



## FAQ ON IPO GRADING

### **1. What is 'IPO grading'?**

ICRA's Grading of Initial Public Offerings (IPOs) is a service aimed at facilitating assessment of equity issues offered to the public. The Grade assigned to any individual IPO is a symbolic representation of ICRA's assessment of the "fundamentals" of the issuer concerned relative to other listed securities. IPO Grades are assigned on a five-point point scale, where IPO Grade 5 indicates the highest grading and IPO Grade 1 indicates the lowest grading, i.e a higher score indicates stronger fundamentals. An IPO Grade is not an opinion on the price of the issue, pre- or post-listing.

### **2. How is IPO grading different from an investment recommendation?**

Investment recommendations are expressed as 'buy', 'hold' or 'sell' and are based on an assessment of the fundamental factors, the current pricing of the security and the likely appreciation on price over a specific time horizon. Thus, investment recommendations carry out a detailed evaluation of the 'market factors' (liquidity, demand supply, valuation etc.) as well. On the other hand, IPO grading is a relative comparison of the assessed fundamentals of the graded issue and does not take cognizance of the price of the security, its valuation compared to peers or the possible gains over a specified time period. Rather, it is designed to be only an additional input to the investor in his decision making process.

### **3. Why is IPO grading necessary?**

An investor in a hitherto unlisted company may either have limited access to information on it, or may find it challenging to appropriately assess, on the basis of the information available, its business prospects and risks. An IPO Grade provides an additional input to investors, in arriving at an investment decision based on independent and objective analysis.

In recent times, with the stock market participation of new and foreign investors increasing, there is need for greater value-added information on companies tapping the capital market and their intrinsic quality. In this context, IPO Grades, being simple, objective indicators of the relative fundamental positions of the issuers concerned, could help in both widening and deepening the market.

### **4. Is the IPO grading also commenting on the price of the issue?**

As already stated, IPO Grading is NOT a recommendation to buy sell or hold the securities Graded. Similarly, it is NOT a comment on the valuation or pricing of the IPO Graded nor is it an indication of the likely listing price of the securities Graded.

### **5. If the IPO Grading is not commenting on the price or valuation, how does it help the investor?**

The IPO grading is a comment on the "fundamentals" of the company being graded. All other things remaining equal, an entity with stronger fundamentals and better growth prospects should be able to generate higher shareholder returns related indicators in the long run

### **6. What do you mean by 'fundamentals'? What are the issues that are assessed while arriving at the grading?**

The emphasis of the IPO Grading exercise is on evaluating the prospects of the industry in which the company operates, its competitive strengths that would allow it to address the risks inherent in the business(es) and effectively capitalise on the opportunities available as well as the company's financial position. In case the IPO proceeds are planned to be used to set up projects, either greenfield or brownfield, ICRA evaluates the risks inherent in such projects, the capacity of the company's management to execute the same, and the likely benefits accruing from the successful completion of



the projects in terms of profitability and returns to shareholders. Due weightage is given to the issuer company's management strengths and weaknesses and issues, if any, from the corporate governance perspective. Accordingly, ICRA's IPO Grading methodology examines the following key variables:

- ◆ Business and Competitive Position
- ◆ New Projects—Risks and Prospects
- ◆ Financial Position and Prospects
- ◆ Management Quality
- ◆ Corporate Governance practices
- ◆ Compliance and Litigation History

## **7. Does SEBI have a role in the grading exercise?**

No. SEBI does not play any role in the assessment made by the grading agency. The grading is intended to be an independent and unbiased opinion of a rating agency.

## **8. How would the grading be indicated?**

It is intended that IPO fundamentals would be graded on a five point scale from grade 5 (indicating strong fundamentals) to grade 1 (indicating poor fundamentals). The grade would read as: "Rating Agency name " IPO Grade 1 viz ICRA IPO Grade 1. The full scale is as follows:

**ICRA IPO Grade 5:** Strong fundamentals  
**ICRA IPO Grade 4:** Above-average fundamentals  
**ICRA IPO Grade 3:** Average fundamentals  
**ICRA IPO Grade 2:** Below-average fundamentals  
**ICRA IPO Grade 1:** Poor fundamentals

## **9. For how long would the assigned grade be valid?**

The assigned grade would be a one time assessment done at the time of the IPO and meant to aid investors who are interested in investing in the IPO. While the grading itself is valid for a period of 6 months from the date of issuance, the grading letter will have a validity of 2 months from the date of issue and would need to be revalidated subsequently- there would not be any additional charges for the revalidation. ICRA however reserves the right to change the grading after the same has been assigned should the circumstances so warrant.

## **10. How can a company get its IPO graded?**

ICRA starts the IPO Grading process on receipt of a formal request from the issuer company. ICRA then sends a questionnaire seeking basic information on the company's existing operations as well as proposed project(s). This is followed by site visits and discussions with the key operating personnel of the company concerned. Apart from officials of the company, ICRA also meets its bankers, auditors, merchant bankers, and appraising authority (if any). If the case so merits, ICRA also obtains the views of independent expert agencies on critical issues like, for instance, the technology proposed to be used. Once all the required information has been obtained, ICRA's team of analysts presents a detailed Grading Report to ICRA's Rating Committee, which then assigns the Grade.

## **11. How long does the IPO grading process take?**

Normally, the grading process takes three to four weeks to complete from the time all information is received by the rating agency



## **12. What are the deliverables of the Grading exercise?**

For the IPO Grading exercise, the deliverables are the Grade itself and a rationale (which is published) highlighting ICRA's key observations against each of the parameters listed in the section 6 above. The IPO Grading alongwith the rationale, will be disclosed in the Red Herring Prospectus (RHP). Accordingly, the company is required to obtain the grading prior to filing of RHP with Registrar of Companies and disclosure of the same has to be ensured in the RHP.