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Boom times

International equity markets are storing up a huge opportunity for Indian companies to raise equity finance outside India in 2010

Bankers in London, where the primary markets – leaving aside rescue rights issues – have been near-moribund all year, are gaining confidence that their own IPO market will re-open in early 2010. They have written off 2009 and are allergic to any talk of IPOs in the next three months, but are now a lot more interested in talking to companies from India and elsewhere about longer term plans for coming to market.

The conventional view about emerging market IPOs is that they are always at the back of the queue when the international equity cycle begins to recover. Institutional investors with a remit to invest worldwide want to start cautiously by buying new issues from well known management teams close to home, the theory goes, and more risky emerging market issuers are welcome only when the party is really heating up and the buy-side have begun to lose their inhibitions.

The adventures of Indian real-estate promoters on the London market from late 2006 certainly fit this stereotype: they raised their funds months after residential and commercial property prices worldwide had started to melt down, and the share prices of their new funds crashed promptly after the offerings had completed. It's not just the hangover that hurts investors, but the memory of those last two or three ghastly drinks that brought it on so badly.

It looks as if things will work differently when the IPO market in London fully recovers. The primary market everywhere is driven by prospects for earnings growth. Where is this going to come from in Europe, Japan and the US in the next couple of years? Certainly there will be isolated areas of rapid earnings growth like cleantech, or value-for-money retail formats. But in a world where most economies are still distorted by having specialised in either consuming or investing far too much in the past decade, there is little hope of sustainable gains in profits across a broad range of industries worldwide.

The exceptions are big emerging markets, as the numbers for IPOs in this drought year of 2009 demonstrate. Approximately $20 billion has been raised by Chinese companies in Hong Kong, Shanghai and Shenzhen so far this year. India's IPO count weighs in at about $2.5 billion. That compares with $1.5 billion of IPOs in London so far this year, and approximately $7 billion in the US (some of that for non-US companies like China's Shanda Games, which at over $1 billion has just completed the largest IPO to be done in the US this year).

The IPO numbers are just one more of the many signs that the two-century era of disproportionate US and European weight in the world economy is ending fairly quickly. An important practical effect of the accumulation of greater economic power by China, India and other leading emerging countries is that as a whole they appear less risky to global investors. And those countries like India and China that have self-insured against currency crises through reserve accumulation have further narrowed the risk premium that used to confine them to the end of the queue of new issuers.

With the IPO market inside India back on track, and confidence returning to the worldwide institutional investor base, India-related initial offerings in London, New York, Singapore or other international stock markets will be feasible again soon, after a nearly two-year break. There is a big opportunity here for Indian groups that have Indian and international assets and ambitions that they want to finance with an international rather than a domestic capital structure.

But it would be a mistake to assume that Indian IPO candidates in international markets can simply pick up where they left off a couple of years ago. Investors will be very wary of small offerings by small companies that are certain to be illiquid, and that are effectively private placements with public disclosure. There will always be brokers who say they can get this sort of deal away, and some can, but anyone planning this kind of deal, in the $30 million or less range, for 2010 may well be wasting their time. The market needs to re-open with offerings that raise $100 to $150 million or more. Other tests include a clear strategy for accessing international rather than domestic stock markets, preferably motivated by ownership of significant assets outside India. And, of course, a management team that already fully understands their responsibilities to outside investors, and is not planning to learn on the job. ◆