

Investors' FAQs

on CRISIL IPO Grading



Frequently Asked Questions

1. What is CRISIL IPO Grading?

CRISIL IPO (Initial Public Offering) Grading is an independent opinion on the fundamentals of the graded issue expressed as a relative assessment in relation to other listed equity securities in India. The assessment is based on a grading exercise carried out by industry specialists from CRISIL's Research division and comprises an analysis of the following:

- ❑ Business prospects which comprises
 - a. Industry prospects
 - b. Company prospects - the alignment between industry opportunities, the company's strategy and its capabilities.
- ❑ Financial Prospects - This includes a forward looking assessment of key financial indicators relevant for an equity investor.
- ❑ Management quality - An assessment of the ability of the management to handle uncertainty in terms of capitalising on future business opportunity and mitigating the impact of contingencies.
- ❑ Corporate governance - An evaluation of the company's governance architecture to determine if it is structured such that the risks and rewards of business are equally available to all shareholders in keeping with the basic tenets of a joint-stock company.

A CRISIL IPO Grade 5/5 indicates strong fundamentals and a CRISIL IPO Grade 1/5 indicates poor fundamentals.

CRISIL's IPO Grading reflects its assessment of the graded company's equity fundamentals as distinct from an assessment of debt fundamentals. CRISIL IPO Grading is based on a process that is totally independent of the credit rating process - a separate analytical team and a separate

grading committee - to bring the necessary equity orientation to the outcome. Notably, therefore, CRISIL IPO Grading is much more than a 'due diligence' exercise - it is an independent view on equity fundamentals. Further, being an independent opinion by an entity that is not connected to the placement of the issue, CRISIL IPO Grading brings fresh information to the market in addition to that provided by merchant bankers.

What a CRISIL IPO Grading is not :

A CRISIL IPO Grading is not -

- ✦ A recommendation to invest or not invest in the graded instrument
- ✦ A comment on the issue price of the shares being offered, likely listing price or likely movement of price post listing
- ✦ A valuation of the equity offering
- ✦ An assessment of the market risk associated with equity investments
- ✦ An audit of the issuer
- ✦ A forensic exercise that can detect fraud



2. Does CRISIL recommend an IPO through its grading?

CRISIL IPO Grading is not a recommendation to invest in the graded instrument. It is not a comment on the price of the graded security or its suitability for a particular investor. It does not comment on issue price, likely price on listing or movement in price post listing. However, CRISIL's IPO Grading is an assessment of 'fundamentals' which is one of the most basic and important components of the investment decision process.



3. How is CRISIL IPO Grading different from an investment recommendation?

Investment recommendations are expressed as 'buy', 'hold' or 'sell' and are based on a security specific comparison of its assessed 'fundamental factors' (business prospects, financial position) and 'market factors' (liquidity, demand supply) to its price. On the other hand, CRISIL IPO Grading is expressed on a five-point scale and is a relative comparison of the assessed fundamentals of the graded issue to other listed equity securities in India.

As CRISIL IPO Grading does not take cognizance of the price of the security, it is not an investment recommendation. Rather, it is one of the inputs to aid the investor in the investment process.



4. Is IPO grading done anywhere else in the world?

Equity markets all over the world have felt the need for independent research. Market regulators have been trying various methods to achieve this. CRISIL believes that IPO Grading is a good way to provide independent research to equity investors.



5. What is the validity of CRISIL IPO Grading?

IPO Grading is a one-time exercise. It does not have an ongoing validity. The IPO Grading letter is valid for 60 days. CRISIL will, if required, issue a fresh letter at no extra cost until 120 days after the assignation of the initial grading.



6. Is CRISIL IPO Grading based on past performance?

No. CRISIL IPO Grading is based entirely on the assessed future performance. The assessed future performance is based on the business plan of the company's management

as understood by CRISIL. CRISIL will subject the business plan to extensive reality checks based on its understanding of industry and market dynamics, future management capability and the management's track record of translating intentions into action.



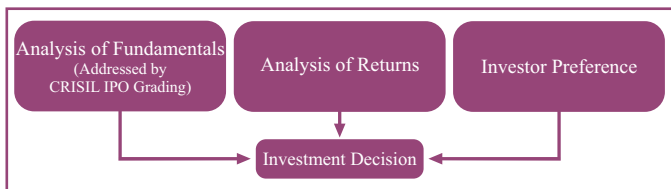
7. Is it 'fair' to compare IPO companies to all other listed companies in India?

IPO Grading is an additional input to aid the investor. The investor can invest as easily in secondary market companies as in IPO companies. Therefore, if IPO grading is to meet investors' needs, the relative comparison set of IPO companies must include all companies that are potential investment equity options for the investor - including all secondary market companies.



8. How is CRISIL's IPO grading useful in the absence of an opinion on valuation?

CRISIL IPO Grading seeks to introduce a new paradigm with respect to the research architecture in the equity market. Until now, research has been available to equity investors only in the form of investment advice ('buy/sell/hold' recommendations). CRISIL IPO Grading, which is an assessment of fundamentals, seeks to singly and comprehensively assess one of the key components that goes into any investment decision as illustrated here:



This is very similar to the research architecture that is available to bond markets in the form of credit ratings. A

credit rating is a relative assessment of the fundamentals of the bond security. Likewise, CRISIL IPO Grading is a relative assessment of the fundamentals of the equity security.

CRISIL believes that, over time, CRISIL IPO Grading will emerge to be a useful **valuation tool** for equity shares just as credit ratings are used for the valuation of 'buy/sell/hold' recommendations of bonds. It is important to note that as a AAA rated bond at a zero coupon might be a bad investment, a 5/5 graded IPO at a very high valuation too would not be an attractive investment opportunity.



9. Is IPO grading useful only to retail investors?

No. IPO grading is value adding to the investment process of institutional investors too ; due to the independent and focused information on relative fundamentals that is contained in the IPO grading rationale. Moreover, the expression of the independent opinion on relative fundamentals as a single unambiguous symbol creates the possibility of discovering meaningful relationships between fundamentals and pricing.



10. How does a CRISIL IPO Grading differ from a credit rating?

Though the basic elements of the analysis that go into credit rating and IPO grading are the same - business prospects, financial prospects, management quality and corporate governance - the orientation of the analysis and, therefore, outcomes, are very different as the assessment is undertaken for very distinct objectives.

A credit rating assesses these factors from a debt-holder's perspective, which is very different and sometimes opposite to an equity-holder's perspective. For instance, companies that raise far more equity than they need in an

IPO and hence suffer a depressed return on equity (RoE) are likely to be assessed unfavourably in the IPO grading exercise. However, they are likely to be assessed more favourably in a credit rating exercise, as equity cushions debt repayment.

The focus on financial prospects in a CRISIL IPO Grading would be on equity related parameters including RoE, return on capital employed (RoCE), earnings per share (EPS) and growth in profits while the focus on financial prospects from a credit rating perspective would be on cash flows in relation to debt servicing.

This distinction of objectives also means that the relative emphasis on the elements is very different in IPO grading and credit rating. For instance, the assessment of corporate governance would be more important in CRISIL IPO Grading than in credit rating where the emphasis of assessment is on estimating cash protection available to service debt.



11. Who pays for the CRISIL IPO Grading exercise?

The issuing company pays for this exercise.



12. If the issuer pays for the grading exercise, how is CRISIL's opinion independent?

Experience from the bond market, where the issuer pays for the credit rating, indicates that the existence of this conflict does not by itself lead to lax standards by the grading agency. This is because the reputation of the grading agency would play a crucial role in the perceived value of its grading. Although the company would pay for the grading, the investor would use it. Investors would use only those gradings that they find objective, independent and analytically rigorous. Thus, even though the company would pay for the grading exercise, grading agencies

would have a strong incentive to maintain their independence due to the reputation risk arising out of lax standards.

CRISIL also ensures that the grading is free from any individual bias by using a multi-layered process for assigning the grading where the facts of every grading are deliberated on in a grading committee. In addition, the team that works on assigning the grading is completely separate from the business development team that originates the grading assignment.



13. What is the CRISIL IPO Grading process?

Step I - The issuer shares the required information with the grading team with the mandate (sample set of information requirements available on request).

Step II - This is followed by detailed management meetings and plant/site visits. Management meetings comprise meetings with the CFO, functional/plant/SBU heads as applicable, independent directors and the CEO, preferably in that order.

Step III - The grading team prepares a detailed note and presents it to CRISIL's Grading Committee. The Grading Committee assigns the grading.

Step IV - CRISIL publishes a grading rationale outlining the reasons for the assigned grade. CRISIL also publishes a one-page public release on the subject.



14. Why should I prefer CRISIL IPO Grading over other options?

Equity focused team: CRISIL IPO Gradings are assigned by a separate equity focused team (and not by credit rating analysts) to bring the necessary equity orientation to the outcome. Notably, therefore, CRISIL IPO Grading is much more than a 'due diligence' exercise it is an independent view on equity 'fundamentals'. CRISIL is the only grading agency to have adopted this best practice.

Unmatched track record of independent research in India: CRISIL IPO Gradings are assigned by CRISIL Research - India's largest independent integrated research house with a 17 year track record of providing research on the Indian economy, sectors and companies to over 600 global and Indian clients across the banking, financial corporate and consulting segments. It has the widest independent research coverage comprising over 47 industry, service and infrastructure sectors.

Deep understanding of equity sectors and methodologies beyond India: CRISIL has an unmatched expertise in high end investment research in India. Irevna, a division of CRISIL, has pioneered third party equity research in India and has recently been voted as the top investment research firm by global buy side firms.



15. Where can I get all the information on the grading assigned by CRISIL for a particular IPO?

It is mandatory for the Issuers to disclose the IPO grading in the Red-Herring prospectus, advertisements and Offer Document released during the IPO period. CRISIL also makes a press release after every IPO grading that it assigns. This press release is sent to all leading print and electronic media engaged in reporting about India. You can even log on to www.crisil.com to get a complete listing of the grades assigned by CRISIL.

16. Does the CRISIL IPO Grading tag make my money safe?

Equity investment does not guarantee safety of the money invested as the likelihood of gains is accompanied by the likelihood of losses. CRISIL IPO Grading is a tool to enable you to make your investment decision with the benefit of an informed opinion on fundamentals in a relative framework. You must use this opinion on fundamentals in conjunction with the other elements outlined in the chart under question 8 to make your investment decision.



About CRISIL Research

CRISIL Research is India's largest independent, integrated research house. We leverage our unique, integrated research platform and capabilities spanning the entire economy-industry-company spectrum to deliver superior perspectives and insights to over 600 domestic and global clients, through a range of subscription products and customised solutions.

About CRISIL Limited, a Standard & Poor's Company

CRISIL is India's leading Ratings, Research, Risk and Policy Advisory company. CRISIL's majority shareholder is Standard & Poor's, a division of The McGraw-Hill Companies and the world's foremost provider of financial market intelligence, including independent credit ratings, indices, risk evaluation, investment research and data.

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