

Grading of IPO System in India

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Introduction

Grading and Credit Rating can be defined as an act of assigning values to credit instruments by estimating or assessing the solvency, i.e., the ability of the borrower to repay debt, and expressing them through pre-determined symbols. It is an assessment of the credit quality or investment quality of a particular credit instrument issued by a given business unit. Credit rating performs the function of credit risk evaluation reflecting the borrower's expected capability to repay the debt as per terms of issue. Credit rating is merely an indicator of the current opinion of the relative capacity of a borrowing entity to service its debt instrument being rated. It is a well informed opinion made available to the public. (Bhole, 2004)

Grading of Initial public offerings In India

The decision to introduce the requirement recognized the needs of the Indian capital market and was the result of pressure from certain investor groups. However, the path to mandatory grading IPOs has been unsteady, with opposition from companies, investment bankers, fund managers, market experts and even the SEBI board members. The parties that are in opposition want the grading to be an optional exercise. They argue that the mandatory grading has increased the cost of raising funds and also has led to delay in the IPO process, which SEBI was attempting to make faster and shorter with the help of grading. Given that the grading expenses have been as high as one percent of the total issue size in some cases, some of the concerns by the opposition deserve consideration. (SEBI Regulations)

In the year 2006 SEBI introduced optional grading of IPOs unlisted companies and framed guidelines relating to disclosure of the IPO by issuer companies who may want to opt for grading of their IPOs by the rating agencies. If the issuer companies opt for grading, then they are required to disclose the grades, including the unaccepted ones, in the prospectus. (Dalal, 2005) The correction in the market in April 2007, resulting in many new scraps dipping below their offer price, triggered the SEBI move to make IPO grading mandatory.

Objectives

This study attempted to understand the utility of IPO grades for the retail investors in evaluating an IPO. The main objectives of the study were:

I) to know the stock issuers to the grading practice when SEBI introduced optional grading of IPOs in the year 2006.

ii) To know the relationship between of IPO rating and price performance of stock after listing.

Methodology

The study was completed with the help of secondary data. Secondary data were collected from the website of SEBI, Bombay stock Exchange, National stock exchange regarding the companies graded and the current price of the companies which have been graded.

IPO Grading and Criteria for Evaluation

Investors, who look for good companies to invest in during their initial public offerings, should prefer those which are rated higher by rating agencies, over those with lower grades. IPOs that are graded higher are more likely to get better valuations on the bourses than those which get lower grades. SEBI's guidelines suggest that the grading of IPOs is a service aimed at facilitating assessment of equity issues offered to the public. The Grade assigned to any individual IPO is an assessment of the "fundamentals" of the issuer concerned on a relative grading scale, in relation to the other listed equity securities in India. The grading is 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

The Grading exercise emphasizes on evaluating the prospects of the industry in which the company operates, and the company's competitive strengths that would allow it to address the risks inherent in the business (as). The grading 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.

The Process of Obtaining an IPO Grade

The grading agencies that are approved by SEBI to carry out the grading are as follows:

CARE – Credit Analysis & Research Ltd.

CRISIL – Credit Rating Information services of India Limited.

FITCH Ratings India

ICRA Limited

Steps Involved in the grading process are as follows:

To initiate the process of obtaining an IPO grade, the company first contacts one of the grading agencies. (Sebi Act)

Step I: The issuer shares the required information with the grading team of the rating agency.

Step II: Rating agency follows up with detailed management meetings with the CEO, CFO, and board of directors, and further follows up with subsequent site visits.

Step III: The Grading team prepares a detailed note and grading committee assigns the grade.

Step IV: Grading agency publishes a grading rationale outlining the reasons for the assigned grade.

Step V: Grading agency sends the grading report to SEBI, stock exchanges, and to the company.

The issuing company then discloses the IPO grade on the prospectus that it files with the Registrar of Companies. SEBI believes grading will act as an investment information tool for investors.

Analysis and Findings

To analyze the response of the issuers to the grading of IPOs, data relating to the number of companies graded with their respective grades was collected and analyzed.

Table 1: shows that during the year 2011-12, 25 IPOs were graded by various companies

Name of the company	Issue Date	Assigned Grade-(Max. 5)	Rating Agency
Omkar Specialty Chemicals	Jan 24,2011	3	CARE
Sudar Garments Ltd.	Feb 21,2011	1	CRISIL
Finotex Chemicals Ltd.	Feb 23,2011	2	CARE
Acropetal Technologies Ltd.	Feb 21,2011	2	ICRA
Lovable Lingeries Ltd.	Mar 08,2011	3	CARE
PTC India financial Services	Mar 16,2011	4,4,3	Care/CI/Icra
Shilpi Cable Technologies	Mar 22,2011	1	CARE
Muthoot Finance Ltd.	Apr 18,2011	4	CI/ICRA
Paramount Printpackaging Ltd.	Apr 20,2011	2	ICRA
Innoventive Industries Ltd.	Apr 25,2011	3	ICRA
Servalakshmi Paper Ltd.	Apr 27,2011	2	ICRA
Vaswani Industries Ltd.	Apr 29,2011	2	ICRA
Sanghvi Forging & Engineering Ltd.	May 04,2011	3	CARE
VMS Industries Ltd.	May 30,2011	1	ICRA
Birla Pacific Medspa Ltd.	June 20,2011	2	M/S BRI
Rushil Décor Ltd.	June 20,2011	2	ICRA
Readymade Steel India Ltd.	June 27,2011	2	CARE
Bharatiya global Infomedia Ltd.	July 11,2011	2	CARE
Multi Commodity Exchange Ltd.	Feb 22,2012	3	CRISIL
National Buildings Constructions Ltd.	Mar 22,2012	3	CARE
MT Educare Ltd.	Mar 27,2012	3	CRISIL
Tribhovandas Bhimji Zaveri Ltd.	Apr 24,2012	3	CRISIL
Speciality Restaurants Ltd.	May 16,2012	3	CRISIL
Tara Jewels Ltd.	Nov 21,2012	3	CARE
PC Jeweller Ltd.	Dec 10,2012	3	CARE/CL

Table 2: The Present Position of the Companies which have been graded from 2011 to 2012

Name of the Company	Issue Date	Assigned Grade (Max-5)	Rating Agency	Issue Price	Present Price (Rounded)
Omkar Speciality Chemicals	Jan 24,2011	3	CARE	98	119
Sudar Garments Ltd.	Feb 21,2011	1	CRISIL	77	17
Finotex Chemicals Ltd.	Feb 23,2011	2	CARE	72	26
Acropetal Technologies Ltd.	Feb 21,2011	2	ICRA	90	6
Lovable Lingeries Ltd.	Mar 08,2011	3	CARE	205	308
PTC India financial Services	Mar 16,2011	4,4,3	Care/CI/Icra	28	14
Shilpi Cable Technologies	Mar 22,2011	1	CARE	69	23
Muthoot Finance Ltd.	Apr 18,2011	4	CI/ICRA	175	132
Paramount Printpackaging Ltd.	Apr 20,2011	2	ICRA	35	1
Innoventive Industries Ltd.	Apr 25,2011	3	ICRA	120	16
Servalakshmi Paper Ltd.	Apr 27,2011	2	ICRA	29	3
Vaswani Industries Ltd.	Apr 29,2011	2	ICRA	49	3
Sanghvi Forging & Engineerg.Ltd.	May 04,2011	3	CARE	85	19
VMS Industries Ltd.	May 30,2011	1	ICRA	40	32
Birla Pacific Medspa Ltd.	June 20,2011	2	M/S BRI	11	1

Rushil Décor Ltd.	June 20,2011	2	ICRA	72	55
Readymade Steel India Ltd.	June 27,2011	2	CARE	108	135
Bharatiya global Infomedia Ltd.	July 11,2011	2	CARE	82	6
Multi Commodity Exchange Ltd.	Feb 22,2012	3	CRISIL	1032	502
National Buildings Constrctn.Ltd.	Mar 22,2012	3	CARE	106	152
MT Educare Ltd.	Mar 27,2012	3	CRISIL	80	88
Tribhovandas Bhimji Zaveri Ltd.	Apr 24,2012	3	CRISIL	126	133
Speciality Restaurants Ltd.	May 16,2012	3	CRISIL	155	129
Tara Jewels Ltd.	Nov 21,2012	3	CARE	230	117
PC Jeweller Ltd.	Dec 10,2012	3	CARE/CL	135	78

Findings and Analysis

i) Issuers Response to the Grading Practice

The above Table 1 shows that during the year 2011-2012, 25 IPOs were graded by various credit rating agencies in India. The total number of IPOs in the period is 62, it shows that not too many companies are opting for grading, and the reason is some investment bankers feel the procedures are too strict for smaller and business firms.

ii) Stock Prices and Grades

The above Table 2 shows that some of the companies even though graded 4 and 3 by the credit rating agencies, their pricing performances are much below their offer price. A few companies like Lovable lingerie's, Omkar speciality chemicals; Readymade steels India, National Buildings

Which are trading much above their offer price, others like Acropetal Technologies, Paramount Print Packaging, Vaswani Industries, Birla Pacific, and Bharatiya global Infomedia are trading much below their offer price. At the same period a few companies with a low grade of 1 and 2 like Readymade steel India and some other companies are trading at above their offer prices.

Conclusion

The Procedure of Credit Rating of IPOs has so far not turned out to be victorious. There are questions like, are credit rating agencies trading the IPOs, strength of the firms, market situations or the business project for which the money is raised. If they are grading the company, its fundamentals are going to change over a period of time and this will raise the need for grading review like debt rating, If they are rating the project for which the money is raised, it has to be relative to the price (Shankar, 2007) Therefore, Credit Rating and Grading of IPOs is now very useful tool for every Investors, SEBI should consider making the improvements with this present structure of grading so as to make it more useful tool for investors.

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