More promoters forfeit margins on warrants

Jan 19 2012

Promoters, who issued warrants in 2010 and early 2011, are faced with the prospect of either converting the warrants into equity at a huge premium to the issue price or forfeiting 25 per cent upfront margins they paid at the time of issuance as stock prices slumped in the last 12-15 months.

After promoters of JSW Steel and Pantaloon forfeited Rs 523 crore and Rs 100 crore respectively due to more than 50 per cent decline in their warrant conversion price, another firm — Surya Pharmaceuticals, is set to forfeit the upfront margin of 25 per cent.

Arun Scaria of Nishith Desai Associates, a corporate law firm, reckoned that promoters of at least 50 companies may have forfeited the 25 per cent upfront money they paid after Sebi hiked the initial margin from 10 per cent to 25 per cent in early 2009 due to unfavourable conversion prices. The promoters issued warrants when stocks were booming, but markets turned bearish from end-2009 calendar.

Convertible warrants give promoters an option to convert warrants into shares at a pre-determined price. The price of such conversion is decided based on the average price of the last six months or last two weeks, whichever is higher.

Under the rules, promoters have 18 months to convert the warrants into shares at that price.

In February 2009, Sebi hiked the upfront margins promoters' pay at the time of warrants issuance from 10 per cent to 25 per cent, after finding that promoters allow the warrants to lapse if stock prices are quoting far below their conversion price.

The securities regulator Sebi, in an order uploaded on its website last Friday, rejected a plea by promoters of Surya Pharmaceutical to exempt them from takeover code or refund the 25 per cent money paid at the time of warrant allotments.

In case of Surya Pharmaceuticals, the promoters stake will go up from 38.11 per cent to 45.50 per cent, post the conversion of warrants, which according to Sebi triggers the takeover code – meaning they have to launch an open offer from public shareholders.

"As stock prices are ruling far below the conversion prices, we will see lot of promoters forfeiting the upfront margins even if that means 25 per cent upfront payments," said Jagannadham Thunuguntla, strategist and head of research at SMC Global Securities.

For instance, Pratap Reddy of Apollo Hospitals converted his warrants issued in June 2010 on December 2011, but in his case the conversion price was more or less equal to the issue price.

Rejecting Surya Pharmaceuticals plea, Sebi whole time director Rajeev Agarwal said: "..the argument that if the target company is not permitted to allot equity shares by granting this exemption, it shall be under obligation to refund the 25 per cent money received at the time of allotment of warrants is not correct. The target company would rather be entitled to forfeit the amount of 25 per cent of the consideration paid for the allotment of warrants, in case the acquirer decides not to convert the same".

Scaria of Nishith Desai too Sebi is justified in rejecting the Surya Pharmaceuticals plea saying that it was the "legitimate right of public shareholders" to exit when promoters (or some other investors) hike the stake by a substantial percentage.

He, however, pointed out that in an another case relating to Secur Industries in 2009, Sebi gave exemption to its promoter H P Agarwal from takeover code though his stake went up from 17.49 per cent to 36.25 per cent because the company was deep in losses (its networth eroded completely) and the promoters were infusing funds into the company to revive its operations. "In comparison, Surya Pharmaceutical was in healthy condition (its gross sales grew by 40 per cent in the last three financial years)," he said.
