Future of Tech IPOs in India

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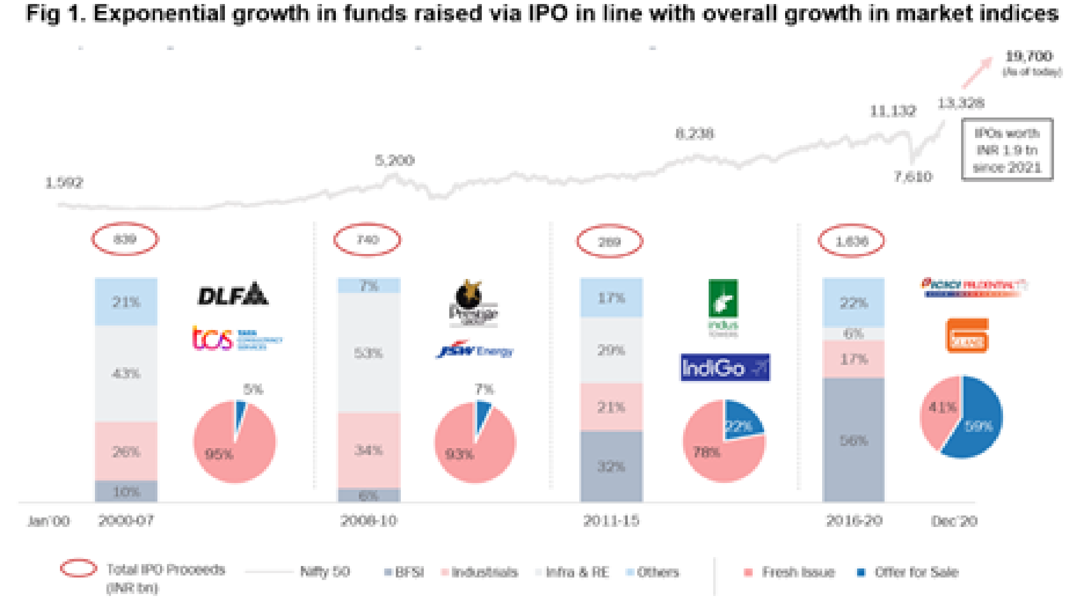
The past decade has been momentous for the Indian economy culminating into India becoming the 5th largest economy in the world. This pace of development has been on account of various tailwinds like an almost doubling of the GDP from ~USD 2 Tn in 2014 to ~USD 3.7 Tn in 2023 and FDI inflows of USD 600+ bn. Multiple government policy initiatives like Make in India, GST, PLI Scheme and Digital India have given a fillip to the economy transforming it rapidly into a digital one with digital transactions having a lion's share of 55% of the GDP in FY22. This has also led to India's emergence as the 3rd largest ecosystem for startups globally producing 100+ unicorns with a total valuation of USD 340+ Bn. Till FY17, approximately one unicorn was added every year, but since then this number has increased manifold across diverse sub-sectors like fintech, edtech, e-commerce, SaaS etc. Of all the unicorns in India, 41% were born in 2021 alone and 19% in 2022. Another theme that has emerged in the Indian markets is listing of companies in newer sectors like affordable housing finance, microfinance institutions, specialty chemicals, insurance and AMCs and market infrastructure institutions, amongst others.

Development in the overall economy was also reflected in the primary and secondary markets performance. India has witnessed tremendous growth in funds raised through IPOs coupled with Nifty 50 growing at a 12% CAGR (Fig 1). Different themes have emerged in the IPO market over time with the average IPO size increasing significantly from INR 400 Cr to INR 1,500 from 2004-10 to 2017-20. The OFS component in IPOs have increased from a meagre 5% in 2000-07 to a substantial 59% in 2016-20, with more private equity funds starting to monetize their stakes through IPOs. Newer instruments and asset classes have emerged with the introduction of REITs and InvITs attracting a new set of yield focused investors to the country.

Fig 1. Exponential growth in funds raised via IPO in line with overall growth in market indices



Fundraising activity from PE-VCs, which had started gaining momentum over the past decade, remained robust in 2021 with PE-VC investments in India peaking at ~USD 70 Bn with 2,000+ deals being signed. As these companies matured and gained significant scale, many of them have also started exploring public markets. The year 2021 ushered in the era of New-Age Tech Company ('NATC') IPOs in the Indian markets with companies across various tech sub-sectors raising funds aggregating to USD 5+ Bn. These IPOs, predominantly being FII led with strong DII and retail participation, were highly oversubscribed (10x to 45x), indicating strong investor interest; double-digit listing day returns bear testament to this fact. With these tech companies emerged another important concept of professionally managed companies – the concept of 0% promoter holding. This was otherwise rare in India, with the average promoter holding in top 500 listed companies being ~50%.

Fig 2. Major tech IPOs in India in 2021

The IPO euphoria in India in 2021 could be attributed to a few factors such as a liberal interest rate environment across the globe, leading to high liquidity chasing fewer investment opportunities. This was in tandem with various tweaks introduced by the market regulator SEBI in its regulations making certain exceptions for loss-making start-ups to also access the capital markets. 2021 also saw IPOs across various other sectors on the back of a China+1 strategy adopted by foreign economies, along with strong earnings and abundant liquidity.

However, with the Covid-19 after-effects playing out in the form of interest rate hikes across the globe to rein in inflation coupled with volatile markets due to geopolitical tensions, overall IPO activity in India also witnessed a slowdown. Despite that, 2022 witnessed India's largest ever IPO by LIC of USD 2.7 bn, predominantly led by DIIs. Mid-sized industrial IPOs continued to gain traction, mainly on account of the global movement away from China. Unlike FIIs which rode the IPO wave in 2021, DIIs played a major role in anchoring IPOs in 2022. Even the investor approach underwent a change with the focus shifting from not just growth but towards a clear path to profitability. Only one tech company, Delhivery, got listed in an extremely tough market environment in 2022, being subscribed only 1.6x times and seeing a meagre 10% listing day return, a marked difference from its counterparts in 2021.

Fig 3. Share price performance of listed tech companies

Prices are indexed to 100

With a shift in investor mindset towards profitability and positive cash flows, tech companies which had surfed the waves of euphoria in 2021 also started seeing corrections in their share prices starting end of 2021 (Fig 3.).

Fig 4. Recent block deal transactions in tech companies

That said, we've now slowly and gradually started witnessing some green shoots with secondary markets in the tech sector starting to get active with block trades of ~USD 3 bn, indicating strong belief of top FIIs, DIIs and Sovereign Wealth Funds ('SWF') in tech business models (Fig 4 & 5).

Fig 5. Top investors in Indian listed tech companies across investor classes:

Empirically, secondary market performance is a leading indicator of primary market activity and accordingly, we expect IPOs of tech companies to gradually pick up pace in the coming quarters. On a holistic level, secondary markets witnessed considerable action over the past quarter with FIIs being net buyers of Indian equities worth ~USD 11.4 bn in Apr – Jun '23. Along with the increasing participation of FIIs, DIIs have generally increased their holdings in Indian listed tech companies in the past three quarters (Fig 6.).

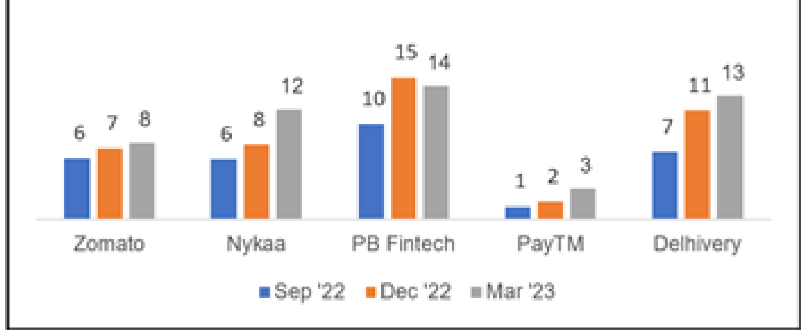


Fig 6. DII holdings (%) in Indian Tech Cos over time

Given that investors have seen the performance of these tech companies for two years now, they have a better understanding of their business models and key drivers. Investors' focus has gradually shifted from growth towards profitability. Understanding this, companies have accordingly started to work on improving their profitability metrics which has also started reflecting in their share prices as they have jumped by an average of 15 – 20% over the past three months (Fig 7.).

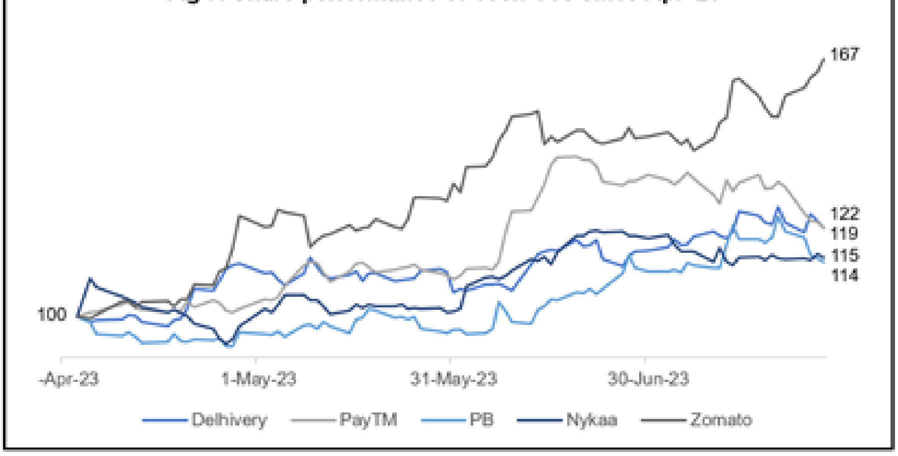


Fig 7. Share performance of Tech Cos since Apr '23

Prices are indexed to 100

Accordingly, the bar for acceptance of tech IPOs has risen as most IPO-bound tech companies are not profitable yet. Based on feedback received from the investors, such tech companies are pivoting towards achieving steady positive cash flows and profitability for at least 2-3 quarters to build investor confidence and appetite before approaching primary markets. These tech companies have essentially started living a public life in a private environment to make themselves ready for capital markets when the opportunity arises.

Visualizing the IPO journey in advance is an important prerequisite for IPO-bound companies, which needs to start 2-3 years in advance by setting up strong ERP systems, appointing quality auditors, having a well-defined capital allocation strategy, consistency in disclosures, engaging with public market investors etc. Based on our constant interactions with tech companies planning to approach the primary markets in the near future, they are getting themselves IPO-ready by taking steps to meet all the relevant regulations, identification, and appointment of key agencies etc.

As a number of new age tech companies operating in India are domiciled abroad, getting listed overseas is always an option open to them. However, very few Indian tech companies have resorted to this alternative despite record number of global tech IPOs. They have instead expressed their belief in the India story by showing their willingness to be patient and approaching the Indian primary market in the next 6-12 months rather than hastily getting listed. In fact, some companies are even exploring the process of redomiciling to India to be listed on Indian exchanges. This is a strong indicator of the resilience of Indian primary markets for new age tech companies. Indian companies also gain strong branding and publicity benefits by getting listed in India instead of abroad, thereby strengthening their positioning in core markets.

Even the market regulator SEBI has taken steps to safeguard the interests of investors investing in these companies. It has come up with regulations for increased disclosure of IPO pricing and KPIs shared with investors during previous rounds, ensuring information symmetry to public market investors. In order to ensure founders' skin in the game, SEBI has even been recommending that if such founders hold more than 10%, individually or collectively with relatives, then they be identified as promoters. Shortfall in the minimum promoters' contribution of 20% in such cases shall have to be met by other institutional investors. The regulations pertaining to lock-in of anchor investors has also been modified, requiring 50% of their investment to be locked-in for a higher period of 90 days in place of 30 days, thereby ensuring anchors to stay invested for longer and witness the story of the investee company play out in a longer term.

Compared to various macro headwinds being faced by global peers, India's economic trajectory is better placed with comparatively lower inflation than global average. Specifically on the tech side, the drivers include a large 600+ million internet user base, impetus given by the government to fintech, digital infrastructure as well as introduction of new initiatives like Open Network for Digital Commerce ('ONDC') (Fig 8.).

Fig 8. Select Indian government tech initiatives:

ONDC	ONDC is the world's first inclusive large scale e-commerce system. It is a set of specifications designed to foster open interchange and connections between shoppers, technology platforms and retailers.
#startupindia	Under the Start Up Indian initiative, eligible companies can obtain recognition as 'start-ups' from Department for Promotion of Industry and Internal Trade ('DPIIT') to access various tax benefits, IPR fast tracking, easier compliance, among others.
Digital India Power To Empower	Digital India campaign was launched in 2015 to make government services available to citizens electronically by improvements in online infrastructure and internet connectivity as also to empower the country digitally in the technology domain
UPI	UPI is an instant payment system developed by National Payments Corporation of India ('NPCI') to facilitate inter-bank peer-to-peer and person-to-merchant transactions

The last few years have seen the emergence of ESG as an important investment theme globally amongst institutional investors. While India has been slower compared to its global counterparts in adopting ESG, the pace of adoption has now increased, to comply with various norms/ initiatives by SEBI. ESG compliant new age tech companies in India shall now have an edge over others in accessing primary markets especially considering the fact that a few Indian tech companies have come under the scanner for their governance practices. High standards of governance can prove to be an important differentiating factor in the eyes of the investors who are currently extremely selective in deploying their funds.

Overall, the primary markets have received considerable attention in 2023 with recently listed companies trading at a significant premium to their listing prices. Adding to this is the increase in the number of DRHPs filed with SEBI across sectors in the last two quarters, which goes on to show that more companies are gearing up to raise capital from the primary markets in the next 6-12 months.

As per our estimates, we expect IPOs of USD 50-70 bn to hit the Indian markets by 2028 across sectors, led by technology, healthcare, BFSI, consumer and industrials. As the Indian GDP is expected to reach USD 5 Tn by 2028, we expect FII and DII inflows to also increase and part of such proceeds would go to fund the future IPOs. At the same time, with PE-VC investors expected to exit investments worth USD 10-15 bn each year, we believe a significant chunk of these exits to come via IPOs. As PE/VCs have a substantial amount of their investments in tech companies, the next 5 years will see several tech IPOs in the Indian primary markets.

Going forward, we believe there is adequate appetite for tech companies in Indian public markets with robust business models, a clearly defined path to profitability and strong corporate governance frameworks. In the coming quarters we expect increasing number of tech companies to approach public markets providing an attractive opportunity for public investors to play the India tech story.