Recent trends and innovations in IPO market in India

Resurgence of IPO market in India amidst diversity in issuances

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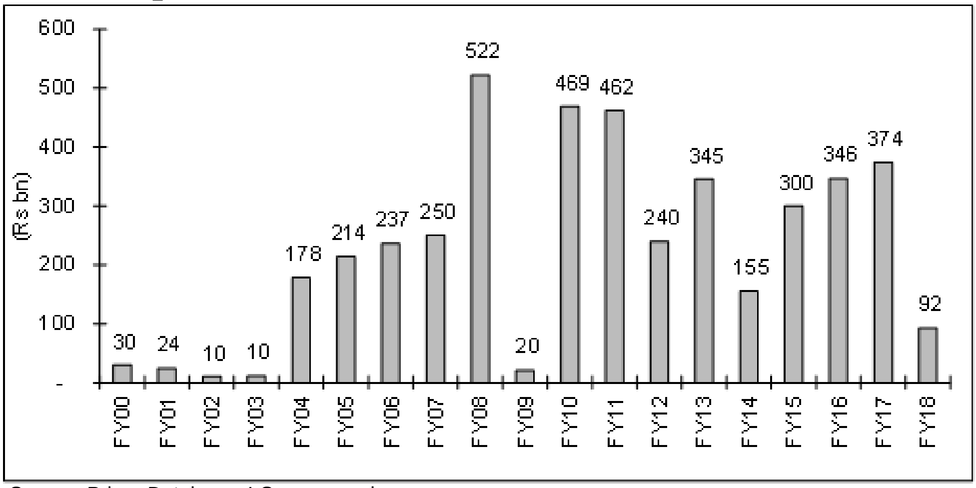
IPO markets in India have been improving over the past three years due to buoyant equity markets, increasing financial savings and outperformance of recent IPO listings. Flows into equity markets, especially domestic flows, have been improving resulting in incremental appetite for new issuances.

With this as the backdrop, we discuss the new trends evolving in the primary markets. As the markets develop, we are seeing new instruments being floated, with InvITs making a debut and REITs expected to make a mark. Government disinvestments will be an avenue to watch out for as the government eyes one of its largest disinvestments in FY18. Financial services firms such as insurance companies and small finance banks will look forward to benefit from the appetite in the market.

Other trends worth mentioning are:

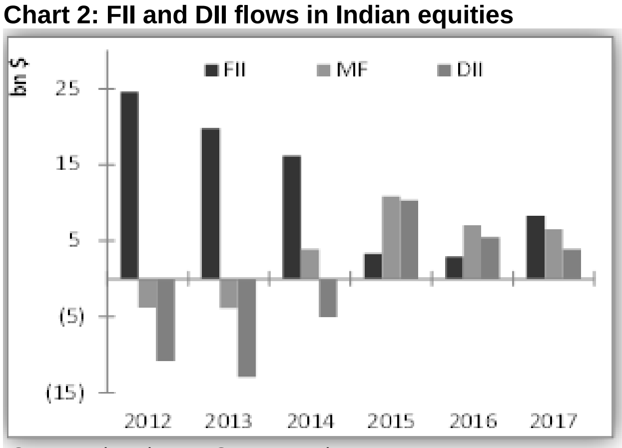
- Diversity of new issuances in terms of new sectors (insurance, exchanges, food retailers, depository services, etc.)
- Majority of IPO launches are resulting in exits for PE (private equity) investors (61% over FY16-FY17), and
- Median size of IPOs (Rs8.8bn in FY17) has been increasing over the past three years.

Chart 1: Surge in IPO / OFS issuances since FY14



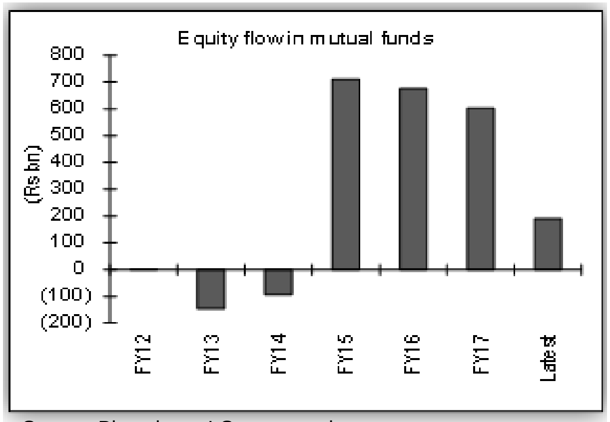
Source: Prime Database, I-Sec research

Chart 2: FII and DII flows in Indian equities



Source: Bloomberg, I-Sec research

Chart 3: Retail flows in mutual funds



Source: Bloomberg, I-Sec research

Diversity of IPOs in recent times

As the Indian economy evolves, businesses from new-age sectors such as stock exchanges, organised food retailers, insurance companies, business service providers, small finance banks, restaurants, asset management companies, etc. are tapping capital markets to grow their businesses.

Table 1: Recent and forthcoming IPOs in new sectors

Sector	Recent IPOs (since 2016)	Upcoming IPOs
Insurance	ICICI Prudential Life Insurance	New India Assurance, National Insurance, United India Assurance, HDFC Standard Life, ICICI Lombard General Insurance, Reliance General Insurance, SBI Life
Exchange and Depository	BSE	
Depository services	CDSL	
Food Retailer	Avenue Supermart, Varun Beverages	Prataap Snacks, Barbeque Nation Hospitality
Small Finance Banks	Equitas, AU Small finance bank, Ujjivan financial services	
E-Commerce	Infibeam	
Business Service provider	Quess Corp	BVG India, Security & Intelligence Services (India) Ltd
Human resource aggregator	Teamlease	
Energy Efficiency / trading		Energy Efficiency Services Ltd / Indian Energy Exchange
Food-Technology		Godrej Agrovet
AMCs		UTI AMC, Reliance Nippon

Source: Bloomberg, I-Sec research

Financial services to be a key driver of capital markets in FY18

Insurance

- After a draft consultation paper to make listing mandatory for insurance firms, the regulator (IRDAI) has slowed down on the proposal for now given the resistance from insurance firms. Despite the move to hold back mandatory listing, interest in insurance company IPOs remains strong.
- The SBI board recently approved SBI Life IPO
- PSUs such as General Insurance Company and New India Assurance are in the pipeline for listing in FY18

Small finance banks

- While Equitas (Apr'16), Ujjivan (May'16) and AU Small Finance Bank (Jul'17) have listed on the bourses, other small finance banks can be expected to list soon as the RBI mandates listing within three years of net worth reaching Rs50bn

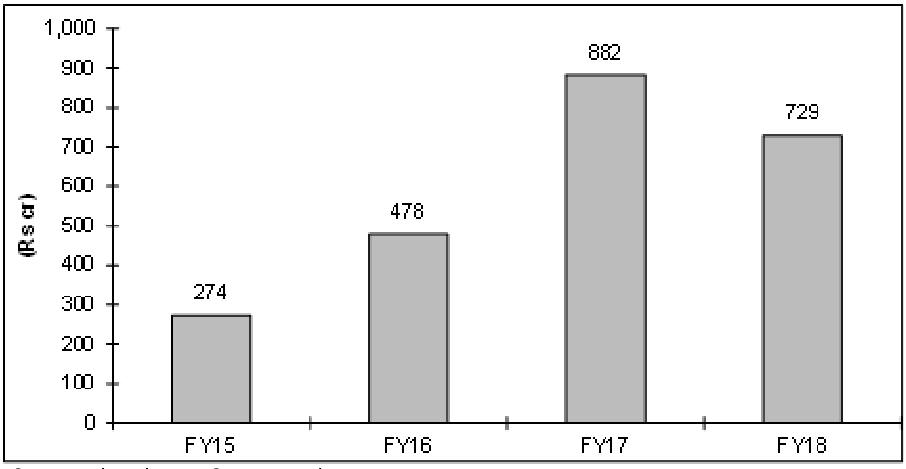
Exchanges

- The sector has recently tested the capital markets as BSE and CDSL listed on the markets.
- NSE is expected to list

Median size of IPOs increasing

Median size of IPOs has been increasing over the past three years with FY17 median IPO size at Rs8.8 bn. Rising IPO size indicates that the companies tapping capital markets are amongst the larger well-established firms looking to further grow their businesses along with providing exits to early stage investors.

Chart 4: Median IPO size trends



Source: Bloomberg, I-Sec research

Table 2: List of large-size IPOs in FY17

Name	Issue Size (Rs bn)
ICICI Prudential Life Insurance Co. Ltd.	60.57
PNB Housing Finance Ltd.	30.00
Equitas Holdings Ltd.	21.77
Avenue Supermarts Ltd.	18.70
Laurus Labs Ltd.	13.31

Source: Bloomberg, I-Sec research

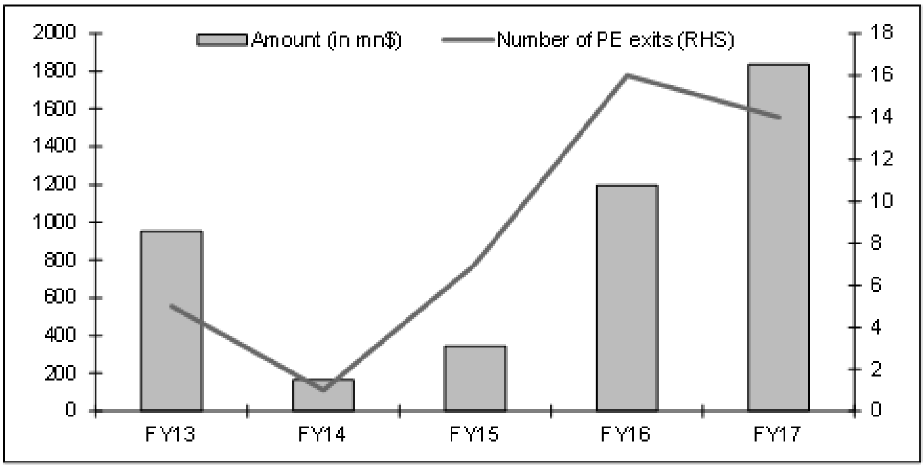
Majority of recent IPOs have provided exits to PE investors

Of the 67 IPOs in the past five years, PE investors exited holdings through 42, with FY17 being a multi-year high for such IPOs in value terms. Presence of PE investors in a company coming for an IPO is seen in a favourable light as they bring improvements in corporate governance, business capabilities in terms of systems and improve capital allocation and growth plans.

Regulations more conducive for PE exits

- On 21-Jun'17 at the SEBI Board meeting, lock-in period restrictions of one year for PE investors were removed. This is expected to improve the theme of PE-backed exits through primary markets. Currently, PE firms cannot sell the shares they acquire in a company before an IPO for one year after listing. They will now be allowed to sell shares in a company any time after it gets listed on exchanges. The move will remove the differential treatment for PE investors compared with other secondary market participants.

Chart 5: PE Exits through the IPO route



Source: Venture Intelligence, I-Sec research

Disinvestment through primary markets to hit all-time high in FY18

FY18 will see the government facing a multi-year high in its disinvestment target. Rs725bn is targeted via stake sales, of which Rs150bn is expected through stake sales in SUUTI. The rest is expected to be achieved via general insurance IPOs, stake sales in listed players such as NTPC, IOC, PFC and SAIL.

Table 3: Annual budgeted disinvestments
(Rs bn)

	Budgeted	Actual
FY14	558.14	158.19
FY15	634.25	243.49
FY16	695.00	282.81
FY17	565.00	462.47
FY18	725.00	11.95

Source: Budget Document, I-Sec research

Table 4: Probable route to the Rs725bn target

Government Assets	FY18 Budget estimates (Rs bn)	Current Valuation (Rs bn)	Current stake	Current holdings (Rs bn)	Proposed stake sale	Probable receipts (Rs bn)	Done till date
Total miscellaneous capital receipts	725					631	66
Insurance firms	110					130	-
Strategic disinvestments (SUUTI)	150	6550		592		150	42
Listed PSUs & Railways	465	8915		6028		351	24
(1) PSU stake sales (announced)						327	24
PFC		343	66%	227	10%	34	
SAIL		233	75%	175	10%	23	
NTPC		1,320	70%	921	10%	132	
NHPC		335	69%	231	10%	33	
REC		369	59%	217	5%	18	
NLC India		159	81%	130	15%	24	
IOC		2,040	57%	1,170	3%	61	
Coal		1,604	79%	1,265	10%	160	
ONGC		2,168	68%	1,475	5%	108	
BHEL		343	63%	216	5%	17	
Others (HCL, NALCO and HUDCO)*							24
(2) Railways		239		239		24	-

Source: Budget Document, I-Sec research

CPSE ETF as a novel method of disinvestment

- CPSE ETF is a passive investment fund managed by Reliance Mutual Fund created to assist government to meet its disinvestment target. The fund allocates the proceeds of FFO in a way that replicates Nifty CPSE Index in terms of its composition and weightage. The fund is rebalanced every quarter such that weightage of no single stock exceeds 25%.
- The second tranche of ETF FFO had an issue size of Rs60bn including a greenshoe option of Rs15bn. As a part of scheme, the government offered a 5% discount across all categories of investors. Nearly a third of the issue was reserved for anchor investors. EPFO was one of the biggest bidders in the anchor category. HDFC Ergo, Nomura, JP Morgan, Axis Bank, Kotak Mutual Fund and Birla Sun Life Mutual Fund were among the others. Issued received an overwhelming response and was subscribed 2.3x times. Investors made decent listing gains of 6.5% on the listing date (allotment NAV: Rs25.21 and Listing NAV: Rs26.75)

- The third tranche of CPSE ETF (issue size: Rs25bn) had opened for subscription on 14-Mar'17 and was subscribed 3.7x. It got listed at Rs27.61 on NSE against the issue price of Rs26.80.

InvITs - Equity instruments with characteristics of high-yield debt

In 2017, India saw listing of two InvITs – IRB InvIT and the India Grid InvIT. Infrastructure Investment Trust (InvIT) as a financial instrument is designed to monetise long-term infra assets with adequate protections to safeguard investor interest. InvITs are institutions similar to mutual funds that enable investments into the infrastructure sector by pooling money from individual/Institutional investors for directly investing in infrastructure so as to return at least 90% of the income (after deducting expenditures) to unit holders of InvITs.

InvITs provide a high-yield financial instrument with strong credit rating: As per current regulations, a public InvIT has to invest at least 80% of the value of its assets in completed infrastructure projects with a further cap of 10% for under-construction projects. This is to shield investors from construction risk and protect their investment from getting stuck in stranded projects, which in turn allows investment grade rating for the instrument. Benefits from InvITs to investors are:

- Diversification tool as it taps India's long-term potential for the long-term investor.
- Direct exposure to stable infra assets.
- Provides 8.5-9% post-tax annuity-like returns with upside potential for the individual investor in a low interest rate environment.
- High credit ratings ensure risk-averse funds can invest in high-yielding assets – both, the IRB InvIT and Indigrid InvIT received 'AAA' ratings (IRB by CARE ratings and India Ratings, Indigrid by Crisil, India Ratings and ICRA).
- 90% of net distributable cashflows have to be returned to the investors in the form of half-yearly dividends, thereby introducing a high dividend yield instrument in a market starved of such instruments.

Importance of InvITs in the current economic context: India's Twin Balance Sheet (TBS) problem and its negative impact on private investment is a pressing issue policymakers are currently facing. InvIT unlocks tied-up capital in completed projects and improves cash positions in corporate balance sheets. To revive the capex cycle and crowd-in private investments, the Union government has been focusing on infrastructure development through higher budgetary allocations, but is limited by financial constraints. InvITs act as a tool to mobilise the surplus liquidity in the economy towards infrastructure spend. Also, the RBI has been highlighting the risk exposures banks have to particular sectors such as infrastructure. InvITs will allow the infrastructure credit to shift to a larger group of investors, thereby ensuring that risks are spread over the economy.

Outlook for IPO market – future bright

Factors such as greater financial inclusion, structural shift towards financial savings, and formalization of a greater chunk of the economy bode well for the primary market. Presence of sophisticated PE investors in interesting new age businesses which are ripe for listing will continue to bring diversity to the IPO market and provide investors new opportunities to invest.