

## INITIAL PUBLIC OFFER (IPO) PRICING OF SHARES



### Introduction

One of the major roles of Investment banks in IPO Management is Underwriting of IPO. Underwriters not only manage the public issue, It take the risk of buying a company's remaining unsubscribed shares to avoid the failure of IPO process charging nominal fees. If size of the issue is too big and one Investment bank or say underwriter is not able to bear whole risk than more than one bank is hired as Underwriter, group of these banks are called Syndicate. Such arrangement is done by Lead investment banks to diversify the risk of an IPO among multiple banks.

In the syndicate, Lead bank assign quota or say certain percentage of total IPO value to each syndicate member. Suppose ABC Ltd wants to issue 100,000 shares to the public and an agreement is signed between underwriter and ABC Ltd If public issue is not fully subscribed then underwriters will buy the remaining shares up to 50% of total issue. Now Suppose ABC Ltd hire ICICI Bank to manage the Public issue but issue is too large to make marketing, to manage risk and sell all the share of ABC Ltd, Lead manager (Here ICICI Bank) make syndicate with four more banks like Axis Bank Ltd, Central Bank of India, HDFC Bank Ltd. HSBC Securities & Capital Markets (India) Private Ltd to manage the issue , Group of these banks will be called Syndicate . As a lead manager ICICI Bank fix the quota of 20 % to each syndicate bank.

## Methods of Pricing of Shares

While making public issue it becomes very important to make reasonable pricing of a company share. Neither it should be in excess nor lower. If share price is more, there are chances getting low response from public and failure of Public issue, similarly if price is far less than company has to refund lot of capital back to applicants Investor. To avoid such circumstances one should make reasonable pricing of share. Underwriter make valuation of Issuer company at initial stage only. Generally two methods are used – Book value method and discounted cash flow method.

## Book Value Method

In the Book Value method underwriter compare the financials of issuer company with its competitor and check the earnings ,Share Market Price, Price to earnings ratio , P/B Ratio , Price to cash flow ratio and other ratios of that competitor company and accordingly get the estimate book value of Issuer Company. Let's understand with one Example :

No of Share of ABC Ltd	10 L	<b>Book Value – Per share</b>	
Total asset value	20 Cr	Tangible assets	20 Cr
Equity	15 Cr	Less : Liability	5 Cr
Loan	5 Cr	Net Assets	15 Cr
		per value share	150

For Computing the book value only Tangible assets are considered , Non tangible assets are not considered but as far liability is concerned all liability current and noncurrent are considered.

Market value of shares is the perception of the market about a company; generally it is measured through the stock price of a company. Market decides the share Price of a company according to its future prospects . Suppose market value of one share of company in above example is 200, it means public is interested to buy share of this company at premium of Rs 50, it shows good future prospectus of this company .We can Find out market value of this company multiplying share price with No of Shares. In above case Market value of company will be INR 20 Cr ( i.e. 10 Lac share \* 200).

## Discounted Cash Flow Method

In this method one forecasts the earnings and growth going to be in the future of the company. Discounted projected cash flows of certain Years are added to find out the fair value of projected cash flow of coming Years. If the total of this discounted cash flow is divided by the number of shares outstanding one can find the stock price for the company.

## Fixed Price issue Vs Book Building Issue

Once rough estimate of book value of share is done by underwriter, it is decided what type of Issue Company wants to offer: Fixed Prices issue and Book Building Issue?

## Fixed Price Method

Under fixed price method, the company going Public determines Share price at certain amount at which its shares are offered to investors. If any investor is interested to buy company share at that Fixed Price they buy it, Else leave it , there is no price change for any investor . The investors know the share price before the company goes public. Demand from the markets is only known once the issue is closed. Investor must pay the full share price when making the application. In this case demand is not ascertained prior to public issue and qualitative factors, market forces are not considered so there is more risk of failure of Public issue. We can understand this method with an Example

Issue Size of ABC Ltd – 2500 Cr

No of share to be issued – 10 Cr

Issue price- 250/ per share

Fixed Lot size – 50 shares

Min Investment – 12500/-

While making public issue a minimum lot size is fixed for investor. An investor has to apply least for that lot size. Suppose ABC Ltd fixed one lot of 50 share, if any investor willing to invest, he has to apply least for one lot or multiple thereof. If public does not subscribe shares Fully , all efforts made by the company for Public issue get void , In this method there are more chances of getting issue unsubscribed resultant more risk for the issuing company and underwriter.

## Book Building Method

Under this method the company going public offers a 20% price band on shares to investors. Investors then bid on the shares before the final price is settled once the bidding has closed. The final share price is determined using investor bids. Unlike a fixed price offering, there is no fixed price per share, a price-band showing Floor price and cap price is offered to Investor . Suppose in the above example ABC Ltd fixed price band at (225-250) to bid (minimum price is 225 and maximum price is 250), whoever wants to subscribe for shares can bid between 225 and 250. In this method issue size also not get Fixed, A Band is fixed for issue size . For example in above case band of issue size can be fixed at 2250 to 2500 Cr.

In book Building method there is less Risk as underwriter asses the Market demand and accordingly cut-off prices is decided. Qualitative factors, market forces are also being considered while fixing the prices. That's why the book building process is always recommended. In the above example if price is proposed in the range of 225 to 250 and Tick size is Rs 5 then investors can bid at 225, 230, 235, 240, 245 and 250 . After bidding it is assessed how much demand is there at each price range. Suppose in said case , ABC Ltd get the application of following number of share at various price range after closure of issue.

Issue Size – 2500 Cr  
No of share to be issued – 10 Cr  
Issue price- 225-250

Lot size – 50 shares  
Tick Size – Rs 5  
Min Investment – 11250- 12500

Price	250	245	240	235	230	225
Demand ( No of Share in Cr)	4	5	2.5	3	3.5	4

If issuer company fixed cut-off price at 245, than it can sell only 9 cr shares but if share price is Fixed at 240 than it can sell 11.5 Cr shares so for fair play Investment bank fixed cut-off price at 240 in consultation with issuing company, in such circumstance all applicants who bid at price of 240 or more will get the share but though who bid at lower than 240 will not get the shares at all . But applicants who bid at 245 or 250 will be issued share at 240 only and remaining amount has to be refunded to them by IPO Company and investor who bid at less than 240 will be refunded the full amount.

In this method Retail investors are given the option to make an application at a cut-off price. it means whatever cut-off price is decided by Issuer company out of range 225 to 250 , retail investor give acceptance to apply on that prices instead of selecting any price ranging 225 to 250 . But this option is not available for qualified institutional investors and non-institutional investors. Retail investors also have the option to revise the bid. For example, in the above example no demand for shares is coming to IPO company at a given price range. Company sees following demand of its share,

Price	250	245	240	235	230	225
Demand ( No of share in Cr)	0	0	0	1	0.5	4

In such a situation, the Issuer company is given the option to revise the Price band for retail investors, suppose the company fixes the new price band at 220 to 225 , in such case the company has to extend the bidding period by minimum 3 working days . Bidding period can be extended by maximum 10 days following are the timeline for time limit in each case,

Fixed price Method – 3 to 10 days

Book Building Method – 3 to 7 days (can be extended by 3 more days if price band is changed)

Public issue can't be kept open for more than 10 days, company get listed in 3 days closure of Public issue

## Partial Book Building

Partial book building is another variation of the book building process. In this process, instead of inviting bids from the general population, investment bankers invite bids from certain leading institutions. Based on their bids, a weighted average of the prices is created and the cut-off price is decided. This cut-off price is then offered to the retail investors as a fixed price. Therefore, the bidding only happens at an institutional level and not at a retail level. This is also an efficient mechanism to discover prices. Even cost and complications involved in conducting a partial book building are substantially low.

Prior to the introduction of book building, a lot of IPO's were either underpriced or overpriced. This created problems because if the issue was underpriced, the company was losing possible capital. On the other hand, if the issue was overpriced it would not be fully subscribed. In fact, if it was subscribed below a given percentage, the issue of securities had to be cancelled and the substantial costs incurred over the issue would simply have to be written off. With the introduction of the book building process, such events no longer happen and the primary market functions more efficiently.

## COMPLIANCE CALENDER November 2022

GST	
GSTR 3B OCT 2022(Turnover in the previous financial year more than Five Crores)	20-11-2022
GSTR 3B OCT 2022 (Others)	22-11-2022
GSTR 1 OCT (Turnover more than Rs. 1.5 Crores)	11-11-2022
Income Tax	
Deposit of TDS	07-11-2022
ESI	
Payment for the month of OCT 2022	15-11-2022
PF	
Payment for the month of OCT 2022	15-11-2022
Return Filing for the month of OCT 2022	25-11-2022

