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WILL 2022 UNVEIL A REWIRED IPO MART?

With new investor-friendly rules kicking in from April 2022, the IPO bazaar is likely to be fraught with action.

The frenzy around the LIC share sale is already palpable. Set to be the biggest in Indian stock market history, it is expected to go live in the March quarter. MINT

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The 1.3 million insurance agents associated with the Life Insurance Corporation (LIC) of India have an urgent new task at hand.

Over the past few weeks, they have been hand-holding long-time policyholders on the procedures that ought to be completed in advance to smoothen the process of subscribing to the upcoming initial public offer (IPO) of the insurance behemoth.

"We are receiving (many) queries from customers after LIC ran advertisements about its IPO," said an insurance agent with the company, who requested anonymity.

The frenzy around the proposed LIC share sale is already palpable. The IPO—set to be the biggest in Indian stock market history—is expected to go live by March 2022. And 10% of the issue size is set to be reserved for policyholders. It will be a first-of-its-kind experiment and may cause a flurry of first-time investors to enter the stock market.

"Most of LIC's policyholders are at the bottom of the pyramid. An effort is being made to get them into the stock market," said Arun Kejriwal, founder of Kejriwal Research and Investment Services. "The exercise is somewhat similar to how Jan-Dhan Yojana brought the unbanked population into the banking system."

What unfolds once LIC lists will just be the beginning. The year 2022 is fraught with action after the record subscriptions, stellar listings and bumper retail investor participation of 2021.

If the LIC IPO is the main highlight over the next few months, the introduction of new IPO rules from 1 April—which the market regulator Sebi announced in December—will set the ball rolling for an entirely new experience in the primary market.

To top it, the Reserve Bank of India (RBI) has put in place new lending restrictions from the same month. The central bank's new rules will put limits on the funding tap for high networth individuals (HNIs) when they try to invest in IPOs.

But, first thing first. Retail investors are interested in wealth creation and good returns. Are IPOs really money-spinners? The data shows otherwise.

> Only 45% IPOs listed since 2000 have delivered positive returns. The rest are either trading below their issue price or have delisted or merged with other listed entities.

THE SCARY IPO STORY

If you were to read 10 IPO notes by different broking firms, you would find eight of them suggesting that you "subscribe to the IPOs for the long-term". But, should you subscribe?

For investors who would want to believe in brokerage recommendations, history throws up a warning sign. Only 45% IPOs listed since 2000 have delivered positive returns for investors. The rest are either trading below their issue price or have been delisted or got merged with other listed entities.

For those who love to bet on listing gains, one in three bets end up going wrong (based on the post-2000 track record). While 66% of issues did list higher on the stock exchanges, only about 51% could muster a gain higher than 10% on debut.

"Hitting a jackpot via IPOs is no better than flipping a coin," said Vivek Bajaj, founder of stock market analytics platform StockEdge.

The historical data holds significance especially in light of the mega LIC IPO. IPOs which are launched with much fanfare rarely perform well on the stock market. Six out of the top ten biggest IPOs ever were trading below their issue prices as on 31 December 2021. These include One 97 Communications Ltd (-37%), Coal India Ltd (-40%), General Insurance Corp. of India (-69%), Reliance Power (-95%), New India Assurance (-65%) and DLF (-26%). Moreover, only five out of the top 10 biggest IPOs have registered listing gains.

However, Deepak Shenoy, founder, Capital Mind, points out that it is wrong to say that IPOs don't make money. "If you had invested at least one lot (up to ₹15,000) in each IPO in 2021, you would have still made money overall. You cannot expect all IPOs to do well. If you want guaranteed returns, invest in fixed deposits," Shenoy said.

If there are loss-making IPOs, then there are some such as Divi's Laboratories Ltd and Astral Poly Technik that have returned over 40% CAGR since their listing day 19 years and 15 years ago, respectively. "IPOs give a fabulous entry point to buy and hold fundamentally strong companies for the long-term. Only about 50% might give you positive returns, but those will be long-term wealth creators... with 50% accuracy, you could still make (a) lot of money," said Bajaj of StockEdge.

Earlier, only profitable companies with a three-year profit track-record could come up with IPOs. But the year 2021 has seen the listing of a spate of loss-making new-age firms such as Zomato, Paytm, Nykaa, Policybazaar and Cartrade, etc. Could these be long-term wealth creators?

"I believe most new-age companies will disappear within 10 years," said Kejriwal of Kejriwal Research and Investment Services. "Their market cap is already well beyond expectations," he added.

"(Clearly), there's information asymmetry in the primary market. Merchant bankers do road-shows with institutional investors and fix the issue price by the book-building process. Retail investors are the last ones in the investment chain," said a merchant banker on condition of anonymity. "Most of the time, institutional (investors) are offered kickbacks to subscribe to the issue. On the face of it, they could be subscribing to the IPO at the issue price, but the actual buying price could be lower. Retail investors get trapped in this setup."

As India's IPO market matures and expands, more rules to protect the small investor are inevitable. To market regulator Sebi's credit, existing rules already ensure that no more than 10% of the issue size of a loss-making entity can go to retail investors at the time of an IPO. Such firms also need to allot 75% of the net public offer to Qualified Institutional Buyers (QIBs) such as insurance firms, mutual fund companies, and alternative investment funds.

But the 10% cap on the retail portion does not offer an adequate level of safeguard, said Kulbhushan Parashar, Director, Corporate Capital Ventures. "The way anchor investors cannot sell shares for a month after the IPO listing, there has to be some timeline restriction of up to 6 months for the QIBs too," Parashar said.

THE RISE OF OFS

Another concerning trend in recent years is the spike in offer for sale (OFS) in the IPO market as compared to attempts to raise fresh capital. For instance, the 63 IPOs in 2021 have collected ₹43,328 crore in fresh capital, compared to ₹75,394 crore in offer for sale. An OFS is when an existing shareholder sells their holding in a company. The money thus raised goes to the personal coffers of those investors. On the other hand, when a company raises fresh capital, it is selling new shares. The money raised can be used in expanding the business, mergers and acquisitions or go towards repaying debt.

Pranav Haldea, managing director, PRIME Database Group, says that the OFS route is not necessarily as bad as it is being made out to be. "It is a part of any maturing capital market ecosystem. It is only fair for PE (private equity) and VC (venture capital) investors to exit after they help the company reach a certain scale. They can also then redeploy the money in newer ventures."

"We must also not forget the '90s and 2000s when greenfield companies came to the primary market and raised only fresh capital. Most of them have vanished or shut shop," Haldea said. What one must look at is, he adds, whether PE and VC investors are exiting fully or holding on to some portion. "If only a part of the stake is being diluted, it is a positive cue."

In anticipation of the slew of big listings planned for 2022, Sebi has decided to partly address the OFS issue. From April 2022 onwards, existing shareholders who hold 20% of the stake in a firm cannot offer more than 50% of their shares in an IPO. Those holding less than 20% of pre-issue cannot sell more than 10% of their shares.

In 2021, several companies raised money without specifying a reason for it or for acquisition purposes without identifying the target. The new norms mandate that the amount—meant for unidentified acquisitions—shall not exceed 25% of the amount being raised. In combination, the amount for such unidentified acquisitions and the "general corporate purpose" shall not exceed 35% of the total amount being raised.

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RBI'S MAGIC WAND

The RBI had already started to tighten some of the existing rules before Sebi got into the act. The banking regulator specified in October that non-banking finance companies cannot lend more than ₹1 crore to investors seeking to buy stocks in IPOs from 1 April. The move is expected to reduce the number of oversubscriptions in the HNI category.

"This is a very positive change that will make the IPO market much more efficient... better price discovery will happen," Kejriwal said. "Often, it is seen that the most subscribed IPOs will have just about 700-800 big investors. The curb on lending will cut the artificial demand. This will moderate the demand among retail investors too, who (often) get influenced due to the oversubscription by HNIs," he added.

With the artificial froth gone, IPOs will have to be sold on merit and fundamentals, come April 2022.

While some of the new regulation will indeed transform the IPO arena in positive ways, several issues remain unresolved. For instance, many PE investors invest in a company via a special purpose vehicle (SPV). "If you look at the DRHP (Draft Red Herring Prospectus), only the SPV's name is disclosed. The names of the PE investors are never disclosed. So, investors cannot connect (the) dots," Kejriwal said.

For instance, Sion Investment Holdings exited from CMS Info during the latter's IPO. Sion is an affiliate of Baring Private Equity Asia. "You won't find the name of Baring in (the) DRHP which rings a bell," Kejriwal added. "Why can't Sebi make disclosure of the name of (the) main PE investor mandatory? The track record of a PE investor should (also) be disclosed in the DRHP."

More clarity is also needed on how a company's financials are disclosed in the DRHP, said Vikas Bagaria, partner, Deloitte India.

More disclosures are needed in the light of covid-19 too. Current Sebi rules mandate firms to disclose the previous three years' financial statements in the IPO document. Most companies which announced their IPOs in recent months put in a disclaimer about how historical figures are not comparable due to covid-19 slowdown. "Three-year time (for financial statements) is a significantly shorter period to analyse the performance of a company, considering covid. What is it that prevents promoters to share additional information? We need more disclosures to make an informed call on the IPOs," said Kejriwal.

While regulatory norms and disclosure requirements keep evolving, what remains somewhat constant is the revolving IPO cycle. Data show that every record IPO fundraising year is followed by a bear market that brings with it a lull in primary issuances. That historical trend calls for added caution in 2022.

Several companies are expected to line up their IPOs in the next three months before the new, more stringent rules kick in. LIC's IPO, though, will exemplify the moment of truth. Will the history of underperformance of big IPOs repeat itself? Investors clearly have some hard calls to make in the months ahead.

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WHAT

The launch of the biggest IPOs—as happened in 2021—is often followed by a big crash in the stock market and the resultant lull in the primary market. Will 2022 be different?

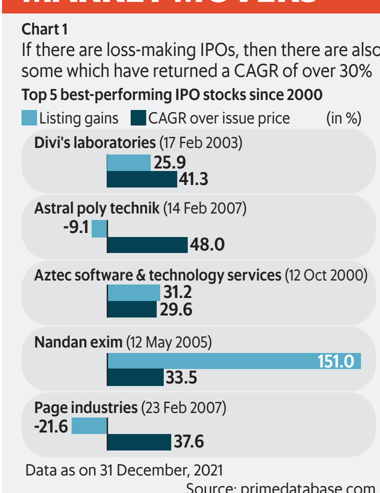
AND

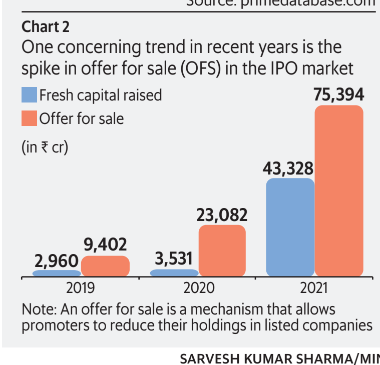
The first three months in 2022 will be distinct from the rest of the year. April will bring in game-changing regulations. The era of crazy valuations and artificial demand seems to be ending.

MOREOVER

Go long-term—the oft-repeated market wisdom—hasn't worked very well in the case of IPOs over the last two decades. More than half of all IPOs listed since 2000 closed below their issue prices.

MARKET MOVERS





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