INTIAL PUBLIC OFFER (IPO)

When private companies i.e. companies that are wholly owned by their promoters, invite the public to subscribe to their shares, this issue of shares is called an Initial Public Offering (IPO). The shares issued could be in the form of fresh equity and/or the promoters sell a portion of their equity to the public. Public issues can be classified into Initial Public offerings and further public offerings. In a public offering, the issuer makes an offer for new investors to enter its shareholding family. The issuer company makes detailed disclosures as per the DIP guidelines in its offer document and offers it for subscription. Initial Public Offering (IPO **) is when an unlisted company makes either a fresh issue of securities or an offer for sale of its existing securities or both for the first time to the public. This paves way for listing and trading of the issuer's securities.**

IPO is **New shares** Offered to the public in the Primary Market .The first time the company is traded on the stock exchange. A prospectus is issued to read about its risk before investing. **IPO** is A company's first sale of stock to the public. Securities offered in an **IPO** are often, but not always, those of young, small companies seeking outside equity capital and a public market for their stock. Investors purchasing stock in IPOs generally must be prepared to accept very large risks for the possibility of large gains. Sometimes, Just before the **IPO** is launched, Existing share Holders get a very liberal bonus issues as a reward for their faith in risking money when the project was new

WHAT IS A PREMIUM ISSUE ?

Generally, most shares have a face value (i.e. the value as in a balance sheet) of Rs.10 though not always offered to the public at this price. **Companies can offer a share with a face value of Rs.10 to the public at a higher price.**

The **difference** between the **offer price** and the **face value** is called the **premium**. As per the SEBI guidelines, new companies can offer shares to the public at a premium provided :

1.The promoter company has a 3 years consistent record of profitable working.

2.The promoter takes up at least 50 per cent of the shares in the issue.

3.All parties applying to the issue should be offered the same instrument at the same terms, especially regarding the **premium**.

4.The propectus should provide justification for the propose premium. On the other hand, exisiting companies can make a **premium issue** without the above restrictions.

A company's aim is to **raise money** and simultaneously serve the equity capital. As far as accounting is concerned, **premium is credited** to reserves and surplus and it does not increase the equity. Therefore, a company which raises Rs.100 crores by way of shares at say Rs.90 **premium per share** increases its equity by only Rs.10 crores, which is easier to service with an investment of Rs.100 crores.

Thus the companies seek to make **premium issues**. As well shall see later, a **premium issue** can increase the book value without decreasing the EPS. In a buoyant stock market when good shares trade at very high prices, companies realize that it's easy to command a **high premium**.

How to apply to a public issue ?

When a company floats a public issue or **IPO**, it prints forms for application to be filled by the investors. Public issues are open for a few days only. As per law, any public issue should be kept open for a minimum of 3days and a maximum of 21 days. For issues, which are underwritten by financial institutions, the offer should be kept open for a minimum of 3 days and a maximum of 21 days. For issues, which are underwritten by all India financial institutions, the offer should be kept open for a maximum of 10 days. Generally, issues are kept open for only 3 to 4 days. The duly complete application from, accompanied by cash, cheque, DD or stock invest should be deposited before the closing date as per the instruction on the from. **IPO's by investment companies** (closed end funds) usually contain underwriting fees which represent a load to buyers.

Before applying for any **IPO** , analyse the following factors:

1. Who are the Promoters ? What is their credibility and track record ?

2. What is the company manufacturing or providing services - Product, its potential

3. Does the Company have any Technology tie-up ? if yes , What is the reputation of the collaborators

4. What has been the past performance of the Company offering the IPO ?

5. What is the Project cost, What are the means of financing and profitability projections ?

6. What are the Risk factors involved ?

7. Who has appraised the Project ? In India Projects apprised by IDBI and ICICI have more credibility than small Merchant Bankers

How to make payments for IPOs:

The payment terms of any IPO or Public issue is fixed by the company keeping in view its fund requirements and the statutory regulations. In general, companies stipulate that either the entire money should be paid along with the application or 50 percent of the entire amount be paid along with the application and rest on allotment. However, if the funds requirements is staggered, the company may ask for the money in calls, that is, the company demands for the money after allotment as and when the cash flow demands. As per the statutory requirements, for public issue large than Rs. 250 crore, the money is to be collected as under:

25 per cent on application

25 per cent on allotment

50 per cent in two or more calls

Understanding IPO Grading

IPO grading is a unique concept involving an independent agency that is free from bias and with the available tools for assessing the investment attractiveness of an equity security. IPO grading is a service aimed at facilitating the assessment of equity issues offered to the public, says SEBI. IPO grading can act as an additional decision-making tool for them. The idea is that IPO grading will help the investor better appreciate the meaning of the disclosures in the issue documents, collapsing all of the above information into a single digit. Thus, IPO grading could be seen as an added investment guidance tool seeking to hide the ignorance of the above factors and still help the investors make an informed decision. *Grading of IPOs in terms of their fundamental quality will enable investors steer clear of unsound offers.* IPO grading in general would be a relative assessment of the fundamentals of the equity security by credit rating agencies registered with SEBI.

But IPO grading is totally unheard of anywhere else and is a First-From-India initiative. The

grading, to be done by the SEBI-registered credit rating agencies, would be applicable to all IPOs for which offer documents are filed after April 30, SEBI said in a circular. **SEBI does not play any role in the assessment made by the grading agency**. The grading is intended to be an independent and unbiased opinion of that agency. The company needs to first contact one of the grading agencies and mandate it for the grading exercise. Though this process will ideally require 2-3 weeks for completion, it may be a good idea for companies to initiate the grading process about 6-8 weeks before the targeted IPO date to provide sufficient time for any contingencies. IPO grading is a service aimed at facilitating the assessment of equity issues offered to the public, says SEBI.

IPO grading is the grade assigned by a Credit Rating Agency registered with SEBI, to the initial public offering (IPO) of equity shares or any other security which may be converted into or exchanged with equity shares at a later date.

The grade represents a relative assessment of the fundamentals of that issue in relation to the other listed equity securities in India. Such grading is generally assigned on a five-point point scale with a higher score indicating stronger fundamentals and vice versa as below.

IPO grade 1: Poor fundamentals
IPO grade 2: Below-average fundamentals
IPO grade 3: Average fundamentals
IPO grade 4: Above-average fundamentals
IPO grade 5: Strong fundamentals

IPO grading has been introduced as an endeavor to make additional information available for the investors in order to facilitate their assessment of equity issues offered through an IPO.

IPO Grading is not a recommendation to invest

Even if a Company is Graded 5 (i.e. with strong fundamentals), IPO grading is not a recommendation to invest in the graded instrument. It does not a comment on the price of the graded security or its suitability for a particular investor. It does not comment on issue price, likely price on listing or movement in price post listing.

When an unlisted company makes either a fresh issue of securities or an offer for sale of its existing securities or both for the first time to the public. This paves way for listing and trading of the issuer's securities.

What is an FPO?

When an already listed company makes either an offer for sale to the public or a fresh issue of shares, this issue of shares is called Follow on Public Offer (FPO).

Who all are the intermediaries in an IPO?

Merchant Banker or Book Running Lead Managers (BRLM) to the issue, Syndicate Members, Underwriters to issue, Registrars to issue, Bankers to issue, Auditors etc. are the intermediaries to an issue. Contact details of all intermediaries like, contact person, Telephone number, address, email address etc are disclosed by the issuer.

Who is a Merchant Banker or BRLM to an issue?

Book Running Lead Manager (BRLM) is the Merchant Banker having valid SEBI registration as per SEBI (Merchant Bankers) Regulations.

What is the role of BRLM?

Book Running Lead Manager (BRLM) or Lead Manager performs all the pre and post issue activities. Pre-issue activities involves due diligence of company's Operations/ Legal / Management / Business plans etc., designing & drafting Offer Document, Prospectus, memorandum for salient features of Prospectus and statutory advertisements. BRLM should ensure to comply with stipulated requirement and formalities in prescribed formats with SEBI, Stock Exchanges, Registrar of Companies (ROC). They also have market the issue and appoint other intermediaries like Advertising Agency, Registrar, Bankers and Printers. Activities like managing escrow accounts, allocation to non-institutional, intimation of allocation and dispatch of refunds to bidders forms the part of Post-issue process. The post offer activities also involve necessary follow-ups, which includes finalization of trading, dealing of instruments, dispatch certificates, demat of delivery of shares with different agencies associated with the work like Registrar to issue, Banker to issue and Bank handling refund operations. BRLM coordinates with Registrar and Escrow Bankers to ensure follow up for proper flow of applications from bank branches to registrar and processing of these applications and other works till the Basis of Allotment is finalized. The Lead Manager is responsible to arrange necessary agreements and documents between these agencies and the Company. They should ensure that these agencies fulfill their functions and discharge responsibilities according to the agreements.

What is the role of a Registrar?

Registrar finalizes the list of eligible bidders after rejecting invalid applications. They ensure credit of allotted shares to demat accounts of respective bidder by taking the corporate action and dispatch refund orders & Confirmatory Allotment Note to those applicable.

What does Banker to the issue do?

Bankers carry out activities of collecting funds in the escrow accounts and inform Issuers, Registrar and Lead Manager about the figures collected.

Why do companies come out with IPOs?

When a private company requires funds, in order to expand its existing facilities, undertake a new project, repay a high cost loan or simply augment its working capital (i.e. funds required for day-to-day business activities) it may resort to an IPO.

IPO PRICING

There are two ways in which the price of an IPO can be determined

How is the issue price decided on?

A company that is planning an IPO appoints lead managers (SEBI-registered merchant bankers who are responsible for helping the company execute the IPO) to help it decide on an appropriate price at which the shares should be issued. There are two ways in which the price of an IPO can be determined – either the company, with the help of its lead managers, fixes a price or the price is arrived at through the process of book building.

Fixed price IPOs

In this case, the company, together with the lead managers, decides at what price they would like to issue the shares. To arrive at a suitable price, the company's past performance is assessed using financial ratios. The share prices of competitor companies' equities and others in the same league are also taken into consideration when the IPO price is fixed.

Book-built IPOs

In the book building approach to price setting, the price of an IPO is demand driven. The issuing company sets a floor or base price and a band within which an investor is allowed to bid for shares. The spread between the floor and the cap of the price band cannot be more than 20 per cent of the floor price. Then the company, through its lead managers, invites price bids from investors along with the quantum of securities that they would be willing to purchase at that price.

While the issue is open, all investors must submit their bids along with payment for the quantity of shares they have bid for. The payment due is calculated at their respective bid prices.

One of the lead managers, who is called the 'book runner', maintains an order book in which the investors demand and price bids are registered. Once the issue period is over, the book runner demarcates a cut off price, i.e., a price at which the issue will be fully subscribed on the basis of the quantity and price bids received. All bids that are below the cut off price are ignored and investors who have bid at the cut off price or above can purchase shares that have been allotted to them at the cut-off price. SEBI guidelines permit only retail individual investors to apply at the cut off price.

IPO QUOTAS

A company that is coming out with an IPO can reserve a part of its issue as "allotment on firm basis

Firm allotment

A company that is coming out with an IPO can reserve a part of its issue as "allotment on firm basis", i.e. some extent of definite allotment, for certain categories such as Indian mutual funds, FIIs, permanent/regular employees of the company, scheduled banks, merchant bankers, etc. There are guidelines that indicate the maximum percentage of shares that can be reserved for firm allotment for each category. For instance, the total of reservations and firm allotment for employees cannot exceed 10 per cent of the issue size.

Quotas for specific investors

For allotment purposes, investors in a book building issue are divided into three categories - Retail Individual Investors (RIIs), Non Institutional Investors (NIIs) and Qualified Institutional Buyers (QIBs). A retail investor is one whose application for shares does not exceed Rs 1 lakh in value. NIIs are investors whose bid values amount to over Rs 1 lakh each and QIBs consist of mutual funds, financial institutions, scheduled commercial banks, insurance companies, provident funds, state industrial development corporations, etc. According to SEBI guidelines, each of these categories must be allocated a certain percentage of the total issue. The total amount allotted to RII must be at least 35 per cent of the total issue and at least 15 per cent must be given to NIIs. QIB must be allotted no more than 50 per cent of the issue.

In case an issue is over-subscribed, the company could decide to use the green shoe option (an option to retain a portion of the oversubscription amount by allotting more shares than

initially offered). The excess shares are allotted on a pro-rata basis across different categories of investors. If, on the other hand, there is any under-subscription in any of the categories, any over-subscription in another category can be allotted shares from the under-subscribed category. The method of allotment is at the discretion of the company and its lead managers.

Lastly, the company must get a minimum subscription of 90 per cent of the issue amount in order to be eligible to list its shares. If it does not, the company will have to return all the moneys and cancel the IPO.

IPO FUNDING

If you wish to take a loan in order to buy shares in an IPO, you can do so from banks and finance companies

About IPO funding

If you wish to take a loan in order to buy shares in an IPO, you can do so from banks and finance companies. They provide finance for subscribing to shares in the public / rights issues of reputed companies that are/will be listed as per the listing requirements of NSE / BSE.

In order to avail of this loan you will be charged interest for the period for which you utilize the funds, i.e. from the date of closure of the issue till the date of the refund of money (in case of no shares being issued) or the repayment of the loan. You will also be charged a processing fee that is either a small fixed amount or a percentage of the amount funded. Lastly, the loan amount offered is usually about 50 per cent of the total value of your application bid and you will be required to put up the balance (your contribution is called margin money) of the application money.

Benefits and pitfalls of IPO funding

When you fund your IPO purchase through a loan, you have access to a higher amount for subscription. Since IPO shares are allotted on the basis of proportionate allotment, this improves your chances of being allotted a larger number of shares. However, since the rate of interest on such loans is steeper than most other loans in the market, you may feel pressured to sell off at least a part of the shares on listing, in order to repay your loan and spare yourself from further interest burden. Further, unless the stock lists at a sufficient premium to the issue price, you could end up with losses over and above the interest payable.

IPO funding procedure

Now here's how you actually take a loan to purchase shares in an IPO. You must first choose your financer (the lending bank) according to your loan requirements. You will then be asked to open a savings and a demat account with the bank that is financing you as your loan amount will be routed through this bank account and your shares will be deposited in the demat account that you open, until your loan is repaid. Along with the duly filled in loan document, you will have to submit your IPO application form and a cheque for the margin money, the interest amount due on the loan until the issue closes and processing charges. Then the bank will apply for shares in the IPO on your behalf.

IPO PROCEDURAL ASPECTS

You can find out about IPOs that are in the offing or underway from SEBI's weekly press releases

Finding out about IPOs that are available

You can find out about IPOs that are in the offing or underway from SEBI's weekly press releases and monthly bulletins. Draft and final offer documents are put up on SEBI's website under the 'Reports/Documents' section. Hard copies of the draft offer documents can be obtained from SEBI's office by paying a small fee or from the lead managers. Some lead managers also post these documents on their websites. You can read about companies' IPOs through their advertisements in popular English, Hindi and regional daily newspapers.

Number of days for which IPOs are open

Public issues are kept open for at least 3 and not more than 10 working days. In the case of book built issues, the minimum and maximum period for which bidding is open is 3−7 working days and this can be extended by 3 days, in case the price band is revised. Public issue of some infrastructure companies can be kept open for a maximum period of 21 working days.

Obtaining and submitting your form

The form for applying/bidding for IPO shares is available with all the issue managers, specified collection centers and brokers and bankers to the issue. This form elicits personal information like your name and address, your demat and bank account details, income tax PAN (in case your application is above a certain value), the number of shares that you are applying for and your bid price, in the case of book built issues. You are also required to sign the form. You can submit your form to the agency from which you acquired it.

Revising bids in case of book built IPOs

If you wish to change or revise your bid, you can. To do this, you must enter the revised quantity or price (in the case of book built issues) on a special form that is available along with the application form. However, you must make sure that you complete the entire process of revising your bid within the date of closure of the issue.

Receiving allotment and refund

All public issues with a value in excess of Rs 10 crore are compulsorily in the demat mode. So, if you choose to apply for such issues, you must have a demat account and mention your depository participant's name and ID number and your client ID details in the bid/application form. In the case of fixed price issues, you are intimated through a Confirmatory Allotment Note (CAN) or a refund order, within 30 days of the closure of the issue.

In the case of book built issues, the registrar ensures that investors receive a CAN in case they have been allotted shares and the demat credit or a refund, as applicable, within 15 days of the closure of the issue. Then the stock is listed on the stock exchange within 7 days from the finalization of the issue.

IPO listing

The equity shares allotted in the IPO are listed on the stock exchanges within 7 days from the finalization of the IPO. Generally, the total processing time between the closure of a book built issue and listing is around 3 weeks. In case of fixed price issue, it would be around 37 days after closure of the issue.

Applying for an IPO online

You can also apply for shares in an IPO online, from the comforts of your home or office or anywhere else. For this, you must be registered with an online broking house, which offers the facility to apply for IPOs online. You must log on to the broking houses' website page which lists the IPOs that are currently available and fill in the application form online. In the form, you will have to mention the number of shares that you wish to apply for and the bid price. The broking house will, in turn, fill in and sign the physical IPO application form (since you will have given them a power of attorney at the time of registration) and draw a cheque on your behalf (as you have to maintain a cash balance with your online broking house). The application will be submitted to the registrar along with a copy of the power of attorney that you have signed and your bank account/brokerage account will stand debited to the extent of the application amount, plus any additional fees, if applicable. Lastly, you will receive an email from the broking house regarding your application status.