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# IPO'S PERFORMANCE AND ITS RELATIONSHIP WITH QIB SUBSCRIPTIONS AND GRADE

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## ABSTRACT

*An initial public offering (IPO), referred to simply as an "offering" or "flotation", is when a company (called the issuer) issues common stock or shares to the public for the first time. They are often issued by smaller, younger companies seeking capital to expand, but can also be done by large privately-owned companies looking to become publicly traded. An IPO can be a risky investment. For the individual investor it is tough to predict what the stock or shares will do on its initial day of trading and in the near future since there is often little historical data with which to analyze the company. Also, most IPOs are of companies going through a transitory growth period, and they are therefore subject to additional uncertainty regarding their future value. QIB or Qualified Institutional Buyers have the time and resources to carefully evaluate the offer and then decide whether or not to subscribe to an issue. Retail Investors, on the other hand, try to make decisions on hearsay. This study aims to find if there is any correlation between the QIB subscription and the returns from these IPO.*

## KEYWORDS

IPO, QIB subscription, Retail investors.

## INTRODUCTION

Issuing equity shares for the first time is a very complex process. The company coming up with an IPO incurs heavy expenditure. Many companies offer the shares at below the market value to ensure good subscriptions and thus make the issue a success. Recently, the retail investor's interest in IPOs has increased manifold, especially after the Coal India Ltd IPO. Investors who were allotted shares got up to 40% returns on the first day itself. In case of Gravita India IPO, successful applicants doubled their money in a single day. So, there is a perception among the investors that investing in IPO is a very safe and lucrative option.

QIB or Qualified Institutional Buyers have the time and resources to carefully evaluate the offer and then decide whether or not to subscribe to an issue. Retail Investors, on the other hand, try to make decisions on hearsay. This study aims to find if there is any correlation between the QIB subscription and the returns from these IPO. Since, QIB carries out only fundamental analysis, the listing gains have not been considered, since listing gains depends on other factors as well, like size of the issue, market sentiment etc. This study explores the actual performance of IPOs in the long run. It explains the various aspects of an IPO. It tries to evaluate the factors that affect the performance of an IPO. The study aims to help the retail investors to make sound investment decisions without utilizing much of their time.

Though IPOs generate huge excitement in the market and many investors put their money in it, very few IPOs give positive returns. Most of the investors don't know how an IPO works. There are very few tools to evaluate an IPO.

It is mandatory for all IPO to be graded by a recognized Credit Rating Agency. The Credit Rating Agency assigns a grade based on the company fundamentals, ranging from 1(lowest) to 5(highest). The study finds that there is a moderate positive correlation between the IPO grade and its returns.

**TABLE 1: LIST OF IPO THAT GAVE POSITIVE RETURN AS ON 4TH MARCH 2011**

| Sl. No | NAME OF THE ISSUE | Last Traded Price | Issue Price | Gain in Rs. | Gain in % |
|---|---|---|---|---|---|
| 1 | C. Mahendra Exports Limited | 212.05 | 110 | 102.05 | 92.77 |
| 2 | Moil Limited | 401.5 | 375 | 26.5 | 7.07 |
| 3 | Power Grid Corporation Of India Limited | 99 | 90 | 9 | 10.00 |
| 4 | Gravita India Limited | 275.5 | 125 | 150.5 | 120.40 |
| 5 | Coal India Limited | 325.1 | 245 | 80.1 | 32.69 |
| 6 | Career Point Info Systems Limited | 334.15 | 310 | 24.15 | 7.79 |
| 7 | Gujarat Pipavav Port Limited | 61 | 46 | 15 | 32.61 |
| 8 | Prakash Steel Age Limited | 123.85 | 110 | 13.85 | 12.59 |
| 9 | Engineers India Limited | 293 | 290 | 3 | 1.03 |
| 10 | Standard Chartered Plc | 116.65 | 104 | 12.65 | 12.16 |
| 11 | Mandhana Industries Limited | 259.2 | 130 | 129.2 | 99.38 |
| 12 | Talwalkars Better Value Fitness Limited | 195.3 | 128 | 67.3 | 52.58 |
| 13 | Persistent Systems Limited | 407 | 310 | 97 | 31.29 |
| 14 | United Bank Of India | 101.35 | 66 | 35.35 | 53.56 |
| 15 | Arss Infrastructure Projects Limited | 602.2 | 450 | 152.2 | 33.82 |
| 16 | Thangamayil Jewellery Limited | 164 | 75 | 89 | 118.67 |
| 17 | Jubilant Food Works Limited | 535.3 | 145 | 390.3 | 269.17 |
| | **Total Returns** | | | | **987.58** |

There is a perception among investors that they can multiply their wealth by investing in IPOs. But when the performance of the issues that came out in 2010 was studied, it was found that only 17 of 56 IPOs gave positive gains. The rest 39 IPOs were in the red. Thus the above table shows that not all the IPOs yield positive returns.

TABLE 2: THE LIST OF IPOS THAT GAVE NEGATIVE RETURNS AS ON 4TH MARCH 2011

| Sl. No | NAME OF THE ISSUE | Last Traded Price | Issue Price | Gain in Rs. | Gain in % |
|---|---|---|---|---|---|
| 1 | Punjab & Sind Bank | 104.75 | 120 | -15.25 | -12.71 |
| 2 | Ravi Kumar Distilleries Limited | 31.75 | 64 | -32.25 | -50.39 |
| 3 | R.P.P. Infra Projects Limited | 66.75 | 75 | -8.25 | -11.00 |
| 4 | Gyscoal Alloys Limited | 16.8 | 71 | -54.2 | -76.34 |
| 5 | Prestige Estates Projects Limited | 117 | 183 | -66 | -36.07 |
| 6 | Bs Transcomm Limited | 90.2 | 248 | -157.8 | -63.63 |
| 7 | Commercial Engineers & Body Builders Co Limited | 31.5 | 127 | -95.5 | -75.20 |
| 8 | Bedmutha Industries Ltd | 100.7 | 102 | -1.3 | -1.27 |
| 9 | Ashoka Buildcon Limited | 245 | 324 | -79 | -24.38 |
| 10 | Tecpro Systems Limited | 283.4 | 355 | -71.6 | -20.17 |
| 11 | Cantabil Retail India Limited | 40.5 | 135 | -94.5 | -70.00 |
| 12 | Electrosteel Steels Limited | 8.55 | 11 | -2.45 | -22.27 |
| 13 | Orient Green Power Company Limited | 23.55 | 47 | -23.45 | -49.89 |
| 14 | Ramky Infrastructure Limited | 291.05 | 450 | -158.95 | -35.32 |
| 15 | Microsec Financial Services Limited | 39.2 | 118 | -78.8 | -66.78 |
| 16 | Eros International Media Limited | 139.3 | 175 | -35.7 | -20.40 |
| 17 | Indosolar Limited | 18.8 | 29 | -10.2 | -35.17 |
| 18 | Bajaj Corp Limited | 475 | 660 | -185 | -28.03 |
| 19 | Sks Microfinance Limited | 619.1 | 985 | -365.9 | -37.15 |
| 20 | Hindustan Media Ventures Limited | 162 | 166 | -4 | -2.41 |
| 21 | Technofab Engineering Limited | 154.1 | 240 | -85.9 | -35.79 |
| 22 | Aster Silicates Limited | 25.7 | 118 | -92.3 | -78.22 |
| 23 | Parabolic Drugs Limited | 41.55 | 75 | -33.45 | -44.60 |
| 24 | Jaypee Infratech Limited | 59.65 | 102 | -42.35 | -41.52 |
| 25 | Sjvn Limited | 20.3 | 26 | -5.7 | -21.92 |
| 26 | Tarapur Transformers Limited | 24 | 75 | -51 | -68.00 |
| 27 | Nitesh Estates Limited | 23.65 | 54 | -30.35 | -56.20 |
| 28 | Goenka Diamond & Jewels Limited | 60.7 | 135 | -74.3 | -55.04 |
| 29 | Intrasoft Technologies Limited | 67.85 | 145 | -77.15 | -53.21 |
| 30 | Shree Ganesh Jewellery House Limited | 151 | 260 | -109 | -41.92 |
| 31 | Il&Fs Transportation Networks Limited | 198.25 | 258 | -59.75 | -23.16 |
| 32 | Pradip Overseas Limited | 73.05 | 110 | -36.95 | -33.59 |
| 33 | Nmdc Limited | 268.05 | 300 | -31.95 | -10.65 |
| 34 | Man Infraconstruction Limited | 148 | 252 | -104 | -41.27 |
| 35 | Texmo Pipes & Products Ltd | 34.5 | 90 | -55.5 | -61.67 |
| 36 | Hathway Cable & Datacom Limited | 110.1 | 240 | -129.9 | -54.13 |
| 37 | Emmbi Polyarns Limited | 13.85 | 45 | -31.15 | -69.22 |
| 38 | D B Realty Limited | 117.35 | 468 | -350.65 | -74.93 |
| | **Total Returns** | | | | **- 1,603.62** |

From the above two tables, it can be calculated that,

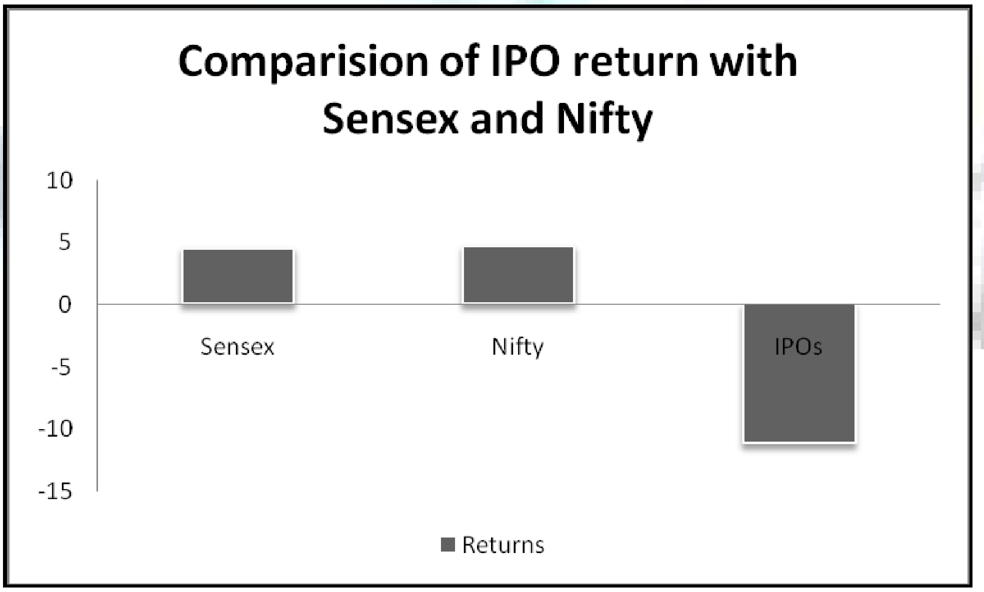
Average return from all the IPOs in 2010 = Total return / number of IPOs

$$\frac{987.58+(-1.603.62)}{55} = -11.20\%$$

This implies that if a person had invested in all the IPOs in 2010, the value would have come down by 11.20%.

Now let us compare these returns with that of Sensex and Nifty from 2010 to 4th March 2011

FIGURE 1: COMPARISON OF IPOS RETURNS WITH SENSEX AND NIFTY FROM 2010 TO 4TH MARCH 2011




From the above chart, it can be observed that Sensex and Nifty gave better returns than IPO. But if one had chosen IPOs wisely, he would have got good returns.

This brings us to the next part. How do we select a good IPO? The answer is to evaluate the IPO carefully as explained earlier. But does a retail investor have the time and resource is questionable. But, we should keep in mind that there is another category of investor who has all the tools to evaluate an IPO. That category is the QIB. If QIBs are satisfied with the prospects of the issue, it will reflect in the number of times the QIB category is getting oversubscribed. The subscription details can be checked on the website of NSE.

**TABLE 3: CORRELATION BETWEEN QIB SUBSCRIPTION AND RETURN**

| Sector | Name of the issue | Issue price | Closing price | QIB Subscription | Gain in Rs | Gain in % |
|---|---|---|---|---|---|---|
| Metals | Resurgere Mines | 270 | 86 | 1.34 | -184 | -68.15 |
| Financial | REC | 105 | 240 | 39.3 | 135 | 128.57 |
| Capital goods | VA Tech Wabag ltd | 1310 | 1304 | 36.13 | -6 | -0.46 |
| FMCG | Jubilant Food works | 145 | 535 | 59.38 | 390 | 268.97 |
| Energy | GVK Power | 310 | 275 | 33.59 | -35 | -11.29 |
| Retail | Cantabil Retail | 135 | 40 | 1.71 | -95 | -70.37 |
| Technology | Career Point Info systems | 310 | 338 | 45 | 28 | 9.03 |
| Realty | DLF | 525 | 222 | 1.5 | -303 | -57.71 |
| Auto | Porwal Auto | 75 | 9 | 0.21 | -66 | -88.00 |
| Pharmaceuticals | Claris Life sciences | 228 | 183 | 1.4 | -45 | -19.74 |

Source: NSeindia.com

From the above table, it can be calculated that,
Correlation between QIB subscription and return = 0.82326796
Now, that's a high degree positive correlation. It shows that QIBs are very good at evaluating IPOs and they are making very good profits out of it.
There is another set of institutions that evaluates the fundamentals of the company before the company can go ahead of the issue. It is the credit rating agencies.

## WHAT IS 'IPO GRADING'?

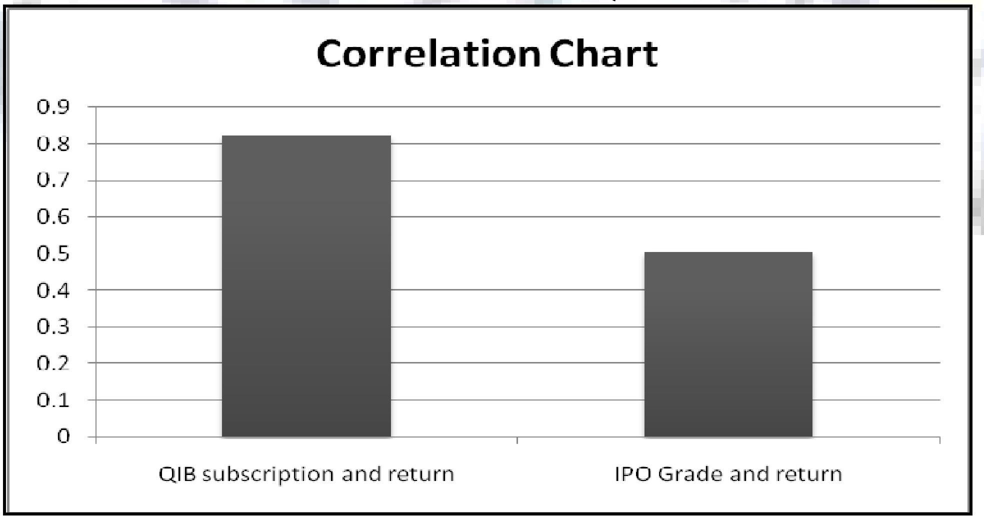
IPO grading is the grade assigned by a Credit Rating Agency registered with SEBI, to the initial public offering (IPO) of equity shares or any other security which may be converted into or exchanged with equity shares at a later date. The grade represents a relative assessment of the fundamentals of 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*
If the CRAs are accurate in giving out grades, then it follows naturally that the correlation between IPO grade and its returns must be 1. But this is not the case. It is because the economic environment keeps changing and this affects the returns from securities. Let's calculate what the actual correlation is.
The data required is presented in the table below:

**TABLE 4: CORRELATION BETWEEN IPO GRADE AND RETURN**

| Sector | Name of the issue | IPO Grade | Issue price | Closing price | Gain in Rs | Gain in % |
|---|---|---|---|---|---|---|
| Metals | Resurgere Mines | 1 | 270 | 86 | -184 | -68.15 |
| Financial | REC | 3 | 105 | 240 | 135 | 128.57 |
| Capital goods | VA Tech Wabag ltd | 4 | 1310 | 1304 | -6 | -0.46 |
| FMCG | Jubilant Food works | 3 | 145 | 535 | 390 | 268.97 |
| Energy | GVK Power | 3 | 310 | 275 | -35 | -11.29 |
| Retail | Cantabil Retail | 2 | 135 | 40 | -95 | -70.37 |
| Technology | Career Point Info systems | 3 | 310 | 338 | 28 | 9.03 |
| Realty | DLF | 2 | 525 | 222 | -303 | -57.71 |
| Auto | Porwal Auto | 1 | 75 | 9 | -66 | -88.00 |
| Pharmaceuticals | Claris Life sciences | 3 | 228 | 183 | -45 | -19.74 |

From the above table, it can be calculated that,
Correlation between IPO Grade and return = 0.503499779.

**FIGURE 2: THE CORRELATIONS CHART BETWEEN QIB AND IPO GRADING**



It can be said that CRAs are right in giving a disclaimer that the IPO grade is not a recommendation to invest or not to invest in IPO. From the two correlations, it can be derived that the returns from an IPO vary more closely with QIB subscriptions.

## CONCLUSION

The performance of an IPO depends on many factors. The most important of these include operational efficiency, future growth prospects of the company and efficient use of funds. Coming out with an IPO is a complex process and it involves a number of parties who work in a coordinated manner to make it a success. It's a general practice to under price an IPO so that it garners enough subscriptions. This makes an investor to think that it's an attractive investment option.

The study analyzed the returns from IPOs that came out in 2010. It showed that a majority of IPOs gave negative returns. Investors who had put their money in these IPOs would be regretting their decision to do so. This study intended to find out simple and yet effective ways to evaluate IPOs. After a thorough analysis of the IPO process, it was found that there are two major indicators that may help an investor to choose the right IPOs. The first indicator is the QIB subscription (Qualified Institutional Buyers). This data is available to all on NSE website and it is updated every day when the offer is open. Investors should choose only those IPO which are getting heavily subscribed by QIB. The second indicator is the IPO grade. This is available in the IPO prospectus. Investors must avoid those IPOs which have received a low grade.

The study compared the returns from IPOs in 2010 with that of Sensex and Nifty. It found that, despite being a risky bet, IPOs gave lesser returns compared to Sensex and Nifty.

## SUGGESTIONS AND RECOMMENDATIONS

1. Caution should be exercised while investing in an IPO. Choosing IPOs based on rumors and hearsay must be avoided.
2. Since the economy is in a recovery stage, there is no dearth of IPOs in the market. Therefore, an investor has to be choosy while investing in IPOs.
3. Investing in a selected few IPOs gives better returns compared to investing in all IPOs. All IPOs which come out in the market are not worth your money. It is better to avoid an IPO if one is not sure about its potential.
4. An investor should keep an eye on QIB subscriptions and choose only those IPOs which are getting heavily subscribed. This will minimize the chances of making a loss to a great extent.
5. An Investor must altogether avoid those IPOs which have been assigned a low grade. By choosing highly graded IPOs, an investor can minimize the chances of making losses.

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Sd/-

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