crore via IPOs by August, compared to ₹5,971 crore raised by 204 firms in FY24, according to Primedatabase.

"An increased activity in the IPO market is a sign something may go wrong. We haven't seen any major fall since 2015 except the covid-19 crash of 2020. SME (small and medium-sized enterprises) IPOs have offered an avenue to make quick bucks in this uptrend. Be wary of it," says S. Ravi, ex-chairman BSE and founder of chartered accountancy firm Ravi Rajan & Co. "Retail investors must do complete research before subscribing in the SME segment. Fundamentals of the company and the business model must be evaluated before subscribing."

There are multiple examples of SMEs getting listed and fetching huge gains but eventually turning into penny stocks. Investing in these without fundamental research is a recipe for disaster, even as it appears a dessert unless you know when to exit.

"I am aware of a lot of companies where promoters get their companies listed and establish a private limited company. They raise money and put it in the private ltd by extending loans. The private limited company would be shown as getting insolvent and the listed company would write off the loan," says Basant Soni (48), a Jodhpur-based veteran stock market investor and clothing manufacturer.

Understanding the nuances of what is transpiring in the SME space is important. Not to forget, SME stocks are of fairly low market capitalisation, hence prone to market manipulation. Veteran stock market investor Vijay Kedia in an interview with a business channel said that nine out of 10 stocks in SME are manipulated either by merchant bankers, owners, promoters or even investors applying in IPOs.

More liquidity, thanks to the reduction in the timeline during which funds remain blocked in Asba (Application Supported by Blocked Amount), has favoured investors. Asba is a payment method to apply for IPOs in which the money remains in the bank account but gets blocked for other purposes.

"Earlier money would remain blocked in Asba for a couple of weeks. However, now that the Sebi (Securities and Exchange Board of India) has slashed the date of the allotment period to three days after the issue closes, the money gets unblocked soon after. This has made a lot of people bid for IPOs as money can be rolled over easily from one IPO to another," Vivek Bhauka, an investor in New Delhi, said.

Some people with good money in their bank account take the overdraft facility. They pledge their FDs for easy access to the loan. "Interest rates on overdraft is too low—just 1-2% above FD rates. Banks extend 90% of the FD value as loan which investors put in IPOs. The listing gains are usually much higher than the interest liability. For some, it is a double benefit as they can show interest payment as expenses in their books," says Kota-based Anant Agarwal, who invests in SME IPOs.

The Sebi last month warned investors that promoters and merchant bankers give "unrealistic picture" of the companies. They create positive sentiment among investors via public announcements and corporate actions such as bonus issues, stock splits and preferential allotments.

No wonder the grey market premium (GMP) jumps to twice or thrice the IPO price.

"Merchant bankers do tend to oversell an issue. Sebi recently came out with a consultation paper to increase the net worth of merchant bankers, primarily to ensure that those with a good track record, play a role in the stock market," says Ravi. The public comments on the consultation paper are awaited until 18 September.

Further, unlike mainboard IPOs, where entities related to the merchant banker cannot subscribe to the offer, on SME Exchange, market-makers work as associates of merchant bankers. "They are mostly hand-in glove. Up to 5% of issue size goes to them. So not only do they control the market with a good quantity of shares, but they also get a fee to do it. It is contradictory to the basic rule," says Arun Kejriwal, founder of Kejriwal Research and Investment Services.

The huge subscriptions in SME IPOs have made it difficult for genuine retail investors to get IPO allotments. Gurugam-based CA Rohitt Kapur, finance head at a multinational company, has stopped applying for IPOs.

"I would often get allotment earlier, but things have transformed in the last two years. Now I try buying shares in the pre-market right before the IPO gets listed," he says.

Unlike investors like Kapur, anchor investors and qualified institutional buyers (QIBs) are better placed in getting allotment in SME IPOs. Anchor investors can be allotted up to 60% of the QIB portion and 30% of the total issue size. QIBs can subscribe to 50% of an IPO's issue size. "Smart investors are trying to set up AIFs and bid for the IPO in the QIB category. The allotment of the anchor portion of QIB is at the discretionary power of promoters and lead managers at the expense of retail investors," says Bhauka.

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Kejriwal questions the need for institutional investors in SME IPOs in the first place. "We don't need multiple buckets of investors in these IPO. Just have two—retail investors and non-institutional investors (NIIs)," he says.

"Investors subscribing to the IPO via anchor/QIB category are not institutional buyers in reality. Lead managers unnecessarily create hype about institutional investment even as they could very well be a group of normal investors coming together to get allotment in the QIB category. This system should be knocked off. It is fraud," he says.

Rajasthan Global Securities, Varsu India Growth Story, Saint Capital Fund, NAV Capital VCC-NAV Capital Emerging Star Fund, and Meru Investment Fund PCC-Cell are the top five anchor investors who have subscribed to 28-51 IPOs in the past year, Primedatabase data shows.

Moreover, the more money you put into an IPO, the better your chances of getting an allotment due to the proportionate allotment process. This too favours QIBs at the expense of retail investors. "If Sebi limits the application amount by category in SME IPO same as mainboard, we will see lesser subscriptions compared to today. Further, if there is normal allotment process in the NII category, there will be an equal chance for everyone to get the allotment," says Agarwal.

Do not follow the herd. Mumbai-based Sanjay Kapoor, MD at Globel Business, applies for IPOs only after he has done ground research. "I do my research by visiting the site, meeting promoters and channel checks. Even if I don't get the allotment, I keep buying shares after listing if I know the company is good," says Kapoor.

This is the way to go. SME space does offer money-making opportunities, but put in efforts to identify those instead of chasing easy money that may trap you and cause dire consequences.

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Blockbuster SME market

SME IPOs are the talk of the town with dramatic oversubscriptions even as Sebi issued a stern advisory cautioning investors

BASANT SONI (48)
Clothing manufacturer, Jodhpur

"I have personally seen how SMEs create unreal hype in the run up to IPOs.

VIVEK BHAUKA (46)
Stock market investor, New Delhi

"No level-playing field between a retail investor and a QIB/anchor. That disappoints me.

ROHITT KAPUR (43)
CA & finance head at an MNC, Gurugram

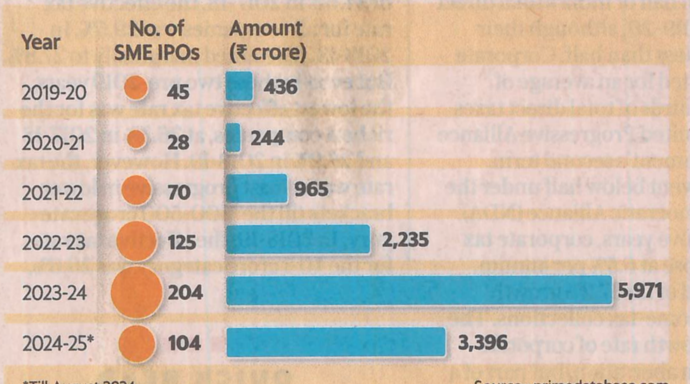
"I have stopped applying in IPOs as getting allotment is nearly impossible now.

SANJAY KAPOOR (53)
Exports business, Mumbai

"I do my ground research instead of subscribing to IPOs for listing gains.

ANANT AGARWAL (22)
Family business, Kota

"Proportionate allotment needs to be stopped to avoid manipulation.



*Till August 2024

Source : primedatabase.com

Why huge subscription?

- More liquidity due to reduction in timeline of blocked money in Asba
- Risk-reward favourable due to bigger lot size
- Unrealistic hype by lead managers & market makers
- Unfair entry in anchor/QIB category*

*For ex, a few investors coming together to fetch AIF licence to apply under QIB

QIB: Qualified institutional buyers

What to do?

- Knock off anchor/QIB category
- Just have two — retail, NII*
- Regulatory intervention in grey market

NII - Non-institutional investors

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