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Views from the
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Author

Tatsuro NIGAURI, CMA
Senior Portfolio Manager

'…the IPO market is verging on a crisis due to oversupply"

A gold mine for investors may lie in newly listed stocks.

The novel coronavirus is taking its toll on stock markets, and initial public offering (IPO) markets are suffering big losses in particular. The stock market is in a state of turmoil due to the pandemic, but the one area that has been particularly affected is the IPO market. A series of newly listed companies have seen their stock price trade far below their IPO listing price due to a lack of buyers. However, I think now is a good time for long-term investors to buy stocks.

I pointed out last November that the IPO market is verging on a crisis due to oversupply. Newly listed stocks managed to ride out the critical situation back then, thanks to the strength of the market overall. However, IPO stock prices have started to retreat since the turn of the year following a shift of course in overall stock markets. When the number of new listings increased again in March amid the global spread of the coronavirus, the supply-demand balance was totally lost.

Out of the 27 companies publicly floated in the first quarter of this year, 17 saw their opening price dip below their IPO prices. The expectation for those that win the chance to participate in IPOs is for the price to be above the listing price. However, for 60% of newly listed companies during this period that did not happen and instead they suffered big losses.

"…60% of newly listed companies… suffered big losses "

The price-setting mechanism in secondary markets is not functioning properly, either. Stock prices of man newly listed companies continued to decline in the wake of disappointing opening prices, as more and more investors rushed to sell shares after watching the worsening supply-demand imbalance. Of the 27 companies mentioned earlier, at the time of writing this article, only five had a share price above their IPO price. The value of seven of these companies have fallen more than 50% from their IPO price.

Worries about the global downturn due to the spread of coronavirus are the main cause of this serious situation. However, there are many other factors that are specific to IPO stocks. First of all, there were too many IPOs.

"the number of IPOs during the latest quarter was 27, up from 21 in the same period of the previous year"

36 companies went public during the last quarter of 2019. The stock market is usually inactive in the first quarter in Japan, as only a few companies go public in January and February. But the number of IPOs during the latest quarter was 27, up from 21 in the same period of the previous year. This figure excludes four companies that were planning IPOs but gave them up later due to a lack of demand. It is no surprise then that IPO markets lost their supply-demand balance, given so many companies sought to list amid a change in direction of the stock market in the second half of January.

I think that corporate information may not have been delivered well enough to investors since the coronavirus outbreak. Companies normally hold large-scale roadshows for analysts and institutional investors ahead of their IPOs, but they were forced to suspend these briefings in March to prevent the spread of infection. Institutional investors who participate in book-building or individual investors who collect information through the internet might not care about roadshows, but I still think a significant number of investors in the broader market failed to grasp clear insights into the companies due to the absence of roadshows. More old-fashioned individual investors who rely on information from securities salespeople, may also have refrained from trading due to information shortages.

The fact that investors were unfamiliar with many of the activities of newly listed companies must have also contributed negatively to their stock prices once the supply-demand balance was lost. "We don't know what this company is doing but its earnings are growing at a solid pace." In cases like this, investors are willing to pay premiums in a bullish market but they tend to become nervous about the lack of information in a bearish, risk-off market as we are in now.

"…some companies looked attractive enough for me to seriously consider an investment following recent stock price falls."

However, the fact that investors are unfamiliar with the newly listed companies is not surprising given the size of IPO markets. Many of them are small in size, but if you look at their business activities it reflects the times we are in.

The most noteworthy businesses are internet-related as expected. As a value investor, I don't like to overstate future growth potential too much, but some companies looked attractive enough for me to seriously consider an investment following recent stock price falls.

Nursery school listings are also surging. Their stock prices have been sluggish as their profit margin is low, once subsidies to open new facilities are factored in. In addition, the current rush to open new facilities is likely to come to an end. But I believe their stocks have been oversold considering the prospect that their profitability will improve due to a re-balancing of the country's distorted age structure.

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Tatsuro NIGAURI, CMA
Senior Portfolio Manager, Japan Equity Small Cap Absolute Value

Tatsuro Nigauri is a Japanese small-cap equities manager with three decades of experience managing money based in Tokyo. He joined the firm in Oct 2002 and has managed the Japan Equity Small Cap Absolute Value strategy since its inception in 2004 and the UCITS funds since their launch in 2017. He started his career as a research analyst at the Daiwa Institute of Research in 1991. Nigauri is an award-winning manager and has received many accolades, including the Lipper Fund Awards Japan (2012, 2013 and 2016), the R&I (Rating and Investment Information) Fund Awards (consecutive years from 2012-2019) and the J Money Fund Awards (2016 and 2017).
He obtained a BA degree in economics from the University of Tokyo in Japan, and is a Certified Member Analyst of the Security Analysts Association of Japan.

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Contact Details

Business Development and Client Relations

Phone: +44 (0) 20 7507 6400

Email: smdukmarketing@smd-am.co.jp

Sumitomo Mitsui DS Asset Management (UK) Limited
5 King William Street, London, EC4N 7DA
United Kingdom
www.smd-am.co.uk