

Corpsec Hotline

February 25, 2009

COUNTERING THE DIP: SEBI AMENDS IPO GUIDELINES

Brief snapshot of the Amendment

- Validity of SEBI's observation letter on draft offer document increased from 3 months to 12 months.
- Listing of equity shares with differential rights as to dividends, voting or otherwise or warrants offered along with NCDs under QIP route now possible.
- Amendment of preferential issue guidelines, including increase in margin to be paid by warrant-holders from 10% to 25%.
- Reduction in the time limit for completing a bonus issue.
- Announcement of price band for an IPO through book building process can now be made merely 2 days prior to opening of the issue.

INTRODUCTION

Indian capital markets regulator, the Securities and Exchange Board of India ("**SEBI**") vide circular dated February 24, 2009 ("**Circular**") has amended ("**Amendments**") the SEBI (Disclosure and Investor Protection) Guidelines, 2000 ("**DIP Guidelines**") which, amongst others, govern the initial public offerings ("**IPO**") and preferential allotments by Indian companies. While some changes are consequential to other recent amendments, the overall objective seems to be to resuscitate the flagging Indian capital markets.

KEY AMENDMENTS AND THEIR IMPLICATIONS

Increase in validity period of SEBI's observation letter

An issuer company, post-Amendment, may open its issue within a period of 12 months from the date of SEBI's letter of observations (on the draft offer documents), as opposed to the pre-Amendment period of 3 months. This Amendment is applicable in all the cases where the validity of such a letter of observation has not expired on December 4, 2008.

Implication: The Indian companies that had stalled the filing of the draft offer documents owing to this 3-month deadline for opening of their issues may now receive the necessary fillip. As per Vyapak Desai, Head, Capital Markets Group, Nishith Desai Associates, "*While this may certainly increase the number of filings with the regulator, we will need to wait and watch whether these actually culminate into listing of the shares by these companies or not.*"

Listing of equity shares with differential rights as to dividends, voting or otherwise

The Amendments provide for listing of equity shares carrying differential rights as to dividend, voting or otherwise subject to fulfillment of certain conditions ("**Conditions**") without using the IPO route by making an application to SEBI for relaxation of Rule 19(2)(b) of the Securities Contracts (Regulation) Rules, 1957. This rule provides that a listed company is required to maintain a public float of only 10% if it has issued 2 million securities, has a minimum offer size of Rs. 1 billion and at least 60% of the allotment has been made to qualified institutional buyers.

The Conditions that need to be complied with are - (i) issuance of such shares with differential rights as to dividends, voting or otherwise has to be done by way of rights/bonus issue to all existing shareholders; (ii) compliance has to be made with the minimum public shareholding norms for the equity shares already listed and for such fresh issue; and (iii) disclosure in the quarterly shareholding pattern has to be filed with stock exchange(s).

Implication: Though not many listed companies have used this option of issuance of shares with differential rights owing to the stringent Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001, an incentive appears to have been provided in the form of listing of the same on the stock exchange(s) without using the arduous IPO route.

Amendment to Preferential Issue Guidelines

The Amendments have incorporated several changes in Chapter XIII of the DIP Guidelines pertaining to preferential issues ("**Preferential Issue Guidelines**"). The same are discussed below.

- *Margin to be paid on allotment of warrants:* Prior to the Amendments, an amount equivalent to at least 10% of the aggregate price of the underlying shares was required to be paid to the issuer company prior to the issuance of the warrants. This amount, post-Amendments, stands increased to 25%. It needs to be borne in mind that this amount stands forfeited in case the warrant-holders do not subscribe to the underlying shares post-conversion within the

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stipulated time as stated in the Preferential Issue Guidelines.

Implication: Pursuant to the Amendments, warrant-holders, who may be apprehensive about the conversion of warrants in light of the low present day valuations, shall now stand to lose a larger sum in case they do not subscribe to the underlying shares post-conversion, and this may therefore have a deterrent effect.

■ **Bringing the Preferential Issue Guidelines in line with the Takeover Code:**

SEBI has recently **amended** the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ("**Takeover Code**"), by including Regulation 29A that provides for exemption from open offer obligations in the wake of the recent Satyam debacle.

Through the Amendment, relaxation has been provided from the pricing norms which mandated allotment of equity shares, warrants and convertible instruments based on the price determined in accordance with historical trading data of the company on the stock exchange(s) where its listed, provided the disclosure obligations as stated in the Preferential Issue Guidelines are complied with.

Implication: Through this Amendment, SEBI has brought the two main legislations, i.e. Takeover Code and Preferential Issue Guidelines in line with each other. Even though the inconsistencies between the two have been plugged, the fact remains that these Amendments are the specific reactions of the regulator to the Satyam crisis.

Reduction in the time limit for bonus issues

Under the DIP Guidelines, listed companies were required to complete a bonus issue within a maximum period of 6 months from the date of board approval for such issuance. However, such a time limit is now reduced to 15 days where no shareholders' approval is required as per articles of association of the company, and to 2 months where shareholders' approval is required for capitalization of profits or reserves as per the articles of association.

Announcement of price band

The Amendment provides that an issuer company may declare the floor price or price band merely 2 working days before the date of opening of offer. The issuer company shall be able to do so only if it publishes such floor price and price band through newspaper advertisements as well as websites along with the financial ratios forming the basis for such floor price or in case of a price band, the upper and lower ends of the same.

Implication: This Amendment shall ensure that the issuer company will be allowed to disclose the issue price just before the opening of the bid. As per Siddharth Shah, Head, Funds Practice Group, Nishith Desai Associates, "*In my perspective, as a result of this change, the price of the issue shall no longer be subject to the vagaries associated with the capital markets as at times the period between the band determination and the actual offer was relatively longer. Additionally, it is also hoped that this change shall help in curbing the gray market activities in a stock prior to an IPO.*"

Source: **SEBI circular dated February 24, 2009**

- Ruchi Biyani & Diptee Deshpande

You can direct your queries or comments to the authors

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