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The Boom of IPOs in India

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❖ Introduction:

India's IPO market has seen remarkable growth in recent years, but not without its share of controversies. The headlines tell a cautionary tale: "XYZ Stock Broking Scam: Misusing Client Funds During IPO Subscriptions"; "PQR Bank IPO Controversy: Manipulative Allotment Practices"; and "Ruchi ABC IPO Row: Insider Trading Allegations Surface".

These cases highlight the vulnerabilities in the IPO ecosystem, where greed and manipulation often overshadow transparency. From inflated valuations to allocation irregularities, such incidents underscore the critical need for regulatory vigilance and informed investing.



❖ What's Initial Public Offerings (IPOs)?

An **Initial Public Offering (IPO)** is the process through which a privately held company offers its shares to the public for the first time which is regulated by the **Securities and Exchange Board of India (SEBI)** to ensure transparency and protect investor interests.

❖ IPO Landscape in 2024:

Year 2024 marked a record-breaking year for India's IPO market, with over 300 IPOs launched across SME and Mainboard categories. According to reports, more than Rs 1.6 lakh crore and Rs 8,753 crore were raised through mainboard and SME IPOs, respectively.



❖ Opportunities for investors:

- 1. Wealth Creation Potential:** IPOs provide an opportunity to invest in companies at an early stage, often at a lower price compared to their future valuations if the company performs well.
- 2. Access to High-Growth Sectors:** Many IPOs are launched by companies in rapidly growing industries such as technology, fintech, renewable energy, and e-commerce, offering a chance to be part of these growth stories.
- 3. Listing Gains:** A well-received IPO can result in significant listing day gains, which can benefit investors seeking short-term profits.
- 4. Retail Investor Quota:** Indian IPOs often reserve a portion of shares specifically for retail investors, providing them with a fair chance to participate.
- 5. Government-Backed IPOs:** IPOs from public sector enterprises often carry perceived stability, and the Indian government has promoted initiatives like disinvestment through IPOs, which attract retail investors.
- 6. Diverse Investment Options:** The boom has led to a variety of companies going public, offering small-scale investors choices across multiple industries to diversify their portfolios.

7. Market Democratization: Technological advancements and mobile trading apps have made IPO investments more accessible, even for the first-time investors.

❖ Risks for Small-Scale Investors:

- 1. Valuation Bubbles in Emerging Markets:** IPO valuations can be speculative, leading to high volatility in the stock price after listing, potentially resulting in losses.
- 2. Overvaluation Risks:** In a booming IPO market, companies may be overvalued, which might lead to correction in stock prices post-listing.
- 3. Information Asymmetry:** Small investors often rely on limited information compared to institutional investors, making it harder to assess the true potential of a company.
- 4. Lock-In Periods:** For investors applying through Employee or Anchor quotas, there may be lock-in periods, restricting liquidity.
- 5. Regulatory and Governance Risks:** Companies new to public markets might face challenges in adhering to stringent regulatory requirements, impacting their performance.
- 6. Limited Historical Performance Data:** IPO companies often have little public financial history, making it difficult to evaluate their long-term potential.
- 7. Sector-Specific Risks:** Investing in niche sectors may expose investors to industry-specific downturns or technological disruption.

❖ Indicators to assess a company's financial health:

1. Regulatory Disclosures:

The Draft Red Herring Prospectus (DRHP) is crucial in the IPO process in India, serving as a comprehensive disclosure tool that informs

potential investors about the company planning to go public. It ensures transparency and protects investor interests by detailing the company's operations, financial health, and associated risks. Regulatory disclosures in the DRHP are significant for several reasons:

- **Transparency:** They provide clarity on the company's business model, financial performance, and prospects.
- **Risk Assessment:** Disclosing potential risks helps investors evaluate investment viability.
- **Compliance:** Ensures adherence to SEBI regulations, promoting fair practices in capital markets.
- **Investor Confidence:** Comprehensive disclosures foster trust among investors, which is essential for a successful IPO.

Key Regulatory Disclosures in the DRHP:

- i. **Company Overview:** Information about the company's history, business model, products/services, and market position.
- ii. **Financial Statements:** Audited financial statements for at least three years, including balance sheets and income statements.
- iii. **Management Discussion and Analysis (MD&A):** Management's perspective on financial results, trends, risks, and outlook.
- iv. **Risk Factors:** Disclosure of various risks impacting business operations or financial performance.
- v. **Use of Proceeds:** How funds raised through the IPO will be utilized (e.g., debt repayment, capital expenditures).
- vi. **Shareholding Pattern:** Current ownership structure and expected changes post-IPO.

vii. **Legal Proceedings:** Ongoing or potential legal issues affecting the company.

viii. **Corporate Governance Practices:** Information on governance structures and practices.

ix. **Regulatory Compliance:** Disclosure of compliance with relevant laws and regulations.

x. **Credit Ratings:** Inclusion of credit ratings from recognized agencies to provide insight into creditworthiness.

There are certain ratios which give us an idea about the company's financial health, which can be found in the following documents:

2. Grey Market Premium (GMP):

GMP is an informal measure of the demand and perceived valuation of an Initial Public Offering (IPO) in the unregulated grey market, which operates before the stock is officially listed on the stock exchange. Although not officially recognized, GMP is widely tracked by investors and market participants as a sentiment indicator.



GMP represents the price at which IPO shares are traded in the grey market over and above the IPO issue price. It reflects the level of enthusiasm and demand among investors before the stock begins trading publicly.

Factors Influencing GMP:

- **Company Fundamentals:** Strong financials, growth prospects, and industry positioning boost GMP.
- **Subscription Levels:** High oversubscription, especially from qualified institutional buyers (QIBs) and high-net-worth individuals (HNIs), generally correlates with a higher GMP.
- **Underwriter Reputation:** IPOs managed by credible and reputed underwriters often enjoy a higher GMP.

Limitations of GMP:

- **Unregulated Market:** Since the grey market operates unofficially, GMP can be prone to manipulation and speculative activities.
- **Not Always Accurate:** GMP does not guarantee listing-day performance; discrepancies between GMP and actual listing price can occur.
- **Short-Term Indicator:** GMP reflects short-term sentiment and does not necessarily account for the company's long-term prospects.



3. Promoter history and Involvement:

The promoters' history is a critical factor in assessing the credibility, reputation, and long-term viability of a company launching an Initial Public Offering (IPO). Since promoters play a pivotal role in the company's strategic direction, leadership, and operational success, their background and track record are of significant interest to potential investors.

Promoters' history refers to an evaluation of the background, experience, achievements, and integrity of the individuals or entities responsible for founding and managing the company. It provides insights into their competence, reputation, and potential to drive future growth.

Role of Promoters' History and Impact on IPO:

- **Ownership Stake and Commitment:** The level of shareholding retained by promoters post-IPO indicates their confidence in the company's future. A high promoter stake is usually seen as a positive sign of long-term commitment.
- **Succession Planning:** Plans for leadership continuity, especially in family-run businesses.
- **Positive History:** A strong and credible history can enhance investor confidence, drive higher subscription rates, and lead to better listing performance.
- **Negative History:** A tarnished reputation or questionable track record can deter investors and result in underperformance.
- Other factors such as **Frequent Business Failures**, **Regulatory Violations**: Involvement in tax evasion, insider trading, or other legal issues. Regular reduction of promoter stake post-IPO may indicate a lack of long-term commitment (**Frequent Stake Dilution**), which is one of the factors that impact the IPO.

4. Merchant Banker Statistics

Merchant bankers, also known as investment bankers, play a pivotal role in the IPO process. They are responsible for underwriting the issue, managing regulatory compliance, marketing the IPO, and ensuring its smooth execution. Evaluating the statistics and track record of merchant bankers involved in an IPO can provide valuable insights into the potential success of the offering.

- **Merchant bankers' statistics** refer to data points and performance metrics related to their involvement in previous IPOs. These include their market share, success rate, average listing gains, subscription rates of their managed IPOs, Valuations, and overall reputation in the capital markets.



Why Are Merchant Bankers' Statistics Important?

- **Credibility and Trust:** Reputed merchant bankers with a strong track record enhance investor confidence in the IPO.
- **Execution Efficiency & Listing Performance:** Merchant Bankers expertise ensures a seamless IPO process, from compliance to allotment.
- **Valuation of the company:** The valuation of a company determined by a merchant banker during an IPO plays a crucial role in influencing the IPO GMP and the eventual listing price.
- **Overvaluation:** If the merchant banker sets the IPO price band too high relative to market expectations or peers, investors may perceive the offering as expensive. This can suppress demand, leading to a **lower GMP** or even a **discounted GMP**.
- **Fair/Undervaluation:** If the valuation is attractive and leaves room for upside, it generates positive sentiment in the grey market. This can result in a **higher GMP**, as investors expect strong listing gains.

5. Financial Ratios:

Financial ratios are essential tools for investors, particularly when analysing IPOs. These ratios provide critical insights into a company's financial health, performance, and valuation, helping investors make informed decisions about whether to participate in an IPO. The relevance of fundamental ratios lies in their ability to facilitate comparisons between companies within the same industry, allowing investors to assess relative value and identify potential investment opportunities. These ratios include:



- i. **Earnings Per Share (EPS):** Indicates profitability on a per-share basis; a higher EPS suggests better profitability, attracting retail investors.
- ii. **Price-to-Earnings (P/E) Ratio:** Assesses whether an IPO is overvalued or undervalued compared to earnings; a lower P/E may indicate a more attractive investment.
- iii. **Debt-to-Equity Ratio:** Measures financial leverage; a lower ratio indicates less reliance on debt for financing, viewed positively.
- iv. **Return on Equity (ROE):** Reflects management's efficiency in using assets to generate profits; a higher ROE is generally favourable.

Where to find these Ratios?

- **Financial Statements:** Companies publish their financial statements, including balance sheets and income statements, which contain the necessary data for calculating these ratios.
- **Draft Red Herring Prospectus (DRHP):** This document is filed with regulatory authorities during an IPO process and provides detailed information about the company's financials, risks, and future outlook.



❖ Final Takeaway:

The IPO environment in India was quite happening in 2024 with both strong and weak listings. Listings came with many opportunities to make money, especially in the field of technology and renewable energy.

However, some IPOs do very poorly and give a reminder that there is risk in investing in newly floated companies. This just shows how important it is to do careful research, understand market conditions, and look at the basics of a company before deciding to invest. As the market keeps changing, investors should stay informed and do their homework to make the most of IPO opportunities while lowering possible risks.

❖ Compliance calendar for the month of February:

S. N.	Due Date	Compliance
1	07-02-25	Payment of TDS/TCS (Monthly)
2	07-02-25	ECB-2 Return
3	11-02-25	GSTR-1 (Monthly)
4	13-02-25	B2B Invoice Reporting through IFF (QRMP Scheme)
5	13-02-25	GSTR-6 (ISD Return)
6	15-02-25	Payment of ESIC and Return
7	15-02-25	Payment of PF and Return
8	20-02-25	Monthly GSTR-3B
9	25-02-25	GSTR-3B (Payment under QRMP)
10	28-02-25	TDS Payment in Form 26QB (Property), 26QC (Rent), 26QD (Contractor Payments), 26QE (Crypto Assets) for January 2025
11	28-02-25	Monthly Return of PTRC
12	28-02-25	Softex form filling

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❖ Special Mention:

Thank you, Nikita, Abhiman, Pratik, and Arun for successfully completing this enriching knowledge series.

❖ RRCO CORNER:

Our Team recently organized an exhilarating Hackathon, where teams showcased their innovation and problem-solving skills. The competition was intense, with creative solutions emerging across various challenges.

The winning team's moment of triumph was met with cheers, applause, and a well-deserved celebration. Their dedication and teamwork truly embodied the spirit of innovation, making this Hackathon a memorable success!

