For every missed IPO, there is the comfort of an SIP

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In favourable market conditions, IPOs undeniably possess rockstar appeal, but mutual fund investments are generally considered fair-weather.

The recent surge in initial public offerings (IPOs) in the UAE has highlighted the great enthusiasm of retail investors, marking a significant shift in the dynamics of capital markets.

Issue after issue in the UAE and the GCC has been oversubscribed. For instance, the PureHealth IPO witnessed an overwhelming response from retail investors, with the retail allocation oversubscribed by a staggering 483 times. The Phoenix IPO was another example oversubscribed by 180 times. The Dubai Taxi Company increased the total number of shares allocated to retail investors to 74.97 million shares from about 62.48 million due to significant demand and oversubscription. Adnoc L&S and Adnoc Gas also adjusted their retail allocations due to unprecedented demand.

The diverse nature of these companies, spanning different industries, underscores the broad appeal among retail investors. While a preference for dividend-paying stocks is evident, companies without a communicated dividend policy have also attracted substantial demand, reflecting a nuanced approach by investors. The outlook for 2024 suggests a potential repetition of this trend, with supermarket retailers LuLu and Spinneys likely to launch their IPOs.

Investing in strong companies, especially those whose businesses you understand, can be beneficial. IPOs can be vehicles of wealth creation over time, and the huge demand for stakes in sound businesses in the UAE and GCC region points to just that.

“What sets this trend apart is the democratisation of stock investment discussions, now taking place in living rooms with the same fervour as discussions about prominent stocks like Tesla or Apple. Retail investors seem to be adopting a fundamental approach, focusing on the underlying economics of businesses rather than getting swayed by stock prices and market noise. In the case of specific IPOs, such as Dubai Taxi and Dewa, investors made informed comparisons with companies such as Lyft and Devon Energy, favouring companies with solid business models over counterparts,” says Vijay Valecha, chief investment officer at Century Financial.

However, investing in IPOs offers both advantages and challenges for retail investors, providing an opportunity for early gains and support for nascent ventures. “Inherent risks include uncertainty about a company’s future performance, price volatility, potential information disparities compared to institutional counterparts, and the need for cautious decision-making. Retail investors, therefore, can participate in IPOs, but it’s crucial to approach them with caution, conduct thorough research, and align investments with individual risk tolerance and long-term goals. A balanced and diversified investment strategy remains key to navigating the potential opportunities and risks associated with IPOs,” adds Valecha.

Vishal Dhawan, CEO, Plan Ahead Wealth Advisors, agrees. “IPOs are typically a stage where promoters are diluting stake and often trying to do so at their best price. Thus, ideally IPOs are not the best place to start investments for first-time investors. Additionally, diversification of exposures in equities is an important part of risk management, which may not be possible with IPOs,” he said

SIPs in mutual funds are always there

A good investment strategy aligns with your risk tolerance and financial goals. If you understand a company’s businesses and agree with its long-term vision, an IPO is a good way to add to your portfolio. However, if you do not have a fair understanding or confidence in a company, don’t get carried away with the hype. It is better to invest in a mutual fund, through the systematic investment plan route.

“SIPs offer a systematic approach to investing, helping investors stay committed to their investment plan and avoid timing the market. It helps investors earn returns through the power of compounding. Investing in an IPO, on the other hand, requires an upfront one-time investment in a particular stock of a company. Therefore, the SIP route is a better option if you are looking at a long-term wealth creation point of view. Investment in a mutual fund also provides diversity as the fund invests in a basket of stocks versus investing in a single stock (IPO),” says Vikas Lakhwani, Chief Revenue Officer, CPT Markets, Dubai.

Come to think of it, the accessibility of mutual funds offered by various fund houses makes them convenient for investors, especially with the flexibility to start with smaller amounts. “SIPs in mutual funds are definitely suggested due to the benefits of dollar cost averaging that can be achieved by regularly investing, professional management of stock selection for both entering and exiting stocks, as well as the possibility of them buying into good IPOs if they choose to, and avoiding the not so good ones,” adds Dhawan.

What to look for in an IPO?

“When evaluating an initial public offering (IPO) as a retail investor, it is essential to consider various factors to make informed decisions. One must start by reviewing the company’s prospectus, understanding its business model, and examining the use of IPO proceeds. For example, if the fund proceeds are going to be utilised for paying off existing debt, then this can be a potential red flag. On the other hand, if the proceeds will be used for expansion, then it could be a potential green light,” advises Valecha.

Retail investors must also analyse the financial health through statements and profitability trends. “One must assess if the market conditions, industry trends, and the economic environment are favourable for the company before investing in the IPO. Scrutinise the leadership team and corporate governance and be aware of potential risks disclosed in the prospectus,” adds Valecha.

Once these parameters fall into place, it is crucial to evaluate the IPO’s valuation by comparing it with industry benchmarks and similar companies. One should also consider the reputation of underwriters and analyst recommendations. Individuals should be mindful of the lock-up period, as insider selling post-expiry can affect stock prices. If available, review management presentations from the IPO roadshow.

“Thorough due diligence is crucial, and seeking advice from financial professionals is recommended. Above all, understanding personal risk tolerance and investment goals is fundamental. By considering these factors, retail investors can make more informed decisions regarding IPO investments,” notes Valecha.

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How to gauge an IPO?

1. Read the prospectus: The prospectus can help investors make informed investment decisions. The document contains a brief summary of the company’s background and financial information, the number of shares being issued, underwriters’ information, and the risks involved with investing in the security.

2. Understand the business: Before investing, one should understand the nature of the business the company is in, the market they are operating in, and the future growth plans of the company.

3. Know about the financial performance and valuations of the company: Investors should try to understand the company’s financial health before applying for an IPO. Looking at past revenues, profits, growth percentages will give you a better idea and help in making the investment decision.

Vikas Lakhwani, Chief Revenue Officer, CPT Markets