The next big leap in Primary Market

Vikas Khemani
President & Head-Investment Banking
Edelweiss Financial Services Ltd.

The presence of robust, deep, well regulated and liquid capital markets is crucial for any economy to function efficiently, especially for an emerging and growing economy like India. Deeper yet well regulated capital markets also offer avenues for saving and investment to the common investor seeking returns higher than those from the conventional banking options. In emerging economies, inflation is a common problem, as is low returns on investment. To avoid the vicious cycle of low returns on savings leading to low domestic consumption, the existence of alternative investment options in the form of sound capital markets is extremely necessary. Indian Capital markets have come off age significantly over last couple of decades since liberalization, becoming a strong source of capital for businesses and effective wealth creator for investors. For instance, HDFC Bank, which launched INR 50 crores IPO within 2 months of receiving the banking license in March 1995, today has a market cap of over INR 3 lakh crores!

Fund raising via primary markets have returned with the markets entering a long term bull run

The IPO capital markets have grown phenomenally over the years, albeit in phases. From INR 200 Crs that were raised in 1989, every year we saw increasing amount of funds being mobilized until 1995, when approximately INR 8,000 Crs were raised. Since then till 2003, the amount mobilized from IPOs was limited with only about 15,000 Crs being raised in those eight years. This had completely changed from 2004, when 370+ companies raised ~Rs. 150,000 Crs by tapping the primary market in the next seven years. However, the capital market raising via this route since 2011 has been extremely subdued on back of various global as well as domestic headwinds. The colossal mandate handed by the people of India to the new government in 2014 general elections laid a strong foundation for revival of capital markets after being dormant for almost four years. However, there is still a long way to go if we compare ourselves with the developed markets. For instance, in US there were 275 IPOs raising approximately $ 85 bn in 2014 alone (i.e. 5-6 deals on an average each week and the median deal size was close to $100 mn). While in India, 32 IPOs have been launched since April 2014 raising approximately $ 3 bn only.

The average deal size for an IPO has also grown massively - From approximately INR 5-6 Crs in 1995, the average deal size since 2015 has been more than INR 600 Crs. With the capital markets entering into a long term bull run phase we are at the cusp of a huge fund raising cycle over the next few years as has been seen in the earlier cycles.

Emergence of new breed of companies and sector agnostic fund raising; Infrastructure fund raising to return

In every stage of economic growth different sectors need capital as the need of the economy evolves. As the economy size grows and integrates with the global economy, width of the sectors tracking capital markets grow. Interesting trend in recent times has been the emergence of newer breed of companies from the non-traditional and service sectors tapping the capital markets as against companies from traditional sectors that used to dominate the primary markets. These companies on the back of their strong growth prospects, broad consumption based theme have added to the depth of capital markets by attracting large pool of investors. These firms range from dairy to micro finance, specialized healthcare to staffing services. Going forward the trend is expected to continue with niche, non conventional IPOs ranging from insurance companies to stock exchanges looking to tap the primary market. We are also likely to see the current internet based unicorn companies backed by marquee private equity investors going public. In the recent times, we have seen a flurry of activities in the primary market across sectors unlike earlier years where fund raising was concentrated in a particular sectors. The public markets have been extremely bullish and these issuances have seen thunderous response from investors. Investors are gabbing quality issuances eventually leading to unimaginable subscription levels as we saw in VRL Logistics, Thyrocare Technologies, and very recently, Quess Corp (more than 140 times subscription!).

Infrastructure sector has been a key driver of the economy and plays a pivotal role in capital market fund raise. Given unfavorable market conditions and lack of investor appetite in this sector, we have not seen much activity from these companies in the capital markets in the recent times. However, government's thrust on infrastructure spending, pick up in consumption and falling interest rate scenario shall revive growth in the sector eventually leading to infrastructure companies tapping the primary markets for growth capital.

Regulatory steadfastness

As our markets grow into the next league, there is immense need of evolving regulations to support this growth. Our regulators have been responding well and taking domestic markets towards the global standards and international best practices. The capital markets regulator SEBI has been unleashing a flurry of initiatives to reduce the turnaround time of IPOs and increase investor participation. From listing within 22 days of issue closing to curtailing the time period of listing to 12 working days in 2010 and further reducing it to 6 working days in 2016, SEBI has been streamlining the process and increasing efficiency, thereby reducing market risk to investors. SEBI is in discussions with market participants to further reduce the time lag to listing within 3 working days from closure of the issue, bringing us closer to developed markets like the US where the time between an IPO and listing of shares is as low as one day.

Another significant next step in this direction is the introduction of e-IPOs, which is targeted to eliminate printing of application forms leading to reduction in overall cost and time involved in public issues.

In order to stop the exodus of high potential start-ups from India in search of easier stock market listings a simplified framework was put in place for fund raising by technology start ups and other companies on the 'Institutional Trading Platform', allowing these startups to help raise funds from Indian capital markets on a separate platform of domestic stock exchanges. While it's yet to take off in a big way, this route will encourage such start ups to seek domestic listing.

It may also be worthwhile for the authorities to consider ways to allow secondary offerings by existing investors through the QIP route as an avenue for public market exits. This would be a quicker way to dilute their holdings as compared to FPOs, where such option is already available.

Today, regulatory bodies have also been hand in glove with one another so as to make sure the offering is viable for investors. For example: Only those transactions where investors pay STT are eligible for capital gains tax exemptions. STT is levied on market transactions through the stock exchange. SEBI has introduced the mechanism of tendering shares under buyback offers, takeovers and delisting transaction through the stock exchange mechanism, so as to encourage wider investor participation.

The continuing efforts for an efficient capital market are in the right direction for creating a climate conducive to investment and economic growth.

Technological advances

Indian economy is still cash driven (approximately only 5% of personal expenditure is electronic). Major disruptions are expected in the financial services sector moving ahead. This disruption is also leading towards cashless payments. There has been a dramatic increase of electronic clearing of payments in the last 3-4 years on back of technological advancements. Today smart phones and e-wallets are replacing the physical cards and POS machines and it might support all banking transactions soon. The overall evolution of digital & mobile wallets, payments bank and unified payments system is set to revolutionize the methods of applying in an IPO, at the click of few buttons. It may soon be very common to invest in IPOs through ATMs and payment kiosks as is already done in few Asian countries. Just as implementing ASBA was able to bring down the listing time drastically, as we move towards e-IPO and newer ways of transacting emerge, we expect to move towards a system which is completely digital.

Alternate domestic fund raising mechanisms and reducing interests in instruments like ADR/GDRs

REITS offers an exit opportunity to developers to monetise their real estate assets, whereas InvITs is a platform for promoters to transfer revenue-generating assets from the parent company. Cash flows generated from this asset transfer can help promoters to churn their capital and effectively utilize towards their future projects.

While globally REITs have been in existence since 1960, India introduced laws for setting up REITs only in 2014. REITs provide a huge opportunity for developers and investors in India given the potential in the Indian real estate market. REITs would help developers resolve their fund-raising issues and allow them to focus on completing their projects in a timely manner.

InvIT is a positive move and we believe that this model of investment under InvIT mechanism will have positive impact on the Infrastructure projects in India. It will, however, inter-alia depend on credibility of sponsor/ investment manager and substance and commercial income of underlying assets of InvIT to entice the investors to invest in this new exciting product.

At a time when the realty and infrastructure sectors are struggling for alternate avenues of funding—other than traditional banks and financial institutions—and private players are sourcing institutional capital, enabling REITs as well as InvITs to operate with ease is expected to act as a key enabler for capital markets in the country, just as OFS was the new found vehicle utilized by the government for disinvestments and used as a prudent measure to meet minimum public shareholding requirements.

A record Rs 31,000 crore was raised through ADR/GDR issuance in FY 2008, and even in FY 2010, cash-starved Indian companies raised Rs 19,000 crore from foreign markets. With the entry of large foreign investors in India, on back of attractive domestic capital markets, steps taken by regulatory authorities, lower costs and shorter timelines, ADRs and GDRs have lost some of the prominence that they enjoyed earlier.

Changing mix of IPO and boost by private equity investments

Another noticeable trend in the IPOs has been the growing proportion of the offer for sale portion by existing investors. Since 2013, almost 60% of the amount raised on an average has been through secondary offering instead of any fresh fund raising by the company. In recent years, secondary offerings have become an increasingly preferred route for investors looking to exit. While this has been accepted trend in the developed markets, secondary offerings have started gaining traction showcasing signs of maturing domestic markets. PE backing played an important role and provided opportunities to companies which would have otherwise found it difficult to raise capital. These niche firms with a good track record, sound business model have grown to a comfortable size allowing their investors to look at an exit opportunity.

Evolution of the Domestic Institutional Investors

Over the last few years, domestic institutional investors have been more bullish as compared to the foreign institutional investors. In FY16, domestic institutional investors pumped in ~$ 13 bn in to equities as compared to an outflow of $1.5 bn by Foreign institutional investors during the same period. Domestic institutional investors have infact been more active in the primary issuances. More than half of the demand in the anchor books of recent IPOs since 2015 has been filled by domestic institutions. As domestic institutions evolve, larger sized transactions are being placed on back of their demand. A case in point is the recent IPO of Equitas which was the largest 'domestic institutions only' IPO in India which saw astronomical demand and garnered ~RS. 27,000 Crs from domestic investors – something that was difficult to imagine earlier. This evolution is crucial for taking the domestic capital markets to the next level as DIIs provide more stable cash flows and typically their allocation is across market capital companies unlike FIIs which are top heavy.

Retail Participation and Domestic Savings

IPO as a product has created significant retail investment opportunity. This has been helped by two main factors, rising domestic capital markets and investor sentiment and steps taken by regulatory authorities to increase retail participation which has led to increasing number of retail investors participating in the recent issues, some of which have seen record breaking levels of application received. However, the overall retail participation is still limited and far behind the levels seen in the global markets. Out of the overall savings of ~ Rs. 22 lakh crores of the household sector in FY13, only 2% was invested in shares and debentures. This has been very low over the years. The net financial savings in the same period has been ~30% of which ~40% is invested in life insurance, provident and pension funds while ~38% is part of deposits. As the domestic market matures, a much larger portion of domestic savings would eventually be channelized in the stock markets as has been the case with developed markets where about 26% - 30% of the households participate in stocks.

As markets entered into long term bull run, we are in for some very exciting times in the capital markets!

India's macros are improving and the process of macro to micro percolation is well underway. I believe that some of the government's major initiatives – Power sector reforms, Implementation of Direct Benefit Transfers, Push to infrastructure spending and Measures to improve efficiency and productivity – will surely pave the way for capex recovery and set the economic juggernaut rolling on the domestic front. The Bankruptcy law, Real Estate bill, Repealing of 1,000 plus redundant central laws are some of the other under-appreciated, but very important and enabling reforms completed by the Modi government.

The domestic liquidity is likely to remain strong. The government's focus on bringing savings into financial markets, getting the unbanked into the banking system, ushering in a low interest rate environment, and brighter equities outlook in the long term will drive domestic liquidity. The pipeline of fund raising is strong, capex cycle is expected to kick in, favorable demand from institutional investors and with the regulators focusing on improving the process, I will reiterate that the structural trend remains very positive and we are looking forward for plethora of possibilities and record breaking fund raisings in the times to come!