

IPO rush: Here's how investors can separate the wheat from the chaff

Be wary of firms with negative cash flow, high short-term debt, supplier concentration and stretched valuations

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Initial public offering (IPO) activity in Indian markets is heating up, with companies raising about ₹22,400 crore this month through 26 August. More IPOs are expected before 30 September, when the one-year validity of approvals from the Securities and Exchange Board of India (Sebi) for several companies is due to lapse.

For investors, it raises an important question: how do you distinguish a promising IPO from one you must avoid? Unlike established listed companies, IPO-bound businesses have no record of exchange disclosures or trading history. Investors have to rely on what firms disclose before listing, chiefly through the red herring prospectus (RHP)—a lengthy, technical document spanning multiple sections. You do not need to read every page. Focusing on a handful of sections can reveal potential red flags, help assess the company's financial quality and, importantly, determine whether the valuation being sought is justified. Here is what to look for.

Spot the IPO red flags

More IPOs are likely before 30 September, when Sebi approvals for several companies lapse, but investors need to look beyond growth narrative and listing-day gains.

IPO fundraising trend (2026)

Month	No. of issues	Total raised (₹ crore)
January	3	4,765
February	7	8,162
March	8	5,852
April	2	1,076
May	0	0
June	7	2,718
July	12	28,648
August*	23	22,378

Source: primedatabase.com; *data as of 26 August 2026



What to watch for in an RHP

Be wary of

- ▶ Any issue that is mostly an offer for sale, with existing investors cashing out
- ▶ Pre-IPO shares sold cheaply, then priced much higher
- ▶ Promoters with frequent business shifts or large related-party deals
- ▶ Auditor remarks flagging weak internal controls
- ▶ Large contingent liabilities relative to net worth
- ▶ Negative operating cash flow despite reported profits
- ▶ Revenue hinges on one or two customers or suppliers
- ▶ Highly leveraged balance sheet or frequent refinancing

Positive signs to look for

- ▶ Industry with a long growth runway
- ▶ Growth and margins ahead of peers
- ▶ Profit and Ebitda growing faster than revenue
- ▶ Operating profit converting into cash
- ▶ Valuation reasonable relative to listed peers

IPO: Initial Public Offering; RHP: Red herring prospectus; Sebi: Securities and Exchange Board of India

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Narendra Solanki, head of fundamental research—investment services at Anand Rathi Shares and Stock Brokers, said investors should also study “what fundraising took place shortly before the IPO, at what valuation and under what circumstances”. The RHP contains these details.

Companies can sometimes make their financials look better around an IPO. Kondawar pointed to instances where businesses pull back on advertising and staff costs to make losses appear smaller or move closer to break-even. Investors should therefore examine employee and marketing costs over several years rather than focus only on the latest period.

Corporate governance can offer similar clues. “The draft prospectus discloses information about promoters, their track record, related-party transactions and pending litigation. Promoters with a history of frequent business changes or large related-

party dealings should make investors cautious. And are there any auditor remarks suggesting weak internal controls?” said Pankaj Pandey, head, retail research, ICICI Direct.

Solanki said investors should also examine promoter and top-management compensation against industry levels, as well as contingent liabilities that may not be immediately apparent. The risk factors section of the RHP is where many such liabilities are disclosed.

Contingent liabilities are potential obligations that do not appear as debt on the balance sheet but could crystallize later, including guarantees given on behalf of others, disputed tax demands, pending legal claims or bills discounted. A large contingent-liability figure relative to net worth could

leave the balance sheet weaker than it appears if those claims materialize.

Financial statements offer another set of warning signs. “If the company shows profits on paper but negative cash flows year after year, that is a red flag,” said Pandey.

Related-party deals, litigation, auditor concerns and a sharp pre-IPO price increase can flag governance risks

Over-dependence on a few customers or suppliers is also a concern. Investors should distinguish short-term from long-term debt, as heavy reliance on short-term borrowing can signal workingcapital stress. Repeated equity issuance is another red flag, as it can dilute existing shareholders.

What to look for

The assessment starts with the business itself. Solanki frames it around three factors: growth, profitability and valuation. “Look at the industry and how fast it is expected to

grow, the company's position and how quickly it is growing versus peers, then how efficiently it operates—capital allocation, returns on equity and margins,” he said. “A company can have high growth and profitability and still be unattractive if it comes at a steep valuation.”

The RHP's “Industry Overview” section sets out the industry's size and growth outlook. Return ratios, margins and capital-allocation trends can be assessed through the “Financial Information” and Management Discussion and Analysis sections, while the “Basis for Issue Price” section provides the company's peer valuation comparison.

Revenue growth alone does not tell the full story. “Profit and Ebitda growth should ideally be higher than revenue growth, because that shows improving efficiency. Also look out for cash flow conversion and free cash flow,” said Kondawar.

Also compare the IPO's valuation with listed peers. “Start with simple metrics such as price-to-earnings and price-to-book and compare them with listed peers in the same industry. Compare growth and margin behaviour of the company with its peers,” said Deepak Jasani, an independent market analyst.

RHP's “Basis for Issue Price” section lists the peers the company uses.

Institutional participation can provide another cross-check.

The IPO decision “comes down to the quality of the company and the valuation at which it comes to market,” said Pranav Haldea, managing director of Prime Database.

He suggests watching how the anchor and qualified institutional buyer books build, and whether private-equity or venture-capital investors—who conduct their own due diligence—are already on the register.

Their presence can indicate that some level of institutional due diligence has already been carried out.

Takeaways

IPO investing is not easy. The disclosures provide a wealth of information, but interpreting them remains demanding—and quick gains are far from guaranteed.

The listing-day numbers underline the risk. The share of IPOs closing below their issue price on listing day has risen to 37% in 2026 so far, as of 26 August, from 33% in 2025. Roughly two-fifths of all IPOs listed since 2022 were trading below their issue price as of 26 August 2026.

And the risks do not end on listing day. Once the initial noise fades and genuine price discovery begins, how a stock performs depends heavily on the valuation at which it entered the market. Judging that valuation is as much an art as a science.

The emergence of a newer breed of loss-making, tech-oriented consumer companies makes that exercise even harder for investors. Unit economics can offer clues about the potential for future profitability, but they can also make valuations more difficult to assess.

For investors new to the market, avoiding IPOs altogether may be the more sensible approach. A diversified mutual fund offers a simpler route: fund managers get anchor-book allocations, conduct research on these businesses and continue tracking them after listing. They can trim positions when execution falters or valuations become unrealistic, and stay invested when growth takes longer than expected to materialize.



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