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IPO grading not mandatory, but companies love it

Suresh Nandi, Mumbai, April 14, 2014, DHNS:



Even as the Securities and Exchange Board of India (Sebi) has made grading of IPOs voluntary, companies tapping the equity capital markets continue to get their issues graded by rating agencies to ensure positive investor sentiment.

Earlier this year, SEBI had made grading of IPOs voluntary as a part of initiative towards easing the regulatory prerequisites to help revive primary markets. Yet, most IPO-bound companies are getting their issues graded from leading credit rating agencies.

To be sure, only a handful of documents have been filed with Sebi since IPO grading was made voluntary. However, investment bankers and rating agencies have indicated that the companies will continue to insist on grading to ensure positive investor sentiment.

Grading helps provides better visibility, especially among small investors, they said. "IPO grading gives retail investors a certain comfort level about a good but relatively unknown company. It shows that the company is transparent and bold enough to get itself evaluated by an independent agency," said the credit rating agency CARE's managing director & CEO D R Dogra.

Also industry players feel that IPO grade is a simpler away to judge a company without really going through the entire offer document. "The layman investor does not have the depth or the reach to analyse a company's financial performance. Which is why companies choose to get their IPOs graded," Dogra said.

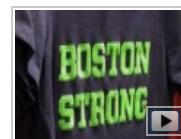
What's more, grading also helps issuers get the right valuations, market players said. "It (IPO grading) helps a company in two ways. One, it gives a certain level of comfort to investors that the issue is reliable. Second, for the company, it helps them get higher valuations," said George Joseph, chairman, Wonderla Holidays — which is planning to launch its IPO next week — to a DH poser while interacting with mediapersons last week at the company's IPO press conference in Mumbai.

IPO pricing is a contentious issue between the issuer company and merchant bankers handling the issue. An IPO is graded on a scale of one to five, with one being the lowest. Some feel that IPO grading helps separate only the good from the bad, but cannot guarantee if an issue will deliver higher returns post listing, which is critical for IPO investors.

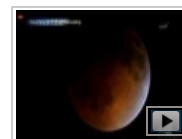
According to a study done in 2012 by the Indian Institute of Management, Ahmedabad, IPO grading does not guarantee higher pricing. "There is no evidence to support IPO pricing improvement due to the introduction of IPO grading. This is contrary to the evidence reported by some earlier studies. This suggests the failure of grading as an IPO certification," said Joshy Jacoby and Sobhesh Kumar Agarwalla, in their report titled 'Mandatory IPO grading: Does it help pricing efficiency?'

However, time and costs incurred for such grading is very small in comparison to

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the benefits, industry players said. An IPO grading process would typically cost a company about Rs 5-10 lakh and the process takes about 3-4 weeks, officials said.

One school of thought maintains that IPO grading is unavoidable as companies do not want to be seen as breaking away from an ethical practice for fear of doubts being raised about the issue.

Satyen Shah at Edelweiss Financial Services said it is likely that issuers will continue with IPO grading as it gives investors some level of comfort on the quality of an issue. "Dropping IPO grading might raise doubts on issue quality. And, as the cost of grading an IPO isn't much, it isn't really much of a problem," he added.

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