

Sub Section – III

IPO Grading

This sub-section attempts to cover the basic concepts and questions related to IPO Grading. For full particulars of laws governing the primary market, please refer to the Acts/Regulations/Guidelines/Circulars appearing under the Legal Framework Section of our website i.e. www.sebi.gov.in.

All details regarding operational aspects of IPO grading like, grading methodology, validity of grading, scope of grading etc, as given below are based on the information obtained from the Credit Rating Agencies (CRAs) (including their FAQs) and are meant only for general informational purpose regarding the overall functioning of the IPO Grading system. Specific details regarding IPO grading may be obtained directly from the respective Credit Rating Agencies.

1. What is 'IPO Grading'?

IPO grading is the grade assigned by a Credit Rating Agency (CRAs) registered with SEBI, to the initial public offering (IPO) of equity shares or any other security which may be converted into or exchanged with equity shares at a later date. The grade represents a relative assessment of the fundamentals of that issue in relation to the other listed equity securities in India. Such grading is generally assigned on a five-point scale with a higher score indicating stronger fundamentals and vice versa as below.

IPO grade 1 - Poor fundamentals

IPO grade 2 - Below-Average fundamentals

IPO grade 3 - Average fundamentals

IPO grade 4 - Above-average fundamentals

IPO grade 5 - Strong fundamentals

IPO grading has been introduced as an endeavour to make additional information available for the investors in order to facilitate their assessment of fundamentals of the company offering equity issues through an IPO.

2. I am an issuer. By when am I required to obtain the grade for the IPO?

IPO grading can be done either before filing the draft offer documents with SEBI or thereafter. However, the Prospectus/Red Herring Prospectus, as the case may be, must contain the grade/s given to the IPO by all CRAs approached by the company for grading such IPO.

3. Who bears the cost of the IPO grading process?

The company desirous of making the IPO is required to bear the expenses incurred for grading an IPO.

4. Is grading optional?

Yes, IPO grading is optional. It was mandatory previously. However, with effect from February 04, 2014 IPO grading has been made optional for the issuer.

5. Can the issuer reject an IPO grade?

IPO grade/s cannot be rejected. Irrespective of whether the issuer finds the grade given by the rating agency acceptable or not, the grade has to be disclosed as required under the ICDR Regulations. However the issuer has the option of opting for another grading by a different agency. In such an event all grades obtained for the IPO will have to be disclosed in the offer documents, advertisements etc.

6. Will IPO grading delay the process of issue?

IPO grading is intended to run parallel to the filing of offer document with SEBI and the consequent issuance of observations. Since issuance of observation by SEBI and the grading process, function independently, IPO grading is not expected to delay the issue process.

7. What are the factors that are evaluated to assess the fundamentals of the issue while arriving at the IPO grade?

The IPO grading process is expected to take into account the prospects of the industry in which the company operates, the competitive strengths of the company that would allow it to address the risks inherent in the business and capitalize on the opportunities available, as well as the company's financial position.

While the actual factors considered for grading may not be identical or limited to the following, the areas listed below are generally looked into by the rating agencies, while arriving at an IPO grade:

- a. Business Prospects and Competitive Position
 - i. Industry Prospects
 - ii. Company Prospects
- b. Financial Position
- c. Management Quality
- d. Corporate Governance Practices
- e. Compliance and Litigation History
- f. New Projects—Risks and Prospects

It may be noted that the above is only indicative of some of the factors considered in the IPO grading process and may vary on a case to case basis.

8. Does IPO grading consider the price at which the shares are offered in the issue?

No. IPO grading is done without taking into account the price at which the security is offered in the IPO. Since IPO grading does not consider the issue price, the investor needs to make an independent judgment regarding the price at which to bid for/subscribe to the shares offered through the IPO.

9. Where can I find the grades obtained for the IPO and details of the grading process?

All grades obtained for the IPO along with a description of the grades can be found in the Prospectus, Abridged Prospectus, issue advertisement or any other place where the issuer company is making advertisement for its issue. Further the Grading letter of the Credit Rating Agency which contains the detailed rationale for assigning the particular grade will be included among the Material Documents available for Inspection at the registered office of the Company.

10. Does an IPO grade, which indicates 'above average or strong fundamentals' mean I could subscribe safely to the issue?

An IPO grade is NOT a suggestion or recommendation as to whether one should subscribe to the IPO or not. IPO grade needs to be read together with the disclosures made in the prospectus including the risk factors as well as the price at which the shares are offered in the issue.

11. How do I interpret the IPO Grades?

The grades are allocated on a 5-point scale, the lowest being Grade 1 and highest Grade 5. The meaning of these grades has been explained under Question 1 in this FAQ.

12. How does IPO Grading help in deciding about investing in an IPO?

IPO Grading is intended to provide the investor with an informed and objective opinion expressed by a professional rating agency after analyzing factors like business and financial prospects, management quality and corporate governance practices, etc. However, irrespective of the grade obtained by the issuer, the investor needs to make his/her own independent decision regarding investing in any issue after studying the contents of the prospectus including risk factors carefully.

13. What is the role of SEBI in IPO grading exercise?

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 that agency.

14. Will IPO Grading given by CRAs be a parameter for SEBI to issue its observations?

The grading is intended to be an independent and unbiased opinion of a rating agency. SEBI does not pass any judgment on the quality of the issuer company. SEBI's observations on the IPO document are entirely independent of the IPO grading process or the grades received by the company.

15. Which credit rating agencies are registered with SEBI?

The details of credit rating agencies registered with SEBI can be accessed at <http://www.sebi.gov.in/sebiweb/home/list/5/33/0/0/Recognised-Intermediaries>