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Money Today

MAKES YOU RICHER

NOVEMBER 30, 2006

THE IPO TREASURE

Pg 20

Initial public offerings have become an easy and assured way of making money. Here's how to make the most of IPO investments.

PRIMARY MARKET PRIMER

BANKING: COMING SOON, THE ALL NEW ATM Pg 47

INSURANCE: TOPPINGS FOR YOUR POLICY Pg 44

NEW BUSINESSES: MAKING OF AN ENTREPRENEUR Pg 75

MUTUAL FUNDS: WHATEVER HAPPENED TO MASTERGAIN Pg 50

A PERSONAL FINANCE GUIDE FROM THE INDIA TODAY GROUP

THE IPO LOTTERY

Initial Public Offerings have created enormous wealth for investors in the past three years. A MONEY TODAY-Prime Database analysis of what makes them such a compelling option and how you could also make money by investing in them.

ILLUSTRATION: RAJ

IPOs have earned ...

39.4% in past 3 years

26.6% in past 2 years

27.5% in past 1 year

20.6% in past 6 months

Two- and three-year returns are annualised

By NARAYAN KRISHNAMURTHY

When blue-chip multinational company Pond's, nudged by the Janata Party government to dilute its equity stake, came out with an initial public offering (IPO) in 1977, its shares were lapped up by investors. Issued at Rs 20 a share—a premium of Rs 10—the stock eventually listed on the Bombay Stock Exchange at Rs 350—a gain of Rs 330 per share on the day of listing. That translates into a return of 1650% in about 90 days, or roughly 6700% on an annualised basis. The bounty continued to roll out for the next couple of years as many more

In The Pipeline

Primary issues worth Rs 3,000 crore have got SEBI approval to raise money. And another75 companies are in different stages of planning their IPOs to enter the market.

COMPANY NAME	ISSUE SIZE (Rs Crore)
POWER FINANCE CORP.	1,500
SHOBHA DEVELOPERS	650
MSPL	500
MALWA INDUSTRIES	60
RENAISSANCE JEWELLERY	50
SUNSTAR OVERSEAS	50
L.T. OVERSEAS	40
PARABOLIC DRUGS	25
TOTAL	3,057

Log on to www.moneytoday.in for a complete list of forthcoming IPOs

RAJ

foreign companies offloaded their shares to the Indian public.

In the 30 years since the Pond's issue, the market has changed beyond recognition. Adam Smith's invisible hand has replaced the Controller of Capital Issue's stranglehold over the pricing and size of public issues. Companies are now free to price their issues, even though the market watchdog, the Securities and Exchange Board of India (Sebi), is more alert and surveillance is more rigorous. There is greater transparency and investors are more informed. What hasn't changed, however, is that IPOs continue to remain the lottery they were have always been. In December 2003, Indraprastha Gas' IPO priced at Rs 48 a share was listed at Rs 199.70, a 316% return in 28 days, or an annualised gain of 4119%.

Sure not all IPOs have given such spectacular returns and a few have actually resulted in equally big losses. Also, IPO investing requires a considerable outlay. If you have applied for 500 shares of a company at Rs 200, that's Rs 1 lakh blocked for up to 45 days. Considering the extent of oversubscription to IPOs, you may be allotted only about 100 shares (*see pullout section on allottment procedure*). In cases where the allottees are selected by lottery, it could be that you get no shares. Imagine the opportunity costs of not fruitfully deploying Rs 1 lakh in a booming market.

The allottment hurdles notwithstanding, it is the assurance of returns that sets IPO investment apart—especially if the experience in the recent bull run is anything to go by. As many as 98% of the IPOs that came out since April 2002 opened at a premium to the issue price on listing day—a failure rate of just 2%. That makes the current rush of IPOs the rarest of the rare investment options: one that is high on reward, yet low on risk. Says Parag Parikh, chairman of Parag Parikh Financial Advisory Services: “IPOs are bound to do well till the markets are on the rise.”

An estimated 87 IPOs are slated to enter the market in the next 12 months, mobilising roughly Rs 19,500 crore (*see table*). Some of them are large and lucrative businesses. So, should you plunge into the primary market right away with all the savings in hand? The answer to this question is—and should be—more than just a yes or no. That's why MONEY TODAY approached the best known and most trusted tracker of primary market, Prime Database, to undertake an exhaustive review of the present and past IPO market going all the way back to 1989. Just for the record, there have been 5,278 primary issues in the past 17 years, and they have collectively raised Rs 76,730.11 crore. The review, led untiringly by Prime Database Managing Director Prithvi Haldea, provides clear thumb rules of understanding and benefiting from IPOs. The six key take-aways:

- Almost all IPOs have listed at a premium.
- Most IPOs continue to be priced at a premium to the issue price post-listing, at least for a few days.
- Since most IPOs give an exit option at a premium, they are not overpriced.
- Yet, IPOs are not homogenous and are floated mostly when the secondary markets are buoyant.
- Pricing of a primary issue depends on the state of the secondary market.
- For short-term returns, the best IPOs come at the beginning of a market boom, and the worst towards the end of a bull run.

H.K. RAJASHEKAR

Since I have a short-term investment frame, I only look at the basic strength of an IPO, not beyond.

Sandeep Pantvaidya
33, CHENNAI

INVESTOR IN IPOS: Since 2003
INVESTMENT PER ISSUE: Rs 30,000-50,000
STRATEGY: Never holds the stock for more than two months after allotment
IPOS INVESTED IN: Indraprastha Gas, TCS and Dredging Corporation
PROFIT: Has earned 30% returns on the amount invested in different IPOs

TAKE AN OFFER

	Allotment	Issue size	Price	Knowledge
IPO	Fixed	Fixed	Variable	Some
FPO	Flexible	Fixed	Variable	Limited
NFO	Single entity*	Flexible	Fixed	None

IPO - Initial public offer; FPO - Follow on offer; NFO - New fund offer. Some IPO and FPO issue come with fixed pricing.
* A single entity can be allotted not more than 20% of the NFO offer.

A quick caveat. We are not suggesting that investing in IPOs is better than investments in the secondary market, or mutual funds or any other savings instrument. Investing in IPOs with your eyes and mind shut is as much a no-no as in any other form of savings. Especially when IPOs are inherently riskier than the secondary market. The companies making IPOs have no previous public record of performance. That's one of the reasons why some of the world's most successful stock investors, including the second richest person on earth, Warren Buffet, never bet their money on primary issues of companies. Sure, there was a period in the early and mid-1990s when the secondary market was on a slide and IPOs bombed badly, trapping many retail investors' hard earned money for years and scaring them off the capital market.

But for reasons of their timing and pricing, more often than not IPOs do tend to be a means of

First Day First Show

Many companies could not sustain the returns they delivered to shareholders beyond the day of listing—perpetuating the belief that IPOs are lotteries.

HIGHEST PRICE ON LISTING DAY

COMPANY	OFFER PRICE (Rs)	HIGHEST PRICE ON LISTING (Rs)	GAINS (%)
INDRAPRASTHA GAS	48	199.7	316.04
FCS SOFTWARE	50	199.9	299.8
SAKSOFT	30	109.7	265.67
DISHMAN PHARMA	175	597.8	241.6
TV TODAY	95	310	226.32
NANDAN EXIM	20	64.9	224.5
VIVIMED LABS	70	224.95	221.36
POWER TRADING CORP	16	46.85	192.81
IMPEX FERRO TECH	10	25.85	158.5
SASKEN	260	624	140

making quick and assured returns if not the best returns. In fact, since 2003 IPOs have been even better than a lottery. It's a game that you almost never lose. The odds against making money in IPO are so minuscule that it could well be the acronym for Instant Profit Opportunity. The IPO investors would hit bull's-eye issue after issue, only if they had sold their shares on the day of listing. What if they didn't do that? The gains were substantially more or substantially less. But more on that later.

Other than the timing and pricing of primary issues, what's made IPOs so fail-safe? There are several reasons for the primary market boom. The record growth of the Indian economy in the past few years, the phenomenal growth in earnings of companies, an infinitely better regulated and more transparent stock market and a fairly regular supply of good public issues, starting from the harbinger of it all—the Maruti Udyog IPO of June 2003. This single issue alone has enriched investors by over Rs 6,800 crore in the past three years. The eight crore shares issued by the company at Rs 125 apiece are worth over Rs 900 now. Similarly, public-sector power generation company NTPC has created almost Rs 5,800 crore since 2004. A booming economy provides countless opportunities for creating new business, just as it does for expanding the existing ones. And more the number of new businesses, the more the number of IPOs.

So obvious has been the opportunity to make easy profits that in April this year, the Standard Chartered Mutual Fund launched a closed-ended scheme only to tap this form of equity investing. The Standard Chartered Enterprise Equity Fund raised Rs 1,548 crore and was mandated to invest up to 15% of its corpus in IPOs. Of course, the mandate was also to sell the shares allotted in the IPOs on the day of listing. However, the fund has not been able to move much in that direction because there were not many good quality IPOs since April.

SHAILESH RAWAL

IPOs are a happy hunting ground for making money. But the quota for retail investors should go up.

Vinod Burade

35, BARODA

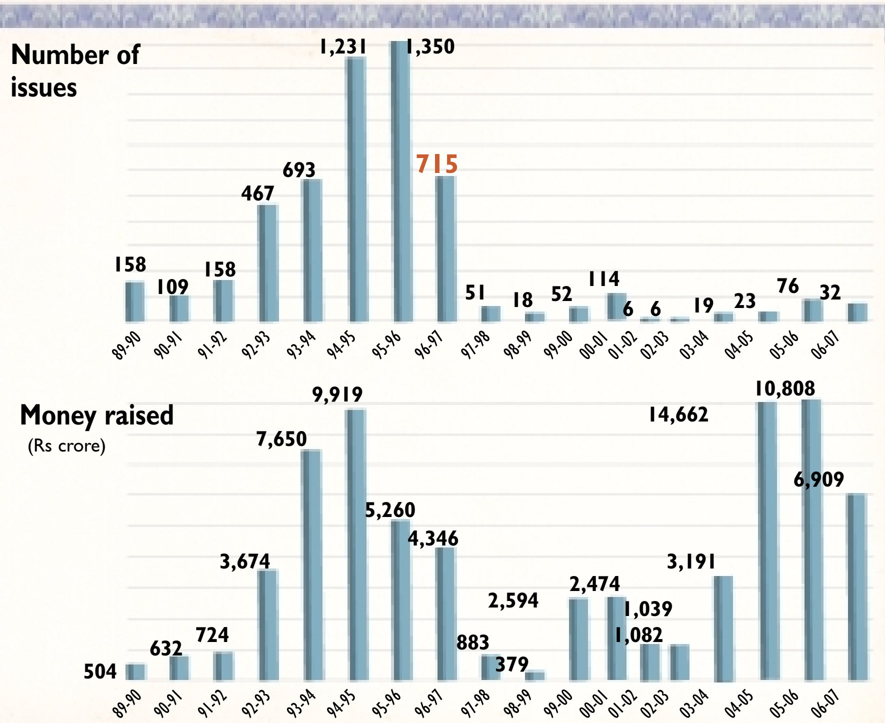
INVESTOR IN IPOS: Since 2001
STRATEGY: Sets a target of 50% rise over the issue price and exits once that has been achieved
IPOS INVESTED IN: TCS, Indiabulls, IDBI and Reliance Petroleum
PROFITS: Sticking to his strategy of exiting once the target has been achieved has meant that he has never made a loss in any IPO

AMITABH CHAKRABORTY, Business Head, Brics Securities

"The 10% margin rule has kept non-serious QIBs away from IPOs."

Quantity ≠ Quality

In 1995-96, an average of 3.7 IPOs were made every single day of the year, but the average issue size was only Rs 3.9 crore. Many of the companies that listed around that time have eroded investors' wealth considerably. Many others have simply vanished.



SANDEEP NEEMA, Fund Manager (equities), JM Financial MF

"The bull run has given good IPO returns but that may not sustain."

Of course, there have been times when new business, and therefore the IPOs, were announced only to raise money from the public—and do no business. The mid-90s were one such period for the Indian primary market. The market is far safer today. The stringent norms laid down by Sebi mean that fly-by-night operators can't enter the primary market easily. Earlier, any company could come out with a public issue. Now, only profitable companies with net tangible assets of Rs 3 crore and a net worth of at least Rs 1 crore will pass muster. The issue size too cannot be more than five times the pre-issue net worth of the company.

The disclosure norms have been made stricter. That means investors, those who care to, can know more about the company they are investing in than they could earlier. A company now has to disclose detailed information about the promoters, the management and its own financials. The average thickness of the red herring prospectus, the preliminary document that a company has to file with Sebi, has increased from just 10-12 pages to about 300-350 pages now (*see pull out* ABC of IPO).

The raising of barriers did have a demonstrable effect on the quality of IPOs. Only 102 companies came out with IPOs in 2005-6, compared with 1,423 issues in 1995-96. But the amount raised was almost three times higher: Rs 23,684 crore in 2005-6 compared with Rs 8,882 in 1995-96. "There are fewer but better public issues now," says Haldea. Among the IPOs in recent years, four were for over Rs 5,000 crore and only seven for less than Rs 10 crore (*see table* Quantity ≠ Quality).

Another, arguably contestable, step to make

PARAG PARIKH, Chairman, Parag Parikh Financial Advisory

"The large QIB quota in IPOs is squeezing the retail investor out."

the IPO market transparent is the recent provision for grading of IPOs by rating agencies. The objective, from Sebi's point of view, is that since most retail investors don't have the skills or the time to go through the lengthy prospectus, ratings could give an idea of the quality of primary issues (*see accompanying story* Understanding Red Herring Prospectus *and box on ratings*).

But as the rating agencies themselves say, a higher rating isn't an assurance for gain on listing or even any time soon after that. For

We decide on an IPO by looking at the promoter's background and financial standing.

PRIYANKA SAHI

Veena and B.L. Koul
52 and 54, DELHI

INVESTORS IN IPOS: Since 1995
HITS: Tech Mahindra, ONGC, NTPC, Rel Petro
AND MISSES: Several, including MS Shoes and Tata Timken which peaked after we sold off. Some other IPOS of companies we invested in vanished without a trace. These include Rock Hard Petro, BioChem Synergy, Gujarat Craft Industries
STRATEGY: Typically hold shares for 5-6 months. Retain for long term if prospects look good.
PROFIT: We have had mixed luck, with profits in some IPOs and losses in others.

retail investors, the institutional investors, called qualified institutional buyers (QIBs) act as beacons. Before these institutions put money in the issue, they put a red herring prospectus under a microscope. "For us, investment in an IPO is based on several factors—the fundamentals of the company, its prospects and the market conditions," says Sandeep Neema, fund manager for equity schemes at JM Financial Mutual Fund.

In some ways, the participation of QIBs in an issue is a validation of the company. Retail investors should wait and watch the institutional investors' response. If QIB interest in the issue is high, go ahead and apply. If it is tepid, stay away. Since QIB started vetting issues in April 2002, four IPOs have bombed, indicating the efficacy of the screening process that seeks to separate the chaff from the grain.

But not everyone looks at QIB

High Five

The Rs 1,142 crore MRPL IPO got three times more applicants than the NTPC's Rs 5,368 crore IPO in 2004.

FIVE MOST SOUGHT AFTER IPOs

COMPANY	YEAR	APPLICANTS
MRPL	1992	4.5 million
TATA TIMKEN	1991	4.1 million
JINDAL VIJAYANAGAR STEEL	1995	2.8 million
RELIANCE PETROLEUM	1993	2.6 million
RAYMOND SYNTHETICS	1990	2.6 million

participation as a positive development. Many small investors are miffed that 50% of book-building issues are now reserved for institutional investors. Almost all the investors MONEY TODAY spoke to complained that only a tiny portion is now left for retail investors. "The large institutional quota is squeezing the retail investor out of the primary markets," agrees Parikh.

Also, some of these gods of the financial markets have clay feet. Till last year, QIBs were not expected to part with any money while applying in a public issue. This led to some QIBs conniving with issuers to create hype around an issue by oversubscribing it and then offloading their allotment on the day of listing to make stupendous gains. Last year, Sebi made it mandatory for QIBs to deposit 10% of the value

SOUMIK KAR

BELLWETHER: Mukesh Ambani, Chairman Reliance Petrochemical at the RPL's listing on BSE

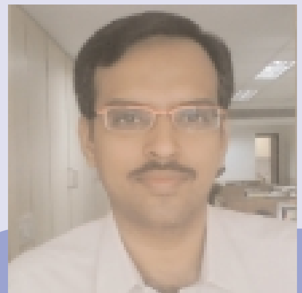
COVER STORY

YEAR-WISE NUMBER OF IPOS

Drought to Deluge

2004-5 was the golden year for IPOs with a mere 23 companies raising Rs 14,662 crore. The average issue size worked out to a record Rs 637 crore.

YEAR	NO. OF ISSUES	ISSUE AMOUNT (RS CRORE)	LANDMARK ISSUES
2001-2	6	1,082	Bharti TeleVentures, Punjab National Bank
2002-3	6	1,039	Canara Bank, I-Flex Solutions, Divi's Laboratories
2003-4	19	3,191	Maruti Udyog, Patni Computers, Biocon, TV Today Network
2004-5	23	14,662	TCS, NTPC, Deccan Chronicle, Jet Airways, NDTV
2005-6	76	10,808	Suzlon, IDFC, Punj Lloyd, Yes Bank
2006-7	32	6,909	Reliance Petro, GMR Infrastructure, Sun TV, Deccan Aviation
TOTAL	162	37,691	



Separating Chaff from Grain

SUDHIR NAIR

Head, Crisil Research

IPO grading is a globally unique concept introduced in the Indian market under the aegis of the Securities and Exchange Board of India (Sebi). Sebi has played a pioneering role in investor protection by increasing disclosure levels by entities seeking to access equity markets for funding. This has caused India to be one of the more transparent and efficient capital markets in the world. However, these disclosures demand fairly high levels of analytical sophistication of the investor in order to effectively disseminate the information. Investment decisions for IPOs are at present based on voluminous and complex disclosure documents, which pose a challenge to investors to arrive at informed decisions. Though seemingly there is a lot of information available on IPOs through free research on websites, media and other sources, investors often look for structured, consistent and unbiased analysis to aid their investment decisions. Moreover, information available on new companies varies with the size of the issue, the market conditions and the industry that the issuing company belongs to. IPO grading aims to bridge this gap and facilitate more informed investment decisions. Credit rating agencies registered with Sebi are authorised to carry out the grading.

IPO grading is optional for companies. Rating agencies have to forward the names and details of IPOs graded by them on a monthly basis to Sebi and stock exchanges for uploading on their website for public information. Any company which opts for IPO grading does not have a choice in accepting or rejecting the grade. The IPO grading given by rating agencies shall form part of the prospectus for the IPO.

Investors however should not misconstrue an IPO grading to be an investment recommendation. Investment recommendations are expressed as "buy", "hold" or "sell" and are based on a security specific comparison of its assessed 'fundamentals factors' (business prospects, financial position, etc.) and 'market factors' (liquidity, demand supply, etc.) to its price. On the other hand, IPO grading is expressed on a five-point scale and is a relative comparison of the assessed fundamentals of the graded issue to other listed equity securities in India. As the IPO grading does not take cognizance of the price of the security, it is not an investment recommendation. Rather, it is one of the inputs to the investor aiding in the decision making process. Other things remaining equal, a stock with stronger fundamentals would command a higher price.

A Crisil IPO grade represents the agency's overall assessment of the fundamentals of the issue graded in relation to other listed equity securities in India. It includes an assessment of business and financial prospects, management quality and corporate governance; and reflects Crisil's understanding of these issues, particularly corporate governance (see box: Summary of Latest Assessment). It thus provides "an independent assessment of fundamentals" to aid comparative assessment of the investor. IPO fundamentals are graded on a five point scale from grade 5 (indicating strong fundamentals) to grade 1 (indicating poor fundamentals). The grading is a one-time assessment done at the time of the IPO and meant to aid investors who want to invest in the IPO. The grade does not have any ongoing validity. So far, Crisil has graded six companies (*see table*).

CRISIL IPO GRADES

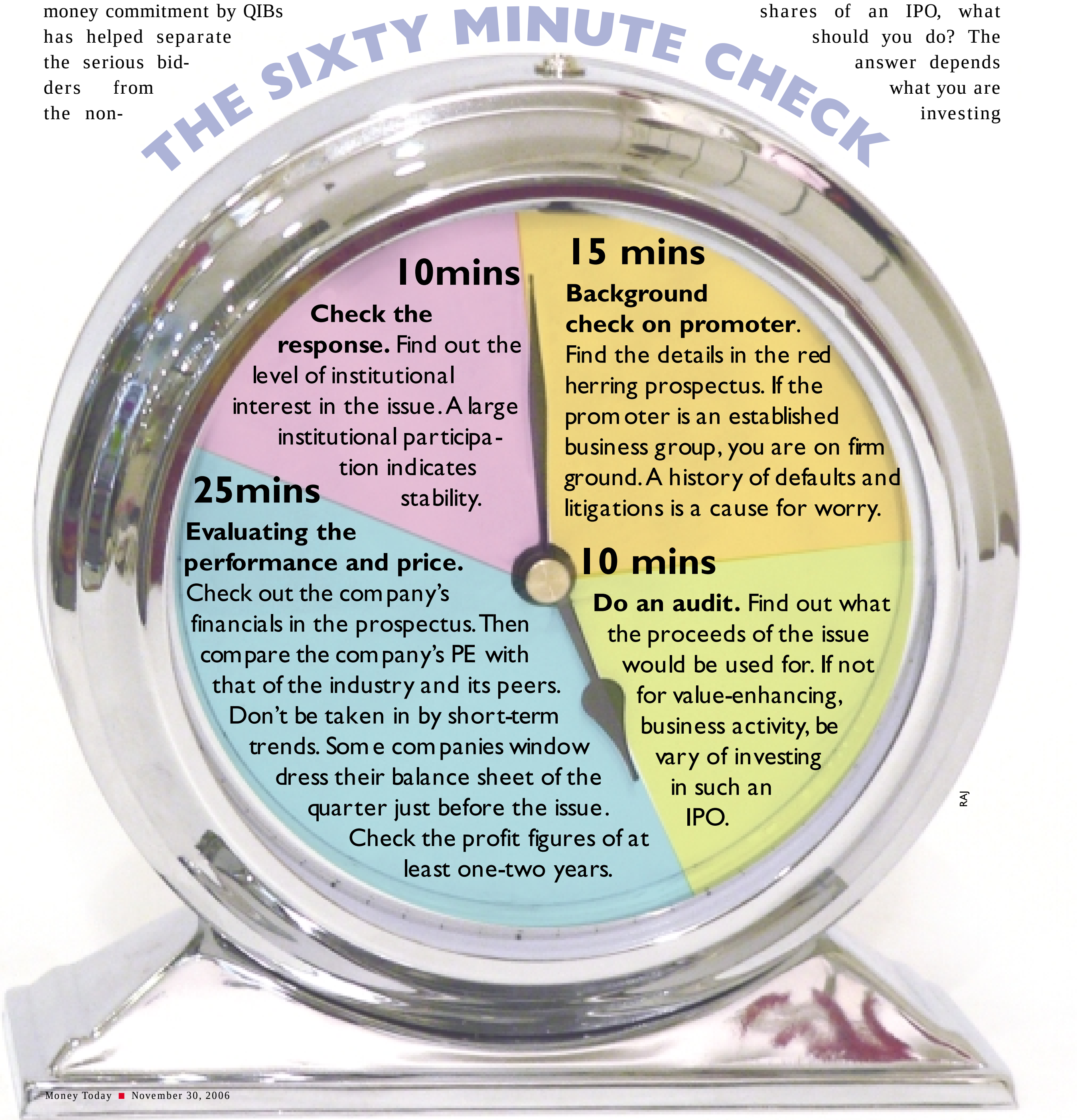
Company	Grade
Shree Ashtavinayak Cinevision	2
Minar International	1
Shukracharya Power Corp	2
SVP Industries	1
Celestial Labs	1
Bhagwati Banquets and Hotels	1

Crisil grades IPO on a five-point scale. 5 points indicate strong fundamentals while 1 point denotes poor fundamentals. The assigned grade is a one-time assessment and does not take into account the issue price.

of the shares applied for. This would ensure that only serious money came into the market. Sebi has also ensured a level-playing field by abolishing discretionary allotment of shares to preferred QIBs and replacing it with the proportionate allotment norm. This lays to rest the fears that FIIs, not assured of big allotments and forced to pay upfront money, will stay away from the primary market. "The margin money commitment by QIBs has helped separate the serious bidders from the non-serious ones," says Amitabh Chakraborty, business head and head of research at Brics Securities.

Given institutional investors' ability to make informed decisions, experts like Haldea propose that a mechanism should be evolved where QIBs should be used to discover the most appropriate price for an IPO, or any public issue for that matter. And the price so discovered should be offered to retail investors for soliciting their subscription. "The so-called price discovery in an IPO is something that is practically impossible for the retail investor," says Chakraborty. This means going back to the system of fixed pricing—as opposed to the current book building process for retail investors.

Having applied and got the shares of an IPO, what should you do? The answer depends what you are investing



PRASUN MUKHERJEE *CEO, Plexus Management Services*

Wanted: A Fund for Investing in IPOs

The number of companies looking to raise public capital over the next 18 months or so is mind-boggling. There is BSNL, Reliance Communications, Hutchison Max and Idea Cellular and a slew of PSUs. These issues could be looking to collectively raise more than Rs 50,000 crore. They would broaden and deepen the market sufficiently. Something like what Reliance Industries did a long time back.

How can the common man participate in this wealth creation exercise that's around the corner? Generally, we invest in an IPO through the book-building process and wait for allotment. But these are such eagerly awaited issues that oversubscription is likely to be substantial, despite their large sizes, and disappointment could be high. A good way to skirt the "problem" is to invest in a mutual fund scheme called the Standard Chartered Enterprise Equity Fund (SCEEF). A closed-ended scheme which becomes open-ended after three years, the fund's objective is to invest a portion of its corpus in IPOs. The fund compulsorily sells the IPOs on listing.

- MEGA IPOs TO HIT MARKET IN THE NEXT 18 MONTHS.
- BUT OVERSUBSCRIPTION MEANS FEW ALLOTTMENTS.
- STANCHART FUND HAS A SCHEME JUST FOR IPOS.
- BEING A QIB, A FUND IS ASSURED OF ALLOTTMENT.
- OTHER FUNDS SHOULD LAUNCH SUCH SCHEMES.

What this scheme does for its investors is it takes exposure to the IPOs and because of its QIB (qualified institutional buyer) status, gets confirmed allotment and that too by paying only the 10% margin. Compare this to a retail investor who would have to pay the full amount and then not know how much is being allotted to her and then await her refund. With the mega issues in the offing an investor should sit back with the idea of making a windfall as and when they hit the market.

A fund like SCEEF with a better performance would be ideal to help the investor around the problem. The Nifty has gone up by 35% compared to the 12% rise in SCEEF's NAV since inception. Clearly, its structure needs a tweak.

It is strange that other fund houses have not spotted this opportunity. But if they do think it is worth their while they would do well to look at the limitations that hinder the product. First, the investor's exit route or rather the lack of it. Being a closed-ended scheme it could have been listed on stock exchanges to give retail investors an exit route. The periodic exit window would let off the investor at NAV-based price and it is safe to assume therefore that the quoted price would not be substantially discounted to the prevailing NAV. Further the idea of selling on listing takes away the fund manager's elbow room in taking a call in the stock and/or the market. The over performance of the fund manager vis-à-vis the benchmark index is decreasing and would continue to do so as the markets mature. But that does not imply that his hand in the deal is totally redundant.

Hopefully, fund houses will take a cue and develop schemes to fill this gap in their product portfolios.

into: just an equity share or a company or, better still, a business. If you treat IPOs purely as a trading opportunity, it is best to sell on the day of listing and book your profits. However, if you are buying into a company, into a business, then a long-term perspective is necessary. Even if the share lists at below the issue price, there is no need for panic if the business itself is on firm ground. Going back to the example of Maruti Udyog IPO, if you had invested in it as a trader and sold all the allotted shares on the day of listing, your gain would have been 36%. But if you had invested in Maruti as India's largest manufacturer of passenger cars—a product whose demand was going to zoom—the absolute returns from your investment till now would have been 626%, or an annualised yield of 86.73%.

Similarly, if you invested in the Deccan Aviation issue as a trader, you would be ruing a loss of 27% on the investment (annualised -53.3%). The share that was issued at Rs 148 listed at Rs 101 (one of the only two IPOs in the past four years to have been listed on a discount to their offer price). But if you invested in

STREET SMART: Investors sizing up IPO opportunities

SOUMIK KAR

Patience Also Pays

Those who invest in a business rather than a share, don't end up selling in a hurry. Many a times they win big.

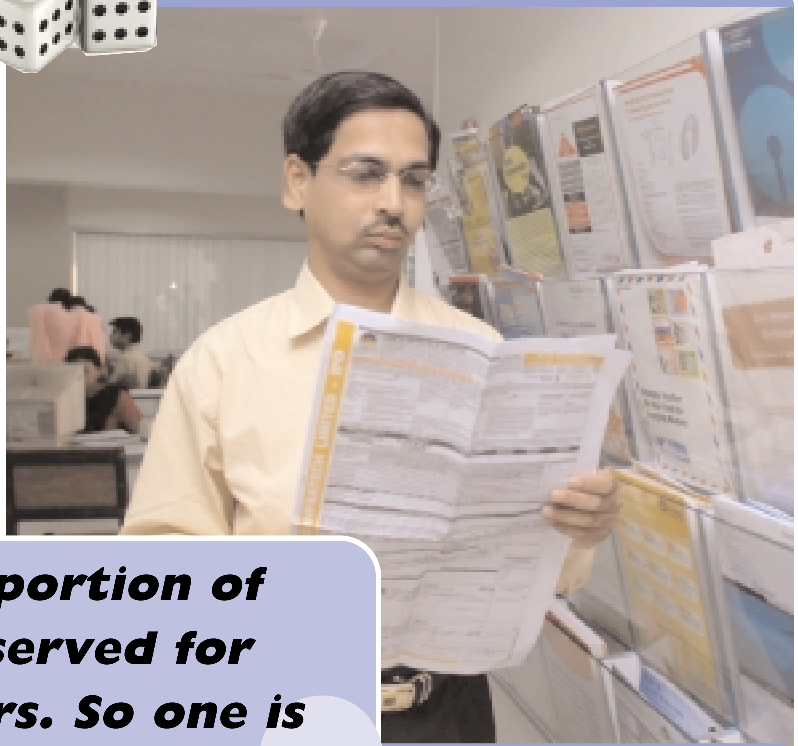
LOW LISTING GAINS BUT HIGH GAINS SUBSEQUENTLY *(Top 10)*

COMPANY	ISSUE DATE	ISSUE PRICE	HIGHEST PRICE ON LISTING	HIGHEST PRICE POST LISTING	GAINS (%)
INDIABULLS	6 Sep 2004	19.00	26.95	447.95	1,562.15
DIVI'S LABS	17 Feb 2003	140.00	183.90	2,680.00	1,357.31
ALLAHABAD BANK	23 Oct 2002	10.00	11.00	106.95	872.27
UNION BANK	20 Aug 2002	16.00	17.40	143.00	721.84
CANARA BANK	18 Nov 2002	35.00	49.75	302.40	507.84
MARUTI UDYOG	12 Jun 2003	125.00	170.40	990.70	481.40
CREW B.O.S.	19 Aug 2004	35.00	48.85	258.70	429.58
SHREE RENUKA SUGARS	7 Oct 2005	285.00	315.00	1,665.00	428.57
JAI BALAJI SPONGE	21 Oct 2003	10.00	13.80	62.00	349.28
RAMKRISHNA FORGINGS	2 Apr 2004	20.00	39.00	172.50	342.31

the future of Indian civil aviation, and especially of the low-cost carriers, through the airline's IPO you don't have reason to panic. Deccan Air is a successful airline and has been able to increase its market share in Indian skies despite fierce competiton. There is nothing to say it won't reward its shareholders once, and if, it is able to improve its profit margins. Says Parikh: "Everyone is acting as a punter. Retail investors often do not realise the importance of staying invested and being patient."

Besides, it is patently unfair to sit in judgement over the pricing of an IPO on the basis of the share's market price on a particular day. The argument is simple: do we hold a company responsible when its shares tumble from a high in the secondary market? IPOs are generally priced not with the future in mind but on the basis of the current market situation. Branding it as

"A very small portion of an issue is reserved for small investors. So one is not sure of allotment."



SANDESH BHANDARI

Mukund Lele
37, PUNE

INVESTOR IN IPOS: Since 1995
HITS: Maruti, NTPC, Andhra Bank, TCS, Reliance Petro and Bank of Maharashtra
AND MISSES: Sold Maruti at Rs 200. Now Rs 900
STRATEGY: Focus is on long-term investing. Holds shares for 2-3 years.
PROFIT: Except Maruti, sold most of the IPO shares at very handsome profits

The No Shows
Out of the 156 IPOs since 2003, the following five had to wind up. Four of these listed failures were in 2006.

BOMBED ISSUES

COMPANY	ISSUE DATE	AMOUNT (Rs Crore)
WEAL INFOTECH	20 Oct 2003	13.90
BLUPLAST INDUSTRIES	5 Jun 2006	35.20
VIGNESHWARA EXPORTS	7 Jun 2006	52.36
SHIRDI INDUSTRIES	29 Jun 2006	43.55
MINAR INTERNATIONAL	25 Sep 2006	69.23

COVER STORY

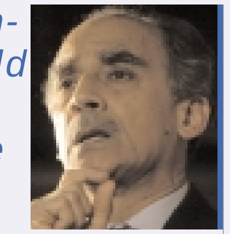
VIVAN MEHRA

Privatisation as the Propellor

The summer of 2003. The Sensex is still in stupor, refusing to rise any higher from the 3000 mark, occasionally dipping below it. That's just 23% of its current value. The one excitement in the air is the news of the Maruti Udyog IPO, the government of India's first big bold privatisation move. The dribbles of disinvestments in the past have neither made companies nor the shareholders richer. The big question is, how much the government will ask for a share of Maruti? Some of the biggest financial wizards in the country are convinced the issue will bomb if it is priced above Rs 100 (face value Rs 5).

The skepticism turns to a near doomsday forecast when the floor price of the issue is decided to be Rs 115. Suzuki Corp has agreed to underwrite the issue—just in case. When the issue finally opened in June it is oversubscribed 10.68 times. At the final offer price of Rs 125, share is listed at Rs 165—a gain of 32% in 15 days. In years to come investors will call the Maruti IPO the bellwether that propelled the stock markets into their biggest and longest unbroken journey of wealth creation.

These could well be the notes from the diary of an official in the Disinvestment Ministry circa 2003. The Sensex shot up 13.4% in June 2003. It crossed 4000 in August and in November of the same year, mount 5000 was scaled. All through PSU stocks were powering the boom and outperforming the Sensex. A Maruti share today is priced at over Rs 900. "The investors were convinced that government was serious about unlocking the wealth for people through privatisation," says Arun Shourie, who as minister for disinvestment in the NDA regime spearheaded India's most successful privatisation programme.



> *The government should keep feeding the stock market with good supply of public sector shares.*
>
> ARUN SHOURIE
>
> *Former Disnvestment Minister*

In retrospect, June 2003 was the first privatisation propeller. The second one came in February-March 2004 when PSU stocks worth over Rs 15,000 crore were sold. Such large-scale supply of quality stocks brought in both foreign investors and Indian retail investors into the market in hordes. In the pre-privatisation era, government had squandered small percentage of its companies' stocks at PE ratios between 2 and 4 (the price it got was between 2 and 4 times the earnings per share). During privatisation, the PE ratio was between 11 and 89.

The UPA Government has virtually banned privatisation. Even faint attempts at selling minuscule proportions of shares in BHEL and Shipping Corporation of India have been halted. That means among other things, no more supply of good government stocks, some of which may not remain good for long. Instead of leading the Sensex, PSU stocks are now trailing it (*see chart*). The extent to which the government can enrich itself and the investors through a bold privatisation plan is mind-boggling. By the time the NDA government was voted out in 2004, it had raised about Rs 40,000 crore by selling just 1.5% of government stake in PSUs (including strategic sales). It had created much larger wealth for investors—and that when Sensex was below 6000. —ROHIT SARAN

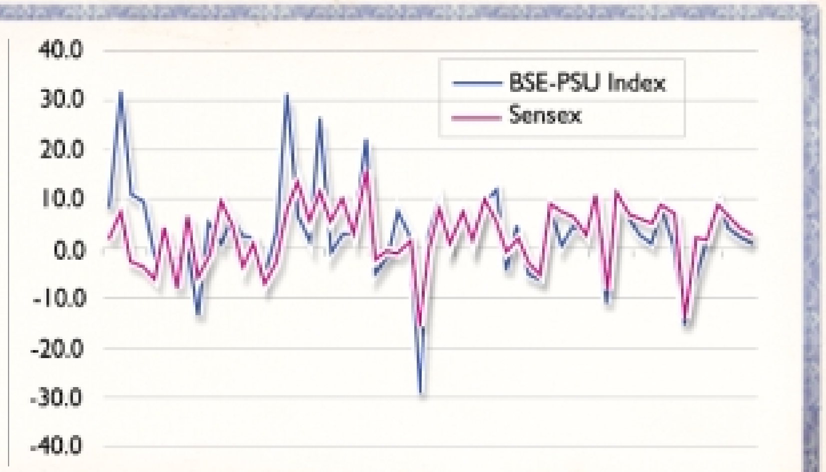
Public Gains

	Issue price	Listing price	Current price
MARUTI UDYOG	125	170	908
PETRONET LNG	15	17	51.9
INDRAPRASTHA GAS	48	199.7	118.25
POWER TRADING CORP	16	46.85	50.65
PUNJAB NATIONAL BANK	31	35	547

All figures in Rs

Leaders turned Laggards

The privatisation programme fuelled the IPO boom and PSU stocks led the Sensex till April 2004. Fortunes reversed since then.



Figures are percentage monthly change in the values of Sensex and BSE-PSU index.

flawed on the basis of its market price on some day in the future would not serve any purpose.

Even if the issue is very good in terms of prospects and as a business, if the price is high, the gains for the investor will be limited. Aggressive pricing of IPOs in the past 12 months have pared the gains that investors could have made from these issues.

Still, it is not as bad as in the past decade when issues used to be priced at astronomical price to earnings (PE) ratio. "In no way will we see the repeat of cases where an issue priced at, say, at Rs 400 slid to Rs 20 post issue," says Haldea.

So, what should you do when you next see ads of an IPO issue? Well, as long as the bull run in the secondary market continues you can keep making money by investing in almost any decent IPO, as long as you sell on the day of listing or soon after that. But the golden rule to keep in mind is: IPO investing is primarily for boom times. Long-term stock investing is for all times.

See detailed tables on the primary markets and read the golden rules of stock market investing and review of Benjamin Graham's The Intelligent Investor, *on* **www.moneytoday.in**

Beyond the Red Herring

India's unusual laws have provoked uniquely *desi* business structures. You need to go beyond western norms of governance to understand these.

By DEVANGSHU DATTA

By the time a business can go public, it's already achieved some success. It has a balance sheet that meets Sebi norms. And, as has already been said (*see cover story IPO Lottery*), the strike rate for successful IPOs has been very high since 2002.

Selling instantly on listing is called "going stag". Since the holding period is short, even small gains can annualise into large returns.

But should you buy IPOs as businesses to be held for the long term? It is more difficult to judge the worth of an IPO. The risks are higher and many great value investors have tended to avoid IPOs. Well, we cannot advise you to ignore instruments that can create such large wealth. But we can warn you about a few risks peculiar to Indian IPOs. Indian companies carry some baggage unique to the Indian regulatory environment.

A study by Professor Amarnath Bhide of the Columbia Business School offers insights. Bhide examined small, high-growth firms in Bangalore. These are typical IPO candidates, so his findings are key. Some of them are:

- Indian startups require large amounts of equity capital.
- Indian businesses own real estate, whatever the business.
- Entrepreneurs build many small companies, not one large company.
- Unlisted group companies create conflicts of interest and affect corporate governance.

In addition to Bhide's finding, one can add that western norms of corporate governance are not easy for Indian businesses to follow and in fact may be convenient to circumvent. What are the implications for investors?

Indian banks are reluctant to fund businesses without physical

Only in India

Indian companies often have unusual structures. Analysts should look for the following in an IPO.

- Indian companies raise more equity because they find it tough to raise debt.
- Indian businesses tend to be highly exposed to real estate markets—up to 80% of startup capital may be invested in real estate.
- Entrepreneurs build groups out of many small companies rather than creating large standalone entities.
- IPOs often have many unlisted "siblings" in the same group that can create conflicts of interests for promoters and thus affect corporate governance.
- Western-style corporate governance is easily circumvented by *Desi*-style family businesses with their extended networks of relationships.

collateral. An average US startup takes $10,000 equity—an average Indian start-up takes Rs 3.75 lakh ($ 8,400). If we compare other indicators, an Indian startup should not take more than $2,000. This means skewed equity ratios.

Indian businesses are real estate plays. It's easy to raise loans to buy land and then, to raise further loans, using the land as collateral. According to Bhide, up to 80% of start-up capital may be tied up in real estate. Expect even businesses with no apparent real estate connection to react to land prices.

Excise exemptions and small-scale industry reservations make it tax efficient to create many small companies rather than one big one. It used to be illegal for a bicycle manufacturer to make lamps or tyres. It is illegal for HLL to make "ice-cream" though it can sell "frozen dessert". It is also easier to hire and fire if you have small, non-unionised workforces. Hence, sideways growth is common.

Unlisted group companies can be a maze for the IPO investor. These can create conflicts of interest that hurt shareholder returns. For example, brands such as Horlicks, Ariel and Oberoi were not owned by the publicly-listed Glaxo SmithKline, Proctor & Gamble and EIH, which use them respectively.

In each instance, the listed company paid licensing fees to a privately held company, which owned the brand. Even when the brand is transferred to the public entity as with Oberoi or Nirma, there may be a substantial cost to minority shareholders.

Jet Airways illustrates another type of potential conflict. Apart from the trademark, which is owned by a private company controlled by the promoter, the general sales agent is also a private company owned by the promoter. Jet pays high commissions on ticketing to the general sales agent and it has a full-fare strategy.

INDIAN REFLECTION: The realities of Indian business aren't always reflected in IPO documents

Suppose the promoter decides to merge unlisted companies with listed ones? You may have a mess. There's room to fiddle the equity structure in unlisted companies and valuations may nosedive. Anybody who has followed the saga of Nalwa Sons (formerly Jindal Strips) of the O.P. Jindal Group through the Company Law Board to the Supreme Court will know how complex this is.

However, group companies may also create strong synergies. Take the Munjals, for instance. Hero Honda's valuation is strengthened by the group companies straddling the value chain.

Most Indian companies have boards composed of friends and families. It is easy enough to find an independent director who is sympathetic to the promoter while technically independent under the definition of Clause 49 of Sebi's Listing Agreement. You may have to go well beyond the letter of the law to judge corporate governance and this is difficult with an IPO.

So we're not saying avoid IPOs though you can make very decent returns without ever touching one. But do focus on these hidden pitfalls before subscribing.