

Grading Rationale for CRISIL IPO Grading

Edelweiss Capital Limited

CRISIL IPO Grade 4.0/5.0

Public Issue of 8,386,147 Equity Shares of face value Rs 5 at a targeted price of Rs * per share.

Bid/Offer Opens	*
Bid/Offer Closes	*
Shares Offered	8,386,147
Shares Outstanding (Post issue)	81,816,067
Lead Managers	
Kotak Mahindra Capital Company Ltd	
Citigroup Global Markets India Private Ltd	
Lehman Brothers Securities Private Ltd	
Registrar to the Issue	
Intime Spectrum Registry Ltd	

Edelweiss Capital Limited			
Past financial performance		2005-06	2006-07
Total income	Rs Million	1,580.0	3,712.5
Total expenditure	Rs Million	885.5	1,974.8
Net profit	Rs Million	405.5	1,090.1
Return on equity	Per cent	34.9	28.7
No. of equity shares	Million	37.8	44.9
Net worth	Rs Million	1,784.2	5,823.2
Earnings per share	Rs	10.7	24.3
Book value per share	Rs	47.2	129.6
Gearing	Times	0.3	0.7

Shareholding pattern	Prior to the issue		Post issue	
	No. of shares	%	No. of shares	%
Promoters	20,348,640	30.6	20,348,640	24.9
Promoter group	8,170,360	12.3	8,170,360	10.0
Others	38,016,608	57.1	45,115,460	55.1
Public	-	-	8,181,607	10.0
Total	66,535,608	100.0	81,816,067 *	100.0

* fully diluted post issue capital

In order to arrive at the overall grade, CRISIL considers the following broad parameters:

- Business prospects and financial performance
- Management capability
- Corporate governance

Overall assessment

CRISIL has assigned a CRISIL IPO Grade '4/5' (pronounced 'four on five') to the proposed initial public offer of Edelweiss Capital Ltd (ECL). This grade indicates that the fundamentals of the issue are above average, relative to other listed equity securities in India.

The grading reflects the company management's ability as seen in its success in building one of the largest institutional equities derivatives desks in India. It also factors the company's strategy of supporting its institutional equities broking and investment banking businesses through breadth of research coverage and its strength in arbitrage trading on its proprietary book. The grading also takes into account the company's strong business relationships with foreign institutional investors (FIIs) in the institutional equities broking segment and its sound corporate governance structure. The grading is tempered by the fact that the company's earnings continue to be dependent on their skills in identifying arbitrage opportunities in its proprietary trading business, where yields have fallen over the years but have remained reasonably stable over the last 18 months. Further, the grading reflects the fact that ECL has created a good position in the mid-size space of Indian investment banking, an area with significant growth potential, but competition is expected to intensify in this space.

Sound top management

ECL has a strong management structure with built-in redundancies in all critical parts of the staffing hierarchy. Two experienced co-heads are at the helm of each of the company's businesses. Over the years, the top management has displayed a sound ability to match strategy with capability and opportunity as seen in the company's success in building a diversified financial services company. Further, the strategy of using graduates as interns, where they are trained on-the-job, has helped the company identify new talent in a cost effective manner. From a strategic perspective, the top management believes that the capital market has evolved as a credible option to the banking system as a source of capital. Going forward, the management expects the capital market to deepen with the development of the credit market along with the equity market. The ability to attract talent at competitive rates, especially after the upside of employee stock options (ESOPs) is spent post the IPO, will be one of the key challenges for the management going forward.

Strong arbitrage trading skills

The company has developed strong arbitrage trading skills in the equity space comprising index-component arbitrage, single stock cash-derivatives arbitrage and single stock options-futures arbitrage. These skills are supported by the company's network of relationships with FIIs and other active participants in the equity market. Strong competence at arbitrage trading in the cash and futures & options (F&O) segments has enabled the company to consistently register profits and improve overall earnings. The institutional understanding of arbitrage skills also enables the company to present differentiated offerings to its equity broking clients.

Sound corporate governance structure

The independent directors on ECL's board have strong career profiles and bring with them significant experience in the areas of equity, debt, risk and finance, after having held several important and senior positions in various companies. Also, most independent directors hold directorships on the boards of several other companies. Apart from experience and willingness, the ability of the independent directors to exercise management oversight imparts a sound corporate governance structure to ECL.

ECL will need to guard against competition in investment banking

ECL has created a good position in the mid-size space of Indian investment banking, an area with significant growth potential, but competition is expected to intensify in this space. Strong business relationships across different businesses have also augmented the company's revenues in the investment banking space.

Earnings highly dependent on profits from proprietary arbitrage trading

The proprietary arbitrage trading business has contributed significantly to the company's earnings in the last few years. In arbitrage trading, the key drivers of profits are likely to be the propensity of the company to take risk on its book, the state of the underlying capital market, the extent of volatility in the market and competition from new players in the business. Competition in this area is expected to go up with increasing funds availability with Indian brokerage houses and the growing focus on India by foreign brokerage houses.

All business lines are critically linked to the state of the Indian capital market

All the company's businesses are driven by the state of the Indian capital market. This, in the absence of any market diversification, makes the company's business and earnings performance vulnerable to any fluctuation in the capital market in India.

Business profile

ECL, promoted by Mr. Rashesh Shah and Mr. Venkatchalam Ramaswamy, was incorporated as a public limited company on November 11, 1995. It has a merchant banking licence from the Securities and Exchange Board of India (SEBI). As of March 2007, the company was predominantly engaged in institutional equities broking, investment banking and proprietary arbitrage trading activities. It also has a small presence in insurance broking, asset management and investment advisory services, wealth management and wholesale financing activities. The company's clientele includes institutions (both domestic and foreign), high net worth individuals (HNIs) and corporates. Headquartered in Nariman Point, Mumbai, the company operates from another 43 offices in 21 cities in India.

Since commencement of business in 1996, ECL has grown from a boutique investment bank into a diversified Indian financial services company organised under agency and capital business lines and operates through the company and its nine subsidiaries.

In institutional equities broking, its diversified client base includes major funds and large international banks/investment banks. ECL's research strategy of focusing on the breadth of coverage has enabled it to offer differentiated offerings such as sector thematic research for its institutional brokerage business. This also supports its niche operations in the investment banking space. The company's investment banking activities are carried out through the six practices that the business runs - equity capital markets (ECM) advisory, M&A advisory, private equity capital raising advisory, structured finance advisory, real estate capital raising advisory and infrastructure capital raising advisory. The company's entry into structured finance and infrastructure capital raising advisory space is expected to support growth in revenues in the investment banking business in the next few years.

On the proprietary trading book, the company does arbitrage trading covering the equity cash and F&O segments and invests in positions which can be liquidated economically within a few days. Strong competence in arbitrage trading in the cash and F&O segments has enabled the company to consistently register profits in the proprietary trading segment. The treasury invests in stocks with sufficient depth in the market.

Going forward, the company plans to increase focus on its new wholesale financing and asset management businesses. In wholesale financing, ECL provides its HNIs and corporate clients with loans against shares (including promoter funding), IPO financing and loans against mutual fund units. Through its asset management and investment advisory services business, the company advises three funds (one of which it also manages) with an aggregate corpus of over USD 330 million.

Of the proposed IPO, the company plans to utilise Rs 3,000 million to enhance margin maintenance with the stock exchanges. In addition, Rs 269.19 million will be utilised for the establishment of additional offices and acquisition of office infrastructure, Rs 30.93 million for enhancing existing technological capacity and Rs 1,050 million for prepayment of loans.

Financial profile

For 2006-07, the company's consolidated total income and net profits were Rs 3,712.53 million and Rs 1,090.08 million, respectively. ECL's revenue profile is supported by its presence across its main business segments such as equities broking, arbitrage trading, and investment banking, though each of these businesses are inherently linked to the capital market. ECL's total income increased at a very strong CAGR of 119.51 per cent from Rs 770.49 million in 2004-05 to Rs 3,712.53 million in 2006-07, while net profits grew at a CAGR of 120.20 per cent from Rs 224.82 million in 2004-05 to Rs 1,090.08 million in 2006-07.

Profile of Management and Board

The company's operations are headed by the two founder promoters. They are supported by professionals from various backgrounds such as investment banking, equity sales and trading, asset management and other related disciplines. Most members of the senior management team have been with the company for the last 5 years. Over the last year, leading global investors such as Government of Singapore, Galleon Group, Shuaa Capital, Lehman Bros. etc, have invested in the company.

Board of directors

Name	Designation	Age (years)	Qualification	Other directorships	Previously held positions
Mr. Rashesh Shah (Based out of Mumbai)	CEO, Chairman and Managing Director	44	B.Sc.; PGDBM from IIMA	Other directorships in 7 Indian companies, 2 foreign companies and 1 trust	Head of Research, Prime Securities Pvt Ltd; Manager, ICICI Ltd
Mr. Venkatchalam Ramaswamy (Based out of Mumbai)	Executive Director and Co-Head of Investment Banking	41	B.E.; MBA from Uni. of Pittsburgh	Other directorships in 5 Indian companies, 2 foreign companies and 1 trust	Fund Manager, Spartek Emerging Opportunities of India Fund; Asst. Manager, ICICI Ltd; Asst. Manager, Tata Unisys Ltd
Mr. Narendra J. Jhaveri (Based out of Ahmedabad, India)	Independent Director	71	M.A. (Eco.); M.S. (Eco.) from London School of Economics	Other directorships in Indian companies include SKF India, Usha Martin, Afcons Infrastructure, Voltas, Siemens, Juniper Hotels, Hindalco, Ultra Tech Cement and 7 other companies.	Senior Economist, NCAER; Worked in the Economics Dept. of RBI; Chief Economist, ICICI Ltd; Chairman, IMC Economic Research and Training Foundation
Mr. P. N. Venkatachalam (Based out of Chennai, India)	Independent Director	63	M.A. (Eco.); CAIIB	Chairman and director, Laser Soft Infosystems Ltd; Director, Khazana Jewellery Pvt Ltd	MD, State Bank of India; Member of Interim Pension Fund Regulatory Authority of India; Director, Small Industries Development Bank of India
Mr. Ramanan Raghavendran (Based out of New York, USA)	Independent Director	39	B.Sc. (Finance) from Uni. Of Pennsylvania's Wharton School; B.Sc. (Computer science and engineering) from Uni. Of Pennsylvania's Moore School of Engineering	Managing Partner, Kubera Partners LLC (a private equity firm managing the Kubera Cross-Border Fund); Oversees the TH Lee Putnam Ventures portfolio; Other directorship in an Indian company Netscribes Ltd; Other directorships in 5 foreign companies	Led cross-border investing at TH Lee Putnam Ventures; Senior Partner, Insight Venture Partners; Senior Member of investment team, General Atlantic; Worked in McKinsey & Co. in New York and London
Mr. Sunil Wadhvani (Based out of Pennsylvania, USA)	Independent Director	55	B.Tech from IIT Chennai; MBA from Carnegie-Mellon University	Co-Founder and director of iGate Corporation; Other directorships in foreign companies include Pangea3 LLC, Chen & McGinley and 21 other companies; Other directorships in Indian companies include Quintant Services, Job Curry Systems, Impact India and 3 other companies	
Mr. Sanjay Santhanam (Based out of Greenwich CT, USA)	Nominee Director (Non-Executive)	41	B.Sc. (Hons in Maths and Stats) from Uni. Of Delhi; PG in Applied Maths from Uni. Of Texas; PG in Management Science from Uni. Of California	Other directorships in 4 foreign companies and 1 partnership	MD and Head of Risk Management, Galleon International, LLC; Senior Portfolio Manager, Rock Creek Group; Managing Principal, VS Asset Management & Chaos Systems; CFO & Senior Researcher, RPP International
Mr. Kunnasagaran Chinniah (Based out of Singapore)	Nominee Director (Non-Executive)	50	B.E. (Electrical) from National Uni. Of Singapore; MBA from Uni. Of California; CFA from CFA Inst. USA	Executive VP, GIC Special Investments (private equity arm of Government of Singapore); Other directorships in 95 foreign companies	Senior Field Engineer, Schlumberger Wireline Services Ltd, Middle East; Regional Manager for North America, Europe Divisions, GIC SI

Source: Company prospectus

ECL's board comprises eight directors, which includes two promoter directors, four independent directors and two nominee directors (non-executive). All the independent directors are professionally qualified and are reputed names in their fields; Mr. Ramanan Raghavendran and Mr. Sunil Wadhvani joined the board more than 5 years ago as early investors and stayed on after selling their stake, while Mr. Jhaveri and Mr. Venkatachalam have joined the board recently. The board has had a healthy involvement in the business decisions in the past.

Disclaimer

A CRISIL IPO grading is a one-time assessment and reflects CRISIL's current opinion on the fundamentals of the graded equity issue in relation to other listed equity securities in India. A CRISIL IPO grading is neither an audit of the issuer by CRISIL nor is it a credit rating. Every CRISIL IPO grading is based on the information provided by the issuer or obtained by CRISIL from sources it considers reliable. CRISIL does not guarantee the completeness or accuracy of the information on which the grading is based. A CRISIL IPO grading is not a recommendation to buy / sell or hold the graded instrument; it does not comment on the issue price, future market price or suitability for a particular investor.

CRISIL is not responsible for any errors and especially states that it has no financial liability whatsoever to the subscribers / users / transmitters / distributors of CRISIL IPO gradings. For information on any IPO grading assigned by CRISIL, please contact 'Client Servicing' at +91-22-66913561, or via email: clientservicing@crsil.com.

For more information on CRISIL IPO gradings, please visit <http://www.crsil.com/research/research-faqs-ipo-grading.htm>