JST Investments

April– June 2021 Update

Performance

Particulars	July 2020 to June 2021 (12M)	April to June 2021 (3M)
JST High Conviction PF Return	66.6%	4.8%
Nifty 50 Return	49.9%	5.5%
BSE 500 Return	57.0%	7.9%
No Churn (0 stocks sold)		

A Message from our CIO

Market View

Stock Markets are a like a Pendulum! They move from extreme pessimism to extreme euphoria!

Over the last 6 months markets have run up significantly driven by the abundant liquidity in the system, valuations across sectors have expanded. Poor quality stocks have given more returns when compared to good quality companies!

Needless to say - This is a good time to be careful.

Use this bull market to prepare for a bear market!

Stay away from poor quality stocks/sell them as soon as possible and invest only in good quality companies.

As we had advised in the last letter -

When the market moves irrationally down, do not panic.

When the market moves irrationally up, do not celebrate.

Always be humble - There is a long way to go!

In this newsletter we talk about the Euphoria that is IPO!

Thanks & Regards,
Aditya Shah, CFA
Chief Investments Officer (CIO), JST Investments

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Portfolio Update

Financials

- In the absence of any relief from the RBI, lenders continued to face asset quality pressures and all lenders reported higher NPAs. Banks and NBFCs continued to underperform in the portfolio.
- However, as the economy opened out, the collections of the lenders improved and should be back to normal if there is no 3rd wave.
- We added a micro-finance lender for clients who have the ability to take higher risk.

FMCG

- Companies reported margin pressure due to rise in input costs. All companies reported stable results
- We have added 2 companies to our probable buy list which we will add at an appropriate time.

Information Technology (IT)

- The IT companies reported stable results with the demand remaining very strong for almost all companies.
- Stocks have gone up anywhere between 3-10x.The valuations have become FMCG like in the whole of IT sector and it is time to be careful.

Pharmaceuticals

- Companies continue to do well on the API and CRAMS side.
- Generic companies continued to face pricing pressure.

Cyclicals

- Commodities have seen a massive bull run over the last 6 months. However, many of the stocks have run up so fast that they are in a zone where they cannot be even looked at as of now!
- Auto Ancillaries form a significant part of the tactical side of the JST High Conviction portfolio. While two of them have done extremely well, others should also do well as time goes on.
- All of them have been bought at significantly cheap valuation!

The Euphoria called IPO!

What is an IPO? When do companies tap the markets for money?

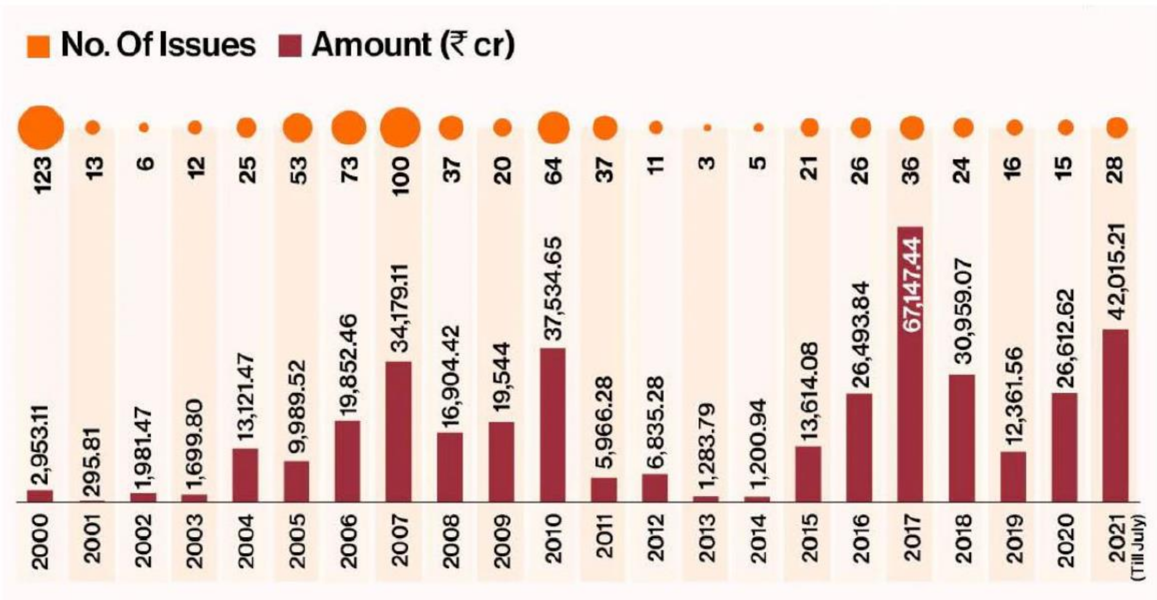
Initial Public Offering (IPO) is the process in which a private company or corporation becomes public by offering its shares (a stake) to the investors at large.

Generally, companies which need capital to grow tap the public markets to raise money.

In 1990s and early 2000s many companies tapped the IPO markets like Hero Honda, Infosys, HDFC Bank etc. All of these companies used the money raised from the issuance of the shares to further enhance the growth prospects.

The current IPO scenario

In FY22 till July, 28 issues have raised Rs 42015 Cr. With the kind of lineup ahead (LIC, Paytm, Nykaa, Policybaazar and dozens of more), it is expected that this year will see the highest ever fund raise by IPOs in a single year. The Highest amount of capital ever raised via IPOs was Rs 67147 Cr by 36 issues in 2017-18.



Source: Prime Database

Why is there a mad rush to raise equity capital?

Over the past year there was a COVID-19 pandemic and to re-ignite economies across the globe, interest rates have fallen to historic lows. Thanks to this there is a gush of liquidity sloshing across the system.

This increase in liquidity has given rise to a massive bull run in stock prices across the world. Valuations across sectors remain in a heated zone. The market continues to be incredibly kind even to companies with poor fundamentals.

Some Bankrupt companies have seen the stocks rise to the extent of 300%-5000%!

In such times of mass euphoria, Investment bankers can fetch a far greater premium for any kind of a company. Looking at recent subscriptions and recent listing premiums, investors are thinking of IPO as a quick lottery and companies are rushing to file their DRHPs to tap the market madness and get a big premium for their stake.

Loss making companies, companies that are still under corporate debt Restructuring, companies with very short or doubtful history, companies with high levels of debt and companies that don't even need a single rupee of funds are lining up for IPOs!

The Curious Case of the Grey Market Premium (GMP)

GMPs seem to drive the actual IPO euphoria amongst retail, instead of the actual underlying fundamentals of the company. Listing gains are driven by some GMP operators!

Most of the times GMP is just a useless figure and doesn't tell anything about the company as we see below.

Examples – Rpower GMP was supposedly 80%, but we all know what happened on listing. The operators jacked up the demand by paying brokers when the company had 0 fundamentals.

SBI Cards had a very good GMP of Rs 300 (issue price was 750 -755) but due to COVID, GMP vanished and stock listed at a discount of Rs 661!

Mahindra Logistics GMP was strong one day before the listing day. On the listing day, the GMP went to 0 in a few minutes as it was the Gujarat election outcome. BJP was losing seats but then counting took a U-turn, and BJP was shown in lead and hence the stock listing also recovered to list at par!

Gland Pharma GMP was just Rs 10 on an issue price of Rs 1500, but the stock listed with a good premium and gained thereafter too. Currently trades at Rs 4275

Valuations now have little meaning!

Most of the companies that listed recently or are coming for listing are demanding astronomical valuations in the name of narratives and imaginary numbers.

IPO Name	Profitability	Valuation
Zomato	Loss Making	Now Rs 1 lakh crore
Car Trade	Listing on 23rd Aug	23x Price to Sales
PayTM	Loss Making	Rs 1.9-2.2 lakh crore

New Age companies or the Startup Frenzy!

<u>The recent listings of new age tech startups are indeed a monumental victory for the Indian startup ecosystem. However, all good things end there.</u>

For instance, Zomato did not even laydown any vision of how they will turn profitable. They did not even clearly explain how had they arrived at a valuation for the IPO!

Post Listing, they say they will only do one call yearly. They used to do a call more frequently before with their PE investors! The level of metrics disclosed in their recent results was also poor!

Why this differentiation between PE investors and public investors?

While listing of new age tech start-ups is great but buying at any price is a disastrous strategy.

Mutual Funds launching IPO focused scheme

To cash in on the IPO boom milk the investor FOMO, some mutual funds are bringing in Mutual Funds schemes which only invest in IPOs. But all of them are narratives as we see below

Table 1 – Companies that IPOed since 2010 (a total of 301 IPOs)

Particulars	No. of IPOs	Percentage of IPOs
Positive Returns from Issue Price	156	51.80%
Negative Returns from Issue Price	145	48.20%

Table 2 – Companies that IPOed since 2010 but removing companies with <3 years listing (a total of 237 IPOs)

Particulars	No. of IPOs	Percentage of IPOs
Positive Returns from Issue Price	100	42.20%
Negative Returns from Issue Price	1.7	57.80%

From Above data, it becomes clear that through IPOs you had a less chance of picking a winner. If we take into account only those IPOs that have outperformed Nifty, then the odds become even less! All those IPOs are narratives after all!

Finally, the Biggest Problem with the current IPO frenzy

Most of the money raised in the IPOs is being used to fund promoter/PE exits. A good amount of money raised in IPOs in 2021 was a pure offer for sale meaning none of that money went to the company!

Companies get little money to keep for future expansion and growth prospects. Little money will be ploughed back into the economy which will spur on growth.

Effectively, IPO investors are now financing spectacular returns for PE investors, promoters or exiting shareholders, etc. and will be the ones left with the shares as and when this bubble bursts.

Conclusion

There is an extreme Euphoria in the IPO market -

1. Any kind of a company is coming for an IPO
2. Valuations are of little meaning
3. GMP drives the listing day/near term returns
4. IPO investors are funding the PE/promoter exits with spectacular returns for them.

In 2007 It was reliance power and in 2017 it was companies like Shankara!

Only when the bubble bursts will the investors realize what a frenzy the IPO Market is!

If you have any queries about your portfolio, about JST Investments or Investing generally do reach out to us –

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