IPO fund cap to hit HNI subscriptions

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RBI last week put limits on non-bank finance in IPOs. HT

A recent Reserve Bank of India (RBI) decision to cap non-bank finance in initial public offerings (IPO) is likely to hit subscriptions in the high net worth individual (HNI) segment, though industry experts said the measure wouldn't significantly impact overall IPO liquidity.

Many wealthy individuals borrow from non-banking financial companies (NBFCs) to make IPO applications seeking quick listing gains. RBI on Friday said NBFCs could lend a maximum of ₹1 crore to finance such subscriptions, adding these lenders are free to fix more conservative limits.

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RBI cap on IPO funding to hit HNI subscription

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According to primary market tracker Prime Database, HNIs have applied for shares worth ₹4.46 trillion in IPOs in FY22 so far, compared to ₹5.11 trillion worth of IPO bids in FY21. Since July, most IPOs have seen the HNI segment subscribed more than 100 times. For instance, the HNI segment of Paras Defence and Space Technologies attracted bids for shares worth ₹24,460.98 for a mere ₹170.78 crore IPO, with the segment subscribed 954.88 times. Similarly, Tatva Chintan Pharma Chemicals' ₹500 crore IPO saw HNIs bid for ₹37,733 crore (subscribed 503 times).

While the RBI cap may cool these numbers a bit, investment bankers believe that this will help IPO activity by reducing the amount of capital blocked in IPOs.

"It's a good move, given the volumes we are seeing in IPOs. This move will reduce the amount of capital that is getting blocked in IPOs. Right now, there is a lot of HNI capital that gets blocked in a highly subscribed offer. So, you had to wait for the capital to be released before you could bring in the next issue," said Ajay Garg, founder and managing director, Equirus Capital.

"Given that there is a pipeline of almost 70-75 issues that are likely to be executed from now to May, which means in the next 22-23 weeks, if this entire pipeline goes through, then you are looking at 4-5 deals every week. So, having a large amount of capital blocked will impact the ability to execute this pipeline within the timeframe that companies are looking to launch their deals," he added.

Garg said this may also reduce the selling pressure on listing day when highly leveraged HNI investors exit to book profits and pay back loans.

NBFCs offer 70-100 times leverage to rich investors looking to make short-term bets on IPOs. For example, if the investor puts ₹1 crore of his own money, the NBFC will lend ₹70-100 crore for seven days—from subscription till listing.

The measure may not significantly hit overall IPO liquidity, analysts said. MINT

The interest rate for such funding varies between 7% and 8%.

Market participants say that this move will help reduce lending risk among NBFCs, which have increased their exposure to IPO funding. Some NBFCs offering IPO financing are ECL Finance, promoted by Edelweiss, Aditya Birla Finance, JM Financial Products, and Sharekhan Financial Services. These NBFCs grant leverage to HNIs and retail investors, so they can apply for more lots with the hope of greater allotments.

"RBI is worried about the health of NBFCs. They do not want NBFCs to be exposed if there is a fall in the market. If the investor doesn't make the return and if the NBFC keeps on lending, the borrower will default," said Sandeep Khetan, partner, EY.

However, some market participants are not ruling out the possibility of investors raising funds from several NBFCs to invest in IPOs. But this is easier said than done as investors need to complete documentation and build relationships with different NBFCs.

The Indian IPO market has soared due to abundant liquidity. Analysts feel several new economy and technology-driven IPOs in the next quarter are likely to keep investors busy as equity indices remain at all-time highs.

Like in global markets, analysts said that investors are willing to invest in companies with attractive business models, fair valuations, good corporate governance, and quality of management teams.

Nasrin Sultana contributed to the story.