

# Fresh issue portion in IPOs at a decade low on high PE exits

The next capex cycle may turn the tide, say experts

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Initial public offerings (IPOs) this year resulted in minimal fresh capital formation. Though funds raised through IPOs more than doubled in 2020, most of the money was used to provide an exit to existing shareholders, promoters, and private equity (PE) investors.

Of the ₹26,611 crore raised through IPOs in 2020, the fresh issue portion was a mere ₹3,531 crore, or 13 per cent — the lowest in 10 years.

Since 2017, three-fourths of IPO fundraises have comprised secondary share sales. Experts said most companies making their debuts these days are asset-lite businesses backed by PE investors.

“We have seen maturing of the Indian capital market in the last 10 years. Private equity and venture capital investors came to India in the mid-2000s. As such, you have seen them exiting their investments through IPOs in the last seven-eight years,” said Pranav Haldea, MD, Prime Database.

A high share of secondary sales is not necessarily a negative as it provides an exit to PE investors, thus freeing up capital to be invested in newer companies. Moreover, it helps promoters liquidate some of their holdings and incentivises them to list.

“These PE investors are now pro-



ILLUSTRATION: BINAY SINHA

viding the early-stage risk capital to companies. This is a global phenomenon. Now we are seeing companies coming to the primary market much later in their lifecycle,” said Haldea.

However, the domination of secondary share sales in IPOs is also a sign of worry as this results in a mere change of equity ownership. Market players say fewer entities are entering the market from capital-intensive sectors. And over the last few years, large issuances were being done by finance players, which were well-capitalised and did not necessarily need large primary capital.

The primary-secondary mix in an IPO is a function of funding requirements of the company and whether existing investors want to exit. And according to experts, raising growth capital far above the company needs may depress the return on equity (RoE).

“If companies raise the capital they do not need, there is a risk to valuation and capital not earning the returns required,” said Pranjal

## SMALLER AND SMALLER

Year	No. of IPOs	Issue amt (₹ cr)	Fresh capital (₹ cr)	(%)
2010	64	37,534	17,000	45
2011	37	5,966	5,850	98
2012	11	6,835	4,430	64
2013	3	1,283	328	25
2014	5	1,200	498	41
2015	21	13,614	6,539	48
2016	26	26,493	9,175	34
2017	36	67,147	11,679	17
2018	24	30,959	7,444	24
2019	16	12,361	2,959	23
2020	15	26,611	3,531	13

Source: primedatabase.com

Srivastava, independent capital markets professional.

Experts said the Indian markets have turned averse to companies requiring loads of capital to sustain the business. Therefore, firms from infrastructure, power, and large-scale manufacturing sectors have barely been able to tap the equity capital markets

for years now. Financial services and specialty chemicals companies dominated the IPO pipeline in 2020.

“A lot of capital intensive companies had issues with their ability to maintain profitable order books. And they had cash flow issues. Many companies in the capital-intensive sector have lost money for investors,” said Skanda Jayaraman, head investment banking, Spark Capital.

Srivastava said there is no demand in the economy for investments to happen in these sectors.

PEs have been investing more and more in new-age firms that don't require a huge amount of capital and have high RoE. This rules out the companies considered critical to supporting the core of the economy, such as roads and other big infra projects.

“Typically, PE investors eye for an exit between five and seven years. Most capital-intensive businesses require a much longer gestation,” said Jayaraman.

Experts said that for infra and manufacturing companies to find favour in the markets, they will first have to improve their financial track record. While the IPO pipeline for the next financial year looks healthy, the fresh issue component may continue to lag. “For fresh capital requirement, companies are increasingly looking at the QIP route after listing,” said Haldea.

Bankers said the one thing that can change this trend is the next capex cycle. “If the capex cycle happens earlier due to low-interest rates or labour reforms, you will see the need for capital and the fresh issue component going up,” said Jayaraman.