Dalal Street Journal's

STOCK MARKET BOOK

MAXIMISE RETURNS
on your
INVESTMENT

Contents

DALAL STREET

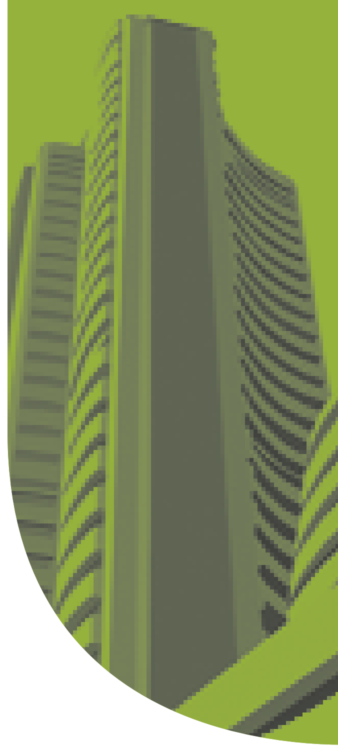
Contents

11. Loan funds
12. Secured and Unsecured loans
13. Application of funds
14. Understanding gross block and depreciation
15. Profit and loss account
16. Manipulation of profit and loss account
17. Director's report

5. How To Do Fundamental Analysis?

In this Chapter you will know about:

1. Fundamental analysis
2. General steps to fundamental evaluation
3. Importance of fundamental analysis
4. Method of fundamental analysis
5. Difference between fundamental analysis and technical analysis
6. Stock market related ratios
7. Profitability ratios
8. Liquidity ratios
9. Activity ratios
10. Importance of EPS
11. HEPS and CEPS
12. Importance of dividend
13. P/E ratio
14. Book value
15. Choosing rights and bonus issue companies
16. Sick or take over companies
17. FERA companies



6. How To Apply The Principles Of Technical Analysis?

In this Chapter you will know about:

1. Computing stock market index
2. Rationale of technical analysis
3. Dow theory
4. Price Vs volume change
5. Advance - Decline Line
6. New High and New Low indicator

Contents

CHAPTER

ONE

How Stock Market Fuctions?


The stock market is bullish these days!!
Yes, they really are.
What is a stock market daddy?
Stock market is like any other market.
Its just a place where buyers and sellers meet.
Only the nature of goods dealt with is different from here.

Chapter 1

Going through a book on the stock market is quite an experience. You skip few paragraphs, flip through pages, get foxed by the mathematical expressions and finance jargons and finally conclude, "This book is too academic". And your queries remain unanswered!

The question that hovers in your mind is, can a layman without any finance background understand the stock market?

Certainly. You just need to understand the basics of investment.

What are the basics of Investment?

The money you earn is partly spent and the rest saved, for meeting the future expenses. If you keep your savings idle its nominal value remains the same but real value decreases by prevailing inflation. This can be defined by the following formula:

Real rate of return = Nominal rate of return - Inflation

Instead of keeping the savings idle, you park it somewhere to get a return on this capital in the future. This is called an investment. There are various avenues for investment. You may invest in the bank deposits, postal deposits, real estate, jewelry, paintings, life insurance, tax savings schemes likes PPF/NSC or stock market related instruments called securities like shares, debentures, bonds, etc. However, the return from each investment option depends on the associated risk. The riskier the investment, the higher will be the return. For instance, stock market related investments are risky, but makes you earn more returns than other modes of investment.

What are the benefits of investing in the stock market?

Stock Market investments offer you benefits like easy liquidity, flexibility of amounts invested/disinvested, reasonable returns and a regulatory framework to safeguard your rights. Shares are the most popular form of stock market investments due to their higher potential for capital growth.

Bank of India

The first bank to open a branch outside India in London in 1946

In the long run it is empirically found that investment in equities gives maximum return.

PRESENT VALUE OF RS 1 LAKH (INVESTED IN 1992)		
Mode of Investment	**Value of Rs1 Lakh**	**Remarks**
Bank Fixed Deposit	Rs. 3,79,535	Calculated on the basis of prevailing average different bank rates in 1992-97 (11 per cent), in 1997-2002 (11.5 per cent) and in 2002-08 (5.5 per cent)
SBI-MF Magnum Tax Gain (1993)	Rs. 4,89,300	Mutual Fund Scheme started in 1993
Gold	Rs. 2,61,000	In January 1992, the price of gold was Rs.4,200 per 10 gram and in January 2008 the price of gold is Rs.11,000 per 10 gram
Property	Rs. 5,00,000 to Rs.7,14,000	In 1992, the rate of real estate in Nariman Point Mumbai was Rs.7,000 per sqft and in January 2008 the rate of same property was Rs.35,000 to 50,000 per sqft
Sensex	Rs.10,30,346	In January 15, 1992 Sensex was at 2020 and on January 07, 2008 Sensex was at 20813
(Values are calculated on the basis of prevalent average rate in case of property and gold while value for the mutual funds is calculated on the basis of returns/dividend given by the bank)		

"A stock broker is one who invests other people's money until its all gone"

Woody Allen, *American Film Maker*

What is a share?

A Share or stock is a document issued by a company, which entitles its holder to be one of the owners of the company. A share is directly issued by a company through IPO or can be purchased from the stock market. By owning a share you can earn a portion of the company's profit called dividend. Also, by buying and selling the shares you get capital gain. So, your return is the dividend plus the capital gain. However, you also run a risk of making a capital loss if you have sold the share at a price below your buying price.

What is a company?

A company basically means a group of persons associated together for achieving some objectives. The term company means a company formed and registered under the Indian Companies Act 1956.

As company is a voluntary association of persons its capital is divisible into parts which are known as shares with limited liabilities. A company exists only in contemplation of law and it has no physical existence.

What is a company's legal identity?

A company is considered as a juristic person with a perpetual succession and a common seal. Its life does not depend upon the life of its members, who can change from time to time. On registration, a company acquires a personality distinct from its members.

A company can sue and be sued in its own name. It can institute and defend suits and other legal proceedings in its own name.

A company has limited liability. The privilege of limited liability for business debts is one of the principal advantages of doing business in the corporate form. In a company limited by shares, liability of the members is limited to the unpaid value of the shares, whereas in a company limited by guarantee, liability of members is limited to such amount as the member may undertake to contribute to the assets of company in the event of it being wound up.

Can you tell me about the financial cycle of the business?

Earlier when the companies did not have the access to the primary market they had to borrow funds to raise the necessary money. But, after the popularization of the securities market (specially after 1980's) the Initial Public Offering of equity shares or IPO has become the favourite method for financing. However, before a company approaches the securities market in order to raise money, it has to go through various stages of financing.

When an entrepreneur wishes to start a business, he raises money in the form of 'seed capital'. For this he may offer certain shares in the business to the people who have contributed for this initial capital. Since at this stage the capital required is limited the entrepreneurs prefer the seed capital

Sir Chintaman D. Deshmukh

Was the first Indian to become the RBI governor

"Trifles make perfection and perfection is no trifle"
Michaelangelo,
1475 - 1564
Italian Artist

to be raised in the personal capacity. In general, at this stage the business entity is known as sole proprietorship or a partnership as the business is closely held and by a single person or a small group of persons.

When the business expands, the need for finance increases. When the business is reasonably established the Venture Capitalists start to take interest in the entity and they look for the investment opportunities. In the return of money invested the venture capitalists usually are given shares or warrants. The company could remain a Private Limited Company at this stage as it is still closely held and owned by a few people. There should be at least two shareholders in a private limited company. The venture capitalists are those people who look for higher profit and are prepared to take higher risk for it.

Now if the business expands further the need for finance rises to the level where the company has to go to public in order to realise their expansion or diversification plans. At this juncture they take the IPO route.

How do shares come into being?

Any business is owned either by a single promoter or joint promoters with an unlimited liability, or a group of people (both promoters and non-promoters) with a limited liability. Limited liability means, in case of bankruptcy of the company, the owner's liability will be limited to the extent of their individual contribution towards capital. These three forms of the business organizations are called proprietorship, partnership firm and limited company respectively.

Since each owner has his own share of contribution towards the owner's capital (also called equity), each of them is given his legal entitlement to share the ownership of the company in the form of document. These documents are rightly called shares and the owners are shareholders. A limited company is either called a public limited or a private limited company depending on its turnover and number of members in its board. Among public limited companies, the companies with their shares widely held are listed in the stock exchanges, and the shares of only these limited com-

Chapter 1

SBI

The largest Commercial bank in India

panies are traded.

All public limited companies are started privately by a promoter or a group of the promoters. But, the promoters' capital and the borrowings from banks and financial institutions are not sufficient for financing the project or setting up a business. So, these companies invite the public also, to contribute towards the equity and issue shares to these individual investors through initial public offering (IPO). A company is run by a Board of Directors - who are shareholders' nominees - but are generally controlled by the promoters.

What is a General Body Meeting (GBM)?

It is a meeting of the shareholders, and being the most powerful body of any company, the GBM takes all the decisions regarding the working of the company. Held annually, this meeting is also called the Annual General Meeting (AGM), and discusses among other issues, the performance of the company in the previous accounting period and even finalizes the accounts. The AGM also appoints Auditors and Directors for the company, approves of the dividend declared by the company (it also has a right to lower the dividend). Statutorily, the period between two AGMs should not exceed 18 months.

The AGM has the authority to pass resolutions empowering the Board of Directors to take important decisions regarding the day-to-day working of the company. Companies often convene the GBM in between two AGMs to take important decisions. This meeting is termed as Extraordinary General Meeting (EGM). The proposal to declare a bonus or rights issue and the ratio thereof are put forward to the AGM/EGM and approved by the shareholders. In case of a rights issue, the premium of conversion, the instrument and other terms are also approved from this meeting.

Are there any instruments other than shares (IPO) available for the company to raise the funds?

Yes, the fresh issue includes equity shares, debentures or

“Average investors who try to do a lot of trading will only make their brokers rich”

Michael Jenson,
Finance Professor -Harvard

some kind of hybrid instruments. These securities may be issued in the domestic market or in the international market. In case of international market the funds are raised through ADR/GDR/FCCB/QIP route.

Apart from raising fund through IPO/FPO the companies can raise fund by issue of debt in the form of Debentures. Companies also can offer Warrants as a part of their new offing. Warrant is an instrument which can be converted into equity shares at the choice of investor at a certain predetermined price and quantity at a specified time in the future. There is no obligation involved on the buyer in case of warrant.

The companies also can raise funds in the foreign markets. Foreign currency loans can be availed from the foreign banks or foreign financial institutions. The other means of raising funds in the international market is the approaching public and NRIs abroad. This helps companies to diversify their investor base and build its profile in the international market. This also offers flexibility in terms of shifting between fixed/floating rates and switching between currencies.

Indian companies are permitted to raise foreign currency through following two main resources:

- Issue of Foreign Currency Convertible Bonds (FCCBs)
- Issue of ordinary equity shares through depository receipts, i.e., Global Depository Receipts (GDRs) and American Depository Receipts (ADRs)

Both the FCCBs and Depository Receipts (ADR/GDR) are convertible to equity shares at the option of investor. Because of this these carry lower interest rates in comparison to similar non-convertible debt instruments. FCCBs/ADRs/GDRs issued by the companies to the NRIs have free convertibility outside India. In order to improve liquidity in the ADR/GDR market RBI has issued the guidelines in 2002 to allow two-way fungibility in ADRs/GDRs. This implies that the investors can convert their holdings from ADRs/GDRs into shares and vice versa. In order to issue shares in the overseas market the companies are required to register themselves in the concerned market and would be subjected to the laws prevailing in that market.

What is the difference between debt and equity?

Following are the differences between debt and equity:

Debt	Equity
Debt instruments do not give ownership rights to holders	Equity instruments entitle the holders to own part of the business
Interest is payable	Dividend is payable
Interest is legal obligation to pay	Dividend is not legally necessary
Debt holders get preference in case of dissolution of company	Equity holders are paid only after all other obligations are met
Interest not paid is carried forward	Dividend cannot be carried forward

Tell me more about the stock market?

This is an organized set-up with a regulatory body and the members who trade in shares are registered with the stock market and regulatory body SEBI. Stock markets exist in different cities all over the world with each market having a different set of "listed" shares. Thus, the shares listed in the Bombay Stock Exchange (BSE) will be different from those in the Delhi Stock Exchange (DSE), because a company may not want to be listed in a particular stock exchange or may not fit the eligibility requirements of the particular exchange.

The stock market is also called the secondary market as it involves trading between two investors.

Give me a brief history of Indian Stock Market.

The history of Indian stock market is about 200 years old. Prior to this the hundis and bills of exchange were in use, specially in the medieval period, which can be considered as a form of virtual stock trading but it was certainly not an organized stock trading. The recorded stock trading can be traced only after the arrival of East India Company. The first organized stock market that was governed by the rules and regulations came into the existence in the form of The Native Share and Stock Brokers' Association in 1875. After gone through numerous changes this association is

Sir Benegal Rama Rau

Was the longest serving RBI governor, 1949 - 1957

"Success in business does not depend upon genius. Any young man of ordinary intelligence who is normally sound and not afraid to work should succeed inspite of obstacles and handicaps if he plays the game fairly and keeps everlastingly at it"

J.C. Penney
1875 - 1971, American Retailer

today better as Bombay Stock Exchange, which remains the premier stock exchange since its inception. During this period several other exchanges were launched and some of which were closed also. Presently, there are 19 recognized stock exchanges out of which four are national level exchanges and the remaining are regional exchanges. National Stock Exchange, established in 1992, was the last exchange.

Although the regional level exchanges are in existence the volume of trading in these exchanges is negligible. National Stock Exchange and Bombay Stock Exchange are the leaders of Indian Securities Market in terms of listing, trading and volumes.

The last 15 years of the Indian securities market can be considered as the most important part of the history where the market gone through the post liberalization era of Indian economy and witnessed the formation of Securities and Exchange Board of India (SEBI) which brought substantial transparency in share market practices and thus managed to bring in trust of not only domestic investors but also the international ones.

What are the primary and secondary markets?

There are two mediums for investors to acquire shares from the primary and secondary markets. In the primary markets, securities are bought by way of the public issue directly from the company. In the secondary market shares are traded among investors. We shall discuss the primary market operations first.

Who are the market players?

Investors: Retail or individual investors, Partnership/HUF, Societies and Trusts, Companies, Mutual Funds, Financial Institutions and Foreign Institutional Investors

Issuers of Securities: Companies (Promoters), Corporate Bodies Government and Mutual Funds, Banks

Intermediaries: Investment Bankers (Lead Manager), Registrar to an Issue, Bankers to an Issue, Credit Rating Agencies and Depositories

Regulators: RBI, SEBI, Ministry of Company Affairs

Appellate Tribunals: SAT, National Company's Law Appellate Tribunal

Apart from these, each companies appoints legal counsel and auditors who are not referred as intermediaries. Their work includes conducting due diligence, drafting legal parts of the prospectus, various agreements and providing legal opinion and assistance in closing the issue.

Elaborate on various types of investors.

The investors can be categorized as follows: Individual investors, Partnership/HUF, Societies and Trusts, Companies, Mutual Funds, Financial Institutions and Foreign Institutional Investors

Individual investors: Individuals form a major part of the securities in terms of numbers. The individual investors are further divided into two categories in case of IPO: Retail investors who can apply for share of an amount less than Rs 1 lakh) and High Networth Individuals (HNI) who can apply for shares of an amount Rs 1 lakh or more.

The share of the retail investors in an IPO is 35 per cent and that of HNIs is 25 per cent. Thus according to SEBI regulations retail investors are preferred over the other types of investors.

Partnership/HUF: Association of members or partnership formed by various groups or a joint family come together to invest their surplus fund in order to earn returns fall into this category.

Societies and Trusts: These are also associations of persons. But they have to be empowered by their by-laws to invest in the security markets. Here the income earned by such investment should be invested for the objectives for which the society or trust is formed.

Companies: Also termed as corporate investors, companies can also operate as individual investors for which the board should be authorised by the Memorandum of Articles.

Mutual Funds: It is a form of collective investment. A mutual fund collects money from many investors and invests such pooled fund in share market. Income is

90 Million

The number of customers served by SBI

"To the investment manager, soft dollars are someone else's money and hard dollars are your own"

Dean LeBaron, *ibid*

received in the form of capital gains, interests or dividends on securities. (Further details in Chapter 08 Mutual Funds)

Financial Institutions: They are the major investors in terms of volumes and values in the securities market both in the primary and secondary market. These include banks, insurance companies, pension funds and venture capital companies.

Foreign Institutional Investors (FIIs): This is an entity formed or incorporated outside India with the purpose to invest in India. These entities are required to be registered with SEBI as FIIs.

As per SEBI regulations an FII cannot invest more than 10 per cent of total issued capital of an Indian company. These prescribed limits are subjected to the overall limit of 24-49 per cent or the sectoral limit as prescribed by the Government of India/Reserve Bank of India.

What do you mean by Qualified Institutional Buyers (QIBs)?

Qualified Institutional Buyers are those institutional investors who are generally perceived to possess expertise and the financial muscle to evaluate and invest in the capital markets. In terms of clause 2.2.2B (v) of DIP Guidelines, a 'Qualified Institutional Buyer' shall mean: Public financial institution as defined in section 4A of the Companies Act, 1956; Scheduled commercial banks; Mutual funds; Foreign institutional investor registered with SEBI; Multilateral and bilateral development financial institutions; Venture capital funds registered with SEBI; Foreign Venture capital investors registered with SEBI; State Industrial Development Corporations; Insurance Companies registered with the Insurance Regulatory and Development Authority (IRDA); Provident Funds with minimum corpus of Rs.25 crore; Pension Funds with minimum corpus of Rs. 25 crore.

As per the SEBI, following measures shall be implemented in respect of participation of QIBs in the book built issues:

- QIBs shall bring at least 10 per cent margin while submitting the bids.

- The allotment of shares to QIBs shall be on proportionate basis.
- Out of the existing 50 per cent portion available for QIBs, 5 per cent thereof shall be specifically available for Mutual Funds registered with SEBI. However, these Mutual Funds participating in QIB category will also be eligible for allotment in the remaining portion, i.e., 45 per cent, available to QIBs.

Primary Market

New capitals are raised by the companies in the form of IPO from the primary market.

How are shares floated?

The way to invite the share capital from the public is through a 'public issue'. Simply stated, a public issue is an offer to the public to subscribe to the share capital of a company. Once this is done, the company allots the shares to the applicants as per the law and thus shares come into existence.

Here, the listed company offers its shares directly to the investors for raising the required fund. An IPO offers a number of advantages to the company as listing and trading generates considerable interest in a company. It provides opportunities to the companies for repeated access to the market with follow on issues (FPO). In addition to follow on public issues, the company could mobilize addition equity funds through private placements, rights issues or bonus issues.

Is Demat a/c necessary for obtaining IPO/shares?

As stated in the previous answer, if issue size is more than Rs 10 crore, then you have to apply for Demat shares only. Even if the issue size is less than Rs 10 crore it is advisable to apply for shares in the Demat mode as shares are tradable only in Demat mode, apart from other benefit of Demat.

Give me a brief account of IPO process in terms of issuer's perspective.

Sir Osborne A. Smith

Was the first governor of the Reserve Bank of India

"Nobody works as hard for his money as the man who marries it"
Kin Hubbard , 1868 - 1930 , American Journalist

IPO Process (Issuer's perspective)	
Function	**Carried out by**
Decision to issue shares →	Issuer
Appointment of intermediaries →	Issuer
Draft Red Herring Prospectus →	Issuer/Investment Banker/ Legal Advisor
Agreements to finalise →	Issuer with Intermediaries
Opening of bid →	Issuer/Investment Banker/ Banker
Offer closure →	Issuer/Investment Banker/Banker
Allotment of Securities →	Issuer/Investment Banker/Registrar/DP
Refund of money →	Issuer/Investment Banker/Banker

Give me a brief account of application for IPO process in terms of investor's perspective.

IPO Process (Investors' perspective)	
Functions	**Investors' actions**
Announcement of IPO by the company	Through media/related people/friends and relatives
Draft Red Herring Prospectus comes to market with application forms	Through the appointed merchant bankers, lead managers, brokers, investment consultants
After taking the decision to purchase submission of the duly filled up forms along with the payment instrument	To the collecting members or to the bank directly
Bank credits the account and sends the form to the registrar for sorting and data entry for records	
Records reconciled with the bank	
Opening of bid and Offer closure	Check through media/related people/friends and relatives
Basis of allotment drawn and sent for the approval to SEBI	Check through media/related people/friends and relatives
Registrar draws out the list of allotted applicants	Check the list with Registrar office
Allotment and Refund process starts	Ask for share if allotted or ask for refund in case of partially allotted or not allotted

How do I apply to public issues?

When a company comes with an IPO, it prints and circulate/distribute IPO application forms among the investors. To subscribe to an IPO, Investors have to fill an application form. These forms are made available with Syndicate members, brokers, sub-brokers, Investment advisors and generally also available in stalls outside the stock exchanges, Banks and with vendors in various other areas. The forms can also be obtained from the websites of the company or registrar's of the issue.

Once you get the form, you have to fill it, remit the amount after calculating the number of shares applied for in the bank that is designated in the form as collecting centre for that IPO. Investors have to provide the details of their Demat account and bank account in the form. In a book built issue, the investors have choice to bid at the price as per their decisions.

You can also apply for physical share if issue size is less than Rs 10 crore. If issue size is more than that you have to apply for Demat shares only. It is advisable to apply for shares in the Demat mode as shares are tradable only in Demat mode, apart from other benefit of Demat.

1969

Year in which the Banks were nationalized in India

What is the difference between Fixed Price Issue and Book Built Issue?

An issuer company is allowed to freely price the issue. The basis of issue Price is to be disclosed in the offer document where the issuer discloses in detail about the qualitative and quantitative factors justifying the issue price. There is only one price and issue will be offered at that price. Such type of issue is known as Fixed Price Issue.

"Book Building" means a process undertaken by which a demand for the securities proposed to be issued by a body corporate is elicited and built up and the price for the securities is assessed on the basis of the bids obtained for the quantum of securities offered for subscription by the issuer. This method provides an opportunity to the market to discover price for securities. Individuals who apply for the IPO put their bids.

What is "Price Band"?

The prospectus of the issuer company may contain either the floor price for the securities or a price band within which the investors can bid for the shares. The spread

"There are three classes of people who don't think markets work: the Cubans, the North Koreans and the active find managers"

Rex Sinquefield, *Dimensional Fund Managers*

between the floor (minimum) and the cap (maximum) of the price band shall not be more than 20 per cent. The price band can be revised and such a revision shall be informed to the investors by informing the stock exchanges, by issuing press etc. In case the price band is revised, the bidding period need to be extended for a further period of three days, subject to the total bidding period not exceeding thirteen days.

How is the Price Band decided?

Price Band is decided by the issuer company in consultation with Merchant Bankers keeping the various factors about the issuer company in mind. The basis of issue price is disclosed in the offer document. The issuer is required to disclose in detail about the qualitative and quantitative factors taken into account in arriving the price band.

What is cut off price?

In Book building issue, the issuer company is required to indicate either the price band or a floor price in the red herring prospectus. The actual price is discovered through book building based on demand and supply. Issue price can be any price in the price band or any price above the floor price. The finally decided price by the Issuer, i.e., issue price is called "Cut Off Price". The retail individual investors have been given an option to apply for IPO at the cut off price. In short, it is the final issue price decided by the issuer.

Why shares are not allotted on the face value always?

The face value of the share of a company is generally Rs 10. It may be other than Rs 10. If the company is performing well and having good fundamentals, the shares are issued at higher price. If shares are issued at price higher than the face value, it means the shares are issued at premium.

Who determines the price?

The price of an issue is decided by the Issuer Company in consultation with the merchant banker. In the fixed price issue, the price is decided by them keeping in the mind various factors pertaining to the company. However, in the case of book built issue, the price is discovered by book -building mechanism and final price is arrived accordingly.

What is the concept of premium?

Generally, most of the shares have a face value (i.e., the value as in a balance sheet) of Rs 10 though not always offered to the public at this price. Companies can offer a share with a face value of say Rs 10 to the public at a higher price. The difference between the offer price and the face value is called the premium. As per the SEBI guidelines, new companies can offer shares to the public at a premium, provided:

- The promoter company has a three years consistent record of profitable working.
- The promoter takes up at least 50 per cent of the shares in the issue.
- All parties applying to the issue should be offered the same instrument at the same terms, especially regarding the premium.
- The prospectus should provide justification for the proposed premium. On the other hand, existing companies can make a premium issue without the above restrictions.

Why do companies make premium issues?

A company's aim is to raise money and simultaneously serve the equity capital. As far as accounting is concerned, premium is credited to reserves and surplus and it does not increase the equity. Therefore, a company which raises Rs.100 crore by way of shares say at a premium of Rs.90 per share increases its equity by only Rs.10 crore, which is easier to serve with an investment of Rs.100 crore. Thus, the companies seek to make premium issues. As we shall see later, a premium issue can increase the book value without decreasing the EPS. In a buoyant stock market when good shares trade at very high prices, companies realize

1945

The year in which India signed the World bank articles of agreement

that it's easy to command a high premium.

Who are the intermediaries involved in IPO?

The main intermediaries involved in the process of IPO are Merchant/Investment Bankers, Registrar to an Issue, Bankers to an Issue, Syndicate Members. Credit Rating of IPO has been made mandatory and therefore Credit Rating Agencies are also part of the whole process. These four intermediaries and the depositories play important role in an IPO. The company, the Registrar and the Depository enter into a tripartite agreement in order to facilitate dematerialisation of the shares and pave the way for trading on the exchanges after listing.

“It is difficult to find a portfolio manager who will continue to provide superior performance after he is retained”

Eugene B. Burroughs

Tell me about the roles of various intermediaries in the process of IPO.

Investment Bankers: Investment or Merchant Bankers play the role of Lead Managers and their primary job is to advice the issuers and to take the company through IPO process. In general, most of the IPOs involve more than one investment banker. A syndicate is constituted to manage the issue. The leader of the syndicate is known as Book Running Lead Manager (BRLM). The key responsibilities of the investment banker are:

- Conducting due diligence on disclosure in the offer document and publicity materials
- Coordinating the offer process
- Appointing other intermediaries and obtaining the legal clearances for the offer
- Obtaining SEBI and Stock Exchange clearance
- Managing the syndicate and coordinating the allotment and listing process

Registrars to an Issue: The Registrars process the application forms received in the IPO. They coordinate with the bankers to an issue and the investment bankers to complete the reconciliation of the received application forms and to complete the post issue work on time. They prepare the documents which form the basis for allotment of shares and the documents securing approval for the listing. They process data for transfer of funds in case of refund and for the transfer of securities in the Demat form for the allotted shares.

Bankers to an Issue: The basic job of the bankers to an issue is to collect application forms and money and deliver it to the Registrar as per agreed schedule. Apart from this they also ensure the refund of money in case of fully or partly rejected applications. They also assist in post issue reconciliation.

Credit Rating Agency: The company has to appoint a credit rating agency as rating of an IPO is mandatory. The Credit Rating Agency assign a grade to the IPO in order to provide an independent and unbiased opinion. This is essentially being one time exercise with a focus to assist the investors for reaching to an informed investment decision.

How do I decide on a good new issue?

This is important especially when a large number of new companies are floating public issues. While a large number of these companies are genuine, quite a few may want to exploit the investors. An investor must therefore, identify the future potential of a company before applying for its issue.

A part of the guidelines issued by the SEBI is the disclosure of information to the public. This disclosure allows the public to know the reason for raising the money, the way the money is proposed to be spent, the return expected on the money and so on.

This information is in the form of a prospectus which includes information regarding the size of the issue, the current status of the company and its creditibility, it's equity capital, its current and past performance, promoters, the project, cost of the project, means of financing, product and capacity.

New Issue also contains a lot of mandatory information regarding underwriting and statutory compliances. This gives the investor a fair chance to evaluate the prospectus of the company in the short and long-term period and make an investment decision using fundamental analysis, which is discussed later in the book.

“We have two classes of forecasters: Those who don't know and those who don't know they don't know”
Jhon Kenneth Galbraith

What is the prospectus? How it comes into being?

Prospectus is a document inviting deposits from the public or inviting offers from the public for subscription or purchase of any shares in or debentures of, a body corporate. Prospectus is a statuary document and investors can sue the company for furnishing wrong information. Here, we will discuss various terms related with prospectus in context of IPO. These terms are defined in detail in SEBI (DIP) Guidelines, 2000. These terms are:

- **Offer document** means Prospectus in case of a public issue or offer for sale and Letter of Offer in case of a rights issue which is filed before Registrar of Companies (ROC) and Stock Exchanges. An offer document covers all the relevant Information pertaining to the issue.
- **Draft Offer document** means the offer document in draft stage. The draft offer documents are filed by the Issuer Company with SEBI, at least 21 days before filing of the Offer with Document with Registrar Of Companies and Stock Exchanges. SEBI may seek explanations/ clarifications and suggest required changes in the draft and the issuer company or the Lead Merchant banker shall make such changes in the draft offer document before filing the Offer Document with ROC/ SEs. The Draft Offer document is also posted on SEBI website for public comments for a period of 21 days from the filing date with SEBI.
- **Red Herring Prospectus** is a prospectus which does not have details of either Price or number of shares being offered or the amount of issue. Only on completion of the bidding process, the details of the final price are included in the offer document. The offer document filed thereafter with ROC is called a prospectus.
- **Abridged Prospectus** means the memorandum as prescribed in Form 2A under sub-section (3) of section 56 of the Companies Act, 1956. It contains all the important features of the issues in brief. All the application form of public issues contains it for the information of the investors.
- **Letter of offer** means the offer document prepared by

the company for its Rights Issue and which is filed with the Stock Exchanges. The required disclosures are made as required by SEBI (DIP) guidelines.

- **Abridged letter of offer** means the abridged version of the letter of offer.

What should a layman look for in the prospectus?

The important factors to be considered are:

- Promoters, their credibility and track record
- Past performance of the company
- Products of the company and future potential of the products
- Technology tie-up, if any, and the reputation of the collaborators
- Project cost, means of financing and profitability projections
- Risk factors
- Rating given by the Credit Rating Agency

What is credit rating of IPO? Is the credit rating of IPO mandatory?

Earlier an unlisted company making IPO of equity shares was given option by the SEBI to obtain grading for IPO from one or more credit Rating Agencies. Since May 01, 2007, it has become mandatory for Issuer to obtain credit rating of IPO. The grade represents a relative assessment of the fundamentals of the issue in relation to other listed equity shares in India. The credit rating agency would assign a 'grade' to the IPO. The grading will be an independent and unbiased opinion of the agency. The purpose of the grading is to help retail investors to take informed decisions as they do not have means to assess the IPO like

IPO Grading

Grade	Fundamentals
1	Poor
2	Below average
3	Average
4	Above Average
5	Strong

$ 34 Million

The first World Bank loan given to India, was also the first loan provided to an Asian country

other groups of investors. The grading is generally assigned on a 1 to 5 scale where higher score indicates stronger fundamentals.

How many Credit Rating Agencies are in India Presently?

There are four SEBI registered Credit Rating Agencies in India viz. CRISIL, ICRA, CARE and Fitch Rating India Pvt. Ltd.

Rating Symbols and their meanings:

Rating of	Crisil	ICRA	CARE	Fitch	Meaning
Long term instruments	AAA	LAAA	CARE AAA	AAA (Ind)	Highest safety
	AA	LAA	CARE AA	AA (Ind)	High safety
	A	LA	CARE A	A (Ind)	Adequate safety
	BBB	LBBB	CARE BBB	BBB (Ind)	Moderate safety
	BB	LBB	CARE BB	BB (Ind)	Inadequate safety
	B	LB	CARE B	B (Ind)	High risk
	C	LC	CARE C	C (Ind)	Substantial risk
	D	LD	CARE D	D (Ind)	Default
Middle term instruments	FAAA	MAAA	CARE AAA	TAAA (Ind)	Very strong
	FAA	MAA	CARE AA	TAA (Ind)	Strong
	FA	MA	CARE A	TA (Ind)	Satisfactory
			CARE BBB		Moderate
			CARE BB		Adequate
			CARE B	TB (Ind)	Inadequate
			CARE C	TC (Ind)	Doubtful
			CARE D	TD (Ind)	Default
Short term instruments	P-1	A1	PR1	F1 (Ind)	Very strong
	P-2	A2	PR2	F2 (Ind)	Lower than P-1
	P-3	A3	PR3	F3 (Ind)	Adequate
	P-4	A4	PR4	F4 (Ind)	Minimal
	P-5	A5	PR5	F5 (Ind)	Default

What do you mean by Demat shares?

Demat is the first five words of **Demat**erialization. Earlier shares were dealt in physical form now shares are trasnsacted in dematerialized form. Physical shares are in paper form and have distinctive number. In case of Demat shares, shares are kept in electronic forms with Depository Participant (DP). Unlike physical shares, Demat shares can-

"The periods of boredom have grown shorter and shorter - and the terrors last a bit longer"

Arthur Cashin,

Floor Broker, New York Stock Exchange

not be differentiated and they are fully fungible.

Can Demat shares be converted in the form of Physical shares?

Yes. If one wishes to get back his shares in physical form, he/she can request for the same with his DP. The DP will forward the request to Depositories (NSDL or CDSL). The depository will intimate the Registrar who will provide you with Physical Share certificates. This process of conversion of Demat shares into physical shares is called Re-materialisation of shares.

What is a Depository?

A depository holds shares and other securities of investors in electronic form. Through Depository Participants (DPs), it also provides services related to transactions in securities. Its structure and functioning are similar to the Bank. Presently in India, there are two depository viz. National Securities Depository Limited (NSDL) and Central Depository Services (I) Limited (CDSL). Both of them are registered with SEBI.

What is a DP?

DP is a member of a Depository who offers its services to hold securities of Investors (Beneficial Owners) in dematerialized form. DP is like a Bank branch. It is an agent of the depository. DP works as an interface between Depository and Investors. DPs are required to be registered with SEBI. If an investor wants to avail the services offered by Depository, he has to open a Demat account with DP similar to opening of a bank account with a branch of the bank.

Can I apply for physical shares through IPO?

Yes, if issue size is less than Rs 10 crore.

What is the process of dematerialization of physical shares issued to me?

Any Beneficial Owner (investor), who has entered into an agreement with DP, shall surrender the physical share

D. S. Purbhoodas & Co.

Stands for the letters DSP in the company name 'DSP Merrill Lynch'

"Stocks are bought on expectations, not facts"

Gerald M. Loeb

certificates to DP. The DP on receipt of the same forward details of the shares to the Depository and inform the depository that an agreement has been entered between DP and the beneficial owner. The DP furnishes the required details to the issuer along with the certificate of shares. The issuer on receipt of the certificates of shares from DP immediately cancel it and substitute its record in the name of the Depository as the registered owner and shall send a certificate this effect to the depository and to every stock exchange where the shares are listed. Immediately upon receipt of information from the issuer, the depository shall enter in its records the name of the person who has surrendered the certificate of the security as the beneficial owner, as well as the name of the participant from whom he/she has received the intimation and shall send intimation to the DP. The issuer maintains a record of certificates which have been dematerialized.

Is there any quota for various types of Investors in IPO?

In case of an Issuer company making an Issue of 100 per cent of the net offer to Public through 100 per cent book building issue, not less than 35 per cent and 15 per cent be available for retail investors and non institutional investor and not more than 50 per cent for the Qualified Institutional Investors (QIBs).

For how many days the issue remains open?

Subscription for public issues remains open for at least three working days and not more than 10 working days. In case of Book built issues, period for which bidding will be open is three to seven working days extendable by three days in case of a revision in the price band.

Please explain the basis of allotment of shares.

After the closure of the issue, the bids received are aggregated under different categories i.e., firm allotment, Qualified Institutional Buyers (QIBs), Non-Institutional Buyers (NIBs), Retail, etc. The oversubscription ratios are then calculated for each of the categories as against the shares reserved for each of the categories in the offer document. Within each of these categories, the bids are then segregated into different buckets based on the number of shares applied for. The oversubscription ratio is then applied to the number of shares applied for and the number of shares to be allotted for applicants in each of the buckets is determined. Then, the number of successful allottees is determined. This process is followed in case of proportionate allotment. In case of allotment for QIBs, earlier it was subject to the discretion of the post issue lead manager but now it is done on proportional basis.

How do I know whether the shares are allotted to me?

The investor is entitled to receive a Confirmatory Allotment Note (CAN) if he has been allotted shares within 15 days from the date of closure of a book Built issue. The registrar has to ensure that the Demat credit or Refund as applicable is completed within 15 days of the closure of the book built issue. The Lead Merchant Banker also publishes an advertisement giving details relating to oversubscription, basis of allotment, number, value and percentage of successful allottees, date of completion of dispatch of refund orders, date of dispatch of certificates and date of filing of listing application is released within 10 days from the date of completion of the various activities at least in an English National Daily with wide circulation, one Hindi National Paper and a Regional language daily circulated at the place where registered office of the issuer company is situated . The investors can also contact the office of the Registrar of the company to know about the allotment. The name of the registrar is written on the prospectus or the application form.

When these shares are listed on the stock exchange?

The listing on the stock exchanges is done within 7 days from the finalization of the issue. Ideally, it would be around 3 weeks after the closure of the book built issue. In case of fixed price issue, it would be around 37 days after closure of the issue.

Eugene Meyer

The First president of world bank

“If you would like to know the value of money, go and try to borrow some”

Benjamin Franklin

Once allotted can I trade the shares immediately?

Yes. After listing of the shares you can trade in the secondary market very first day of listing. Many investors try to get benefited by selling at higher prices on the very first day itself.

What if I am not allotted the shares?

If you have not been allotted the shares, you will receive the refund of money. As stated above, the merchant banker will give advertisement in news, among others, regarding refund of money. In case of delay, you will get the interest on your money for the excess period.

What is the role of SEBI in the process of IPO?

SEBI regulates the IPO process and issued detailed Guidelines under section 11 of the SEBI Act, 1992 in the name of SEBI (Disclosure and Investors Protection) Guidelines, 2002 generally known as DIP Guidelines.

It is also noted that under the provisions sections 55 of the Companies Act, 1956. the matters pertaining to issue and transfer of securities and non payment of dividend in case of listed companies, the companies intend to get listed are being administered by SEBI.

Enlighten us more on convertible debentures in the public issue?

Since debt funds available from the financial institutions prove more expensive and the lenders impose conditions on the company, most companies prefer to tap the stock market to obtain debt funds as well. However, the investors in the primary markets look for much higher returns than that offered by the companies who look to pay lower than the institutional lending rates. Subsequently, a new concept of equity linked debt source has been evolved by the different companies in various forms called "instruments" of which the debentures are most popular.

As you know a debenture is a debt instrument that is backed by the security of fixed assets. The debentures carry a coupon rate. A convertible debenture is an instrument which, when issued, is in the form of a debenture carrying a coupon rate. However, at the expiry of a given time from the date of allotment, the debenture is converted into an equity share at a predetermined price.

There are basically three types of the debentures:

- Fully Convertible Debentures (FCDs): The entire value of the debenture is converted into shares in a predetermined ratio.
- Non-Convertible Debentures (NCDs): Remain as a debenture for their entire life.
- Partly Convertible Debentures (PCDs): A part of the debentures is converted into shares and the rest remains as a non-convertible portion, which is redeemed at a predetermined price.

Can you elaborate further on the concept of debentures?

The important features of the debentures are:

A debenture has a face value which is the amount paid per debenture. This face value may be divided into different parts say Part A, Part B, etc. To understand the concept we take an example of a debenture of face value of Rs.200 with Part A of Rs.20, Part B of Rs.90, and Part C of Rs.90.

These different parts of a debenture have different terms with respect to conversion of redemption.

For the typical debenture under consideration, the coupon rate is 14 per cent. Part A of Rs.20 will be converted into one equity share on allotment at a premium of Rs.10 per share. Part B is converted into two shares at a premium of Rs.35 per share, one year after allotment. Part C remains as a debt and is redeemed at the end of the sixth, seventh and eighth year; from the date of allotment in three equal installments and a premium of five rupees is payable along with the first installment.

The idea of the scheme is quite simple. During the period of project implementation, the company is not in a position to serve the equity by way of dividends, as it does not earn any profits. On the other hand, it can capitalize the interest during this period and claim depreciation. During

Worli Chemicals

Previous name of Wockhardt

"Rule No.1: Never lose money. Rule No. 2: Never forget Rule No.1"

Warren Buffett

this period, most of the money is in the form of debt. The date of conversion is fixed to coincide with the expected date of project completion. After the second conversion, the company retains a cheap debt at 14 per cent per annum. The shares, issued at premium do not increase the company's equity size substantially. The investor, on the other hand, is thrilled to receive the companies' shares and quite often sells off the part C at a discount.

Part C is called the non-convertible part of debenture or Khokha. The non-convertible debenture often comes with a detachable warrant, which has a validity period. Within that period, at any time, the company can offer the warrant holders equity shares at a predetermined price. This warrant can be separately traded on the stock exchange and is not related to the non-convertible debentures.

The debentures can be independently traded on the stock exchanges for a price.

Are there any more instruments?

One of them is the Secured Premium Note (SPN). Here, the investor puts a certain amount of money as debt in a company and the company returns a much higher amount at a later date. For instance, say the initial investment is Rs.100. The company would pay back Rs.50 each at the end of the fourth, fifth, sixth and seventh year aggregating

Rs.200 overall. These SPNs are often accompanied by a detachable warrant.

Another instrument is the zero coupon bond which is like a fully convertible debenture bearing no interest rate. However, to compensate for the loss of revenue on account of interest, the premium on conversion is sometimes lower.

To which instrument should one apply?

In case of a debenture issue with conversion at a premium, an evaluation criterion would help you to decide the instrument.

For an equity-linked debenture, it is important to ascertain the cost of a share. In an ordinary share issue and

even in the case of fully convertible debentures (FCD), we have a premium. Thus, for a share purchased at Rs.50 premium, the cost of purchase is Rs.60 per share. For FCDs, an investor has to study the terms carefully before ascertaining the cost. Suppose that an FCD with a face value of Rs.150 is divided into two parts. Part A of Rs.50 would be converted into two shares with a face value of Rs.10 at a premium of Rs.15 on allotment. Part B of Rs.100 would be converted into two shares of Rs.10 at a premium of Rs.40 at the end of 18 months from the date of allotment. If the FCD carries interest at a rate of 15 per cent per annum, then the cost of the shares works out as follows:

Two shares of Rs.25 each	=	Rs. 50.00
Less: interest on Rs.100 for 1 1/2 years @ 15 % p.a.	=	Rs. 22.50
Two shares of Rs.50/- each	=	Rs .100.00
Total		**Rs.127.50**

As soon as the cost of the share is derived, the investor may follow his judgment (by analysis) to arrive at a fair value of the share after may be one year or two years, and thus deduce the return he would obtain. This would determine if it is worthwhile to invest in that instrument.

Why are PCDs and NCDs different?

These instruments along with SPNs are interest-bearing funds at least to some extent (e.g., the non-convertible part of PCD is an interest bearing part for the life of that part). In general, the life of an NCD is between seven to nine years with interest as applicable. They are repayable in one or more (very often three yearly) installments at par or at a premium (generally at the most 10 per cent). Thus, a typical NCD portion of Rs.100 face value is redeemed in three installments at the end of the seventh, eighth and ninth year of allotment at a premium of Rs.50 per debenture. Each year, the investor is paid Rs.35.

The return calculations of the different investors vary. An investor interested in investing in shares may not want to block his funds bearing NCDs. However, as the company requires NCDs at a low interest rate, it works in two

"When even the analysts are bored, its time to start buying"

Peter Lynch

ways. On the one hand, it offers NCDs to the public as a part of a package, i.e., alongwith a convertible debenture or a detachable warrant. However, since the investor feels that this NCD portion of a PCD (called a khokha) is a burden, the company finds a party, investor or financier who agrees to buy the NCD portion at a price lower than the face value, i.e., at a discount. This "buyback" arrangement is a recent phenomenon. In a typical buyback arrangement, the khokha of the face value of Rs.100 is purchased by the financier by paying say Rs.77 to the investor. The company gets the advantage of a lower interest rate and the financier, who pays only Rs.77 per debenture, gets interest on the entire paid up value. For instance, a 14 per cent per annum interest on Rs.100 implies an 18.18 per cent return each year. Besides, the financier gets Rs.100 instead of Rs.77, he initially invested, which further improves the net yield. The investor also finds extra gains in the form of entitlement of a share on lucrative terms as compared to the market price. Since in this khokha buyback scheme, every party apparently ends up as per their expectations, and hence the scheme is very popular.

In arriving at the cost of shares in a PCD, the discount at which the khokha is sold is to be added to the cost of the share on conversion.

In SPNs, the companies attach detachable warrants. A typical SPN may have terms as follows: The investor pays Rs.100 today. He gets Rs.200 in four equal annual installments at the end of the fourth, fifth, sixth and seventh years of allotment. Besides, he is given a detachable warrant whereby he is eligible to purchase a share at a predecided premium and within a predefined time frame when the company makes an offer to the investor.

SPNs and debentures with a maturity of over 18 months are required to get a rating from a recognised rating institution. Thus, you can see that NCDs (with detachable warrant), PCDs and SPNs are different types of instruments and therefore are mentioned separately.

The evaluation of an investment can be done by applying the principle of Time Value of Money.

Rajashree Birla

The first woman director on the board of Larsen & Toubro

What is the strategy for investing in the primary markets?

As you know, an application to a new issue is decided by a lottery. In general, the good issues are oversubscribed by several times, i.e., for every one share offered by the company there are many applications. There are instances when issues have been oversubscribed by 1000 times with small chances of getting allotment. While there is no apparent cost in applying to a new issue, the allotment process takes two to three months, thus blocking your money for this period. On the other hand, primary issues if allotted, yield high returns. If a share for which the investor has paid Rs.10 quotes at Rs.20 on listing, it implies a return of 100 per cent in say three to four months or about 300-400 per cent per annum. Also, the risk of applying to new issues (if done selectively and intelligently) is small. Therefore, the critical aspect of applying to new issues lies in increasing the chances of allotment, which, in turn, improves the return. There are many investors who apply to new issues in a scientific manner to average a net return of around 40 per cent (risk free) per annum. Therefore; these investors prefer to operate only in the primary markets.

How does one make selective applications?

First of all, unless it is a company with very good promoters (like Tatas, Birlas, Ambanis or any similar well-known concern with a good reputation), application to new issues is essentially a short term investment. This is because a new issue is made by new companies or existing companies wanting to set up a new plant. Therefore, the returns from the plant depend upon its future performance. Past experience shows that, in general, new plants face teething problems which takes one to two years to stabilize after the commencement of production. Very often, the commencement of production is also delayed. So, a share would take about two to three years on an average before it fetches a reasonable price commensurate with an earning potential of the company (as depicted in the prospectus). However, on listing, the share quotes at a good price due to the phenomenon of supply and demand.

Thus, a share would yield Rs.20 to Rs.30 immediately or

"It's human nature to find patterns where there are none and to find skill where luck is a more likely explanation (particularly if you're the lucky [mutual fund] manager)"

Bernstein William

a price of say Rs.40 to Rs.60 after two years depending on the performance. In these circumstances, it may be better to cash Rs.20 today unless the promoters are known to have a very good track record.

In this scenario, a thorough analysis of the issue may not be necessary. It is enough to ascertain:

- Whether the promoters are genuine and have a reasonable track record.
- Whether the product proposed to be manufactured seems to be marketable. Or
- The purpose for collecting the money is reasonable and genuine.
- The premium asked for is reasonable.

If the answers are positive, the share is almost likely to be oversubscribed and the investor will get a reasonable, risk free return.

The investor should realize that the market for new issues is highly sensitive to the investor's mood and thus good issues may be oversubscribed in a bad market. In such a case, he should wait until the market mood improves.

How does an investor decide on the credibility of the promoters, company and the premium?

An investor should find out through his broker or reputed investment magazines and journals, which give a thorough analysis of the IPO. He can collect weekly updates from investment sections of newspapers, which allocates space for new issues. The investor may then collect forms for these issues, study the prospectus, and confirm his impressions by referring to the write-up on these issues. Keep out of new issues with doubtful history and avoid high premium issues as well. The returns are not lucrative. Let us explain by citing an illustration, say company 'XYZ' offers shares to the public at Rs.160 and imagine the issue getting oversubscribed. To the dismay of the public, however, the share was later listed at Rs.155 and plumbed lower to touch Rs.90. Investors should be cautious of such companies with high brand names who want to collect large premiums. Such companies have failed to restore the expectations of listing of prices and could not sustain the high price.

So, while judging a company the investor must also study the genuineness of the funds requirement. To explain in detail, we shall first learn which companies generally float a public issue.

The first is the common category of a new company setting up a manufacturing facility. These companies are again of two types. Those promoted by promoters/promoter companies with a good track record; and those promoted by new entrepreneurs or entrepreneurs having not very good track record. To reduce the risk it is advisable to study well before making investment in the second category of companies.

The first category of new issues is usually by existing companies. These companies as a rule are required to offer shares to existing shareholders only. A public issue can be made only with the permission of the existing shareholders. Again, such companies are of two types. One is the existing listed company, which generally floats only rights issues. However, if the company is embarking on a programme much larger than its existing operations, it may then offer a public issue. As per the current trend, very few existing listed companies go in for a public issue and such issue is generally offered at a high premium.

The second type is the existing but unlisted companies wanting to expand their operations and/or list their shares. For instance, there is a certain company say 'XYZ' Ltd which floated a public issue in January 1993 at a premium of Rs.80 per share. Here, you must note the past share price trends vis-à-vis the premium. If the offer price is more than 50 per cent of the recent share price, it is not worth applying for the issue. In such cases, unless the company and the promoters are very well reputed, it is not advisable to invest your money.

How many shares should I apply for?

The minimum lot size is given clearly in the application form. It is stated that the applications should be in multiples of say 100 shares. In case of debentures, however, the company may ask for application in say two or three lots so

Calcutta Mint

India's oldest mint, established in 1759-60

> "Good management is the art of making problems so interesting and their solutions so constructive that everyone wants to get to work and deal with them"
>
> Paul Hawken

that at the time of each conversion, the investor may have a marketable lot. This is case dependent and needs to be studied with utmost care.

As we have seen earlier, preference is given to the application in the lowest category in case of over subscription. Therefore, if the minimum lot in an offer is 100 shares with Rs.10 payable on application, and if you want to apply with Rs.10,000, you must make 10 applications in the minimum lot of 100 shares. However, as per law, multiple applications are not allowed. A set of multiple applications is one where the sole or the first applicant is one and the same. You would be, however, advised to make as many legal applications as possible for the amount you want to invest because in case of over subscription, while one application of 500 shares has a better chance than one application of 100 shares, both applications are likely to be allotted only 100 shares and five applications of 100 shares have a better chance than one application of 500 shares. While this conclusion is drawn after studying various public issue allotments, it is not universal and would depend on the company as well the distribution of the applications.

What is Stockinvest?

Stockinvest is one of the recent innovations by the banking sector to cater to the needs of the investors to public/rights issues. In an application to a public issue, the money is blocked for about three months. During that period, the company too cannot use the money. Thereafter, there is a high probability of the applicant not being allotted any shares, resulting in blocking of investors' funds. Stockinvest is a new instrument devised by banks which allows the investor to earn interest on his funds while he awaits allotment.

How do shareholders benefit by the good performance of a company?

In quite a few ways. These are:

- The company may declare a dividend.

A company may distribute a part of its profits to the shareholders by the way of dividend. The normal level of dividend ranges from 5 to 100 per cent. However, loss making, marginal profit making or companies with negative reserves, do not generally declare any dividend. Dividend is computed on the face value of the share. Therefore, a 10 per cent dividend on a Rs.10 share means a dividend of One rupee for every share held.

- Rise in the share price in the stock market.

As the profits as well as Earning Per Share (EPS) increases, the price of the share rises and the investor is benefited.

- The company may issue bonus shares.

A bonus issue is a gift of shares to the shareholders. If a company makes very high profit for a few years, it is eligible to make a bonus issue. The number of shares gifted is proportional to the number of shares held. The usual ratios in which bonus is issued are 1:5, 2:5, 3:5, 4:5, 1:4, 1:2, 1:3, 3:4 and 1:1 (1:2 bonus implies one share gift for every two shares held). Till recently, bonus in the ratio more than 1:1 was not permitted. This restriction has now been eliminated.

- The company may issue new shares/instruments on a rights basis.

If an existing company wants to raise more funds by the way of shares, debentures or such other instruments, it is obliged to offer these instruments first to the existing shareholders. This offer is called an offer on rights basis and is required to be approved by the General Body Meeting (GBM) of the shareholders. Only if the GBM decides so, the instrument can be offered to the public directly instead of rights. This offer is also made in a convenient ratio of the shares held.

Could you elaborate on rights issues?

Rights issue is a fresh issue of an instrument by a company to its existing shareholders in a given ratio for which he has to pay a premium to acquire the rights entitlement. A shareholder must therefore evaluate the pros and cons of such purchases.

Though approved at the GBM, this offer is not necessarily favorable to the investors for two reasons:

- The GBM considers the view of the majority of share-

98

The number of companies Ratan Tata presides over

"When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact"

Warren Buffett

holders. However, because of having significant chunk of shares and their hold on Board of Directors, the promoters' view prevails. Therefore, the management proposals are not likely to be rejected.

- GBMs are often held at unusual places on working days. Moreover, a majority of the shareholders do not attend GBMs nor give proxies. Therefore, decisions taken are not always the decision of the general shareholders.

One must, therefore, scrutinize the following aspects of a rights issue from the letter of offer (like a prospectus) sent to the investor along with the rights form:

- The track record of the company.

This can be ascertained by an analysis of the past working results.

- The purpose of the issue.

Quite often promoters issue rights shares for financing overruns in the project, to finance long term working capital needs of the company or for investment in the sister concerns instead of raising funds for setting up new facilities. Such issues need careful appraisal.

- The premium and terms of the instrument.

In the case of rights issues, a company generally floats PCDs or NCDs. Also, the SEBI guidelines have removed all restrictions on the premium on rights issues. Thus, rights issues are now offered at exorbitant premiums decided by the lead managers. In case of high premium, disproportionate to the market price, an investor must decide whether to subscribe to such issues, based on the current and past ruling prices.

- The rights ratio.

The rights issue amount is very often determined by the requirement of funds. The ratio thus depends on this and the premium charged giving scope to a possible odd share ratio (for instance, a company floated a rights issue in January-February, 1993, with a ratio of 34:100). This implies that the investor is left with an odd lot which does not command the market price.

How does one apply for a rights issue?

The process is divided into two parts. First, being the eligibility for a rights issue and the second, being the actual filling and making of the application.

The eligibility criterion is very clear. The company makes an announcement of the rights issue and a book closure date. The listed shareholders in the company's register on the date of book closure are eligible for an offer of the rights issue. A person is deemed to be a shareholder on the date of book closure if his share certificates with transfer form duly filled reaches the company before the date of book closure. The number of shares standing in the name of a person on the date of book closure are taken into account for computing the rights entitlement.

Thus, if a shareholder holds 100 shares and the rights ratio is 1:2, he is entitled to 50 shares on a rights basis. The rights issue is generally kept open for one month. A person entitled to the rights is at a liberty to apply for the whole or a part of his entitlement. He is also allowed to transfer or renounce the whole or a part of the entitlement to any other person at a price. During the period immediately preceding the rights issue or during the early part of the same, the shareholder receives a rights form that has four parts.

An investor wanting to apply to his entitlement without renunciation should fill in Part A of the form. If he prefers to renounce his entire entitlement, he should fill in part B. The renouncee should fill in Part C. In case, the holder wants to renounce a part and apply to the other part, he must fill in Part D appropriately. Part D is the instruction to the company to supply split forms. These forms are in the denominations required by the renouncer. Thus, a holder entitled to 1000 shares can ask the company to send him 10 split forms of 100 shares each. These forms are similar to the original rights forms. He can then renounce some forms and apply to the others. However, in the letter of offer, the company even announces the last date for receipt of request for split forms. This should be noted and adhered to.

At the time of rights issue of good companies, the rights forms can be purchased in the stock market on cash down, instant delivery basis.

The investor should fill the appropriate part (as applica-

Maastricht Treaty

Treaty signed amongst European Nations for monetary union in 1992 in Maastricht, Netherlands

> "The conventional definition of management is getting work done through people, but real management is developing people through work"
>
> Agha Hasan Abedi

ble) of the form, make a cheque/draft/stockinvest payable as indicated and submit the form to any one of the collection centres/banks. The allotment is not as difficult as in the case of a public issue but the process again takes some time. Each applicant is assured of at least the amount entitled.

Can there be over subscription even in a rights issue?

Yes. That is because all rights issues allow its investors to apply for additional shares. While few companies allow only the original holder to apply for additional shares, others allow even the renouncee to apply. The additional shares are to be indicated in a separate box.

Earlier, most of the companies were allowed to retain over subscription (if any) upto 15 per cent of the issue size. This practice has been stopped after the introduction of the new SEBI guidelines.

In the case of additional applications, companies have a declared method of allocation whereby the shares are allotted to all the forms as entitled. This is generally given in the Letter of Offer. If there is an unsubscribed portion, then the priority is given to the existing shareholders first and then to the renouncers. It is advisable to apply for additional shares to the extent of 20-25 per cent while applying for a rights offer. Since the ratio very often results in an odd lot, you may apply to rights to an extent that would give you a complete lot, if alloted.

How the shareholders get dividend and bonus issues?

Like rights issue, even bonus issue and dividend have book closure date. The shareholders entitled to these benefits are sent the bonus shares or dividend warrant (as applicable) by post.

What happens if the investor does not receive the company's correspondence?

An investor should be aware of the developments in the company of which he hold shares. The declaration of dividend, bonus and rights are announced in the stock exchange and thus known to each and every broker. Besides, it is also published in the major newspapers and investment publications in their investment sections.

If the rights form is not received or received late, then logically the investor cannot apply for the issue, thus losing the option of the rights. If the investor does not get the rights offer at least 21 days before the date of closure of the issue, he can take the

following steps:

- He can check with his broker/stock exchange/or by looking up the dailies whether the dates have been extended. If not,
- He can enquire with the company by Registered Post with A/D mentioning his Regd. Folio No. and date of transfer of shares. If possible, he can also visit the Registrars or the company's registered office alongwith his shares.
- Here, two possibilities arise:
  - (a) If he has recently bought the shares and sent it for transfer around the book closure date, it is likely that, either the company received the shares late or that the form was not in order and shares could not be transferred in his name. In that case, the offer would have been sent to the previous holder (please note that the share transfer is a long process and more often than not, in case the investor has sent the form for transfer near book closure date, the transferred shares come back after the rights shares are allotted). In this case, the company would send back the rejected transfer application to the investor.
  - (b) If the shares are duly transferred, the form is not received due to postal troubles.

  In the first possibility, the investor should take up with his broker who is obliged to compensate to the extent of the rights entitlement. He may, however, need to be shown the rejected form as and when it arrives and the process may be lengthy. In the second possibility, the investor must obtain a duplicate form from the company. Remember that all com-

Lawyer

Finance Minister P Chidambaram started his career as an Advocate in Madras HC in 1969

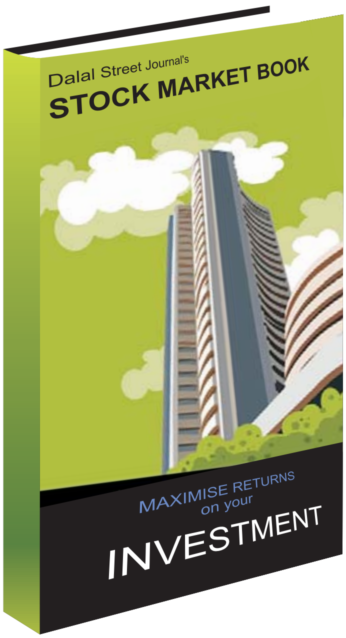
panies do not give these forms easily and the investor may be required to raise a voice for it. The investor should take quick action and correspond immediately to the company with a copy to the nearest stock exchange, SEBI and to a well-known investment journal known for publishing investor's grievances such as the *Dalal Street Journal*.

In case of bonus issue too, the procedure is similar but the investor is not in danger of losing his entitlement. As far as missing dividends are concerned, the company checks its record and if his dividend warrant has not been encashed, he is entitled to get a duplicate.

"Success in management and success in sport are derived from the same basic principles."

Will Carling

In case you are not able to order this book online, you can take a printout of the following strip and send the same attached with DD/Cheque.



EARN PROFITS
KNOW HOW THE
STOCK MARKET WORKS

You Pay
Rs 349

For more details
SMS "DSJ" to 57575

(Write in CAPITAL, except email)

Yes ! I wish to order ☐ **STOCK MARKET BOOK By paying Rs 349/- only**

Enclosing Cheque/DD No ____________ for Rs. ________ Dated ________

Drawn on ______________________ in favour of Ramdeo Media Ltd (Add Rs 25/- for outstation cheque)

Please charge it to my ☐ VISA ☐ MasterCard ☐ Card Number: ☐☐☐☐ ☐☐☐☐ ☐☐☐☐ ☐☐☐☐

Card Member's Name ______________ Card Expiry Date: ☐☐ ☐☐☐☐ Date of Birth: ☐☐ ☐☐ ☐☐☐☐

Date : ____________ Signature ____________

Name: ______________ Age: ________ Occupation : ______________

Address : ____

________________________________ City : ____________

Pin: ____________ Tel(O): ______ - ____________ (R): ______ - ____________ Fax: ____________
(STD Code) (STD Code)

Mobile : ______________ E-mail ______________

Copy will be delivered by Registered Book Post

To order log on to **http://www.dalalstreetjournal.com**

Ramdeo Media Ltd, Motlibai Wadia Building, 104-A, 1st Floor, 22 D, S A Brelvi Road, Fort, Mumbai - 400 001. Fax: 020 40197210 E-mail: service@dalalstreetjournal.com

Customer Care: 020 40197211

DSJ 08