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PRIVATE PLACEMENT

7.1 Introduction

One of the most popular means of raising finance in recent times has been the private placement route. What is commonly known as private placement is referred to under the SEBI Guidelines as preferential issue of securities. It is important to note that a preferential allotment is different from a preference share (which is a type of a share). Hence, when one talks of a private placement or a preferential issue in the context of a listed company, they mean one and the same thing. As both the names suggest, it is an issue of securities to a select group of investors as opposed to the general public at large (in case of a public issue or a rights issue). Further, the SEBI DIP Guidelines only apply in case of a preferential issue by an existing listed company and would not apply to a preferential issue by an unlisted company. Let us look at some of the important provisions governing a preferential issue.

7.2 Companies Act

U/s. 81(1A), a preferential issue of further shares to any persons other than the existing shareholders can be made by:

- A Special Resolution passed in a General Meeting (EGM or AGM);
- If no Special Resolution is passed, then an Ordinary Resolution must be passed and the Central Government should be satisfied that the proposal is most beneficial to the company.

S.81(1A) does not apply to a private company. The section also does not apply when there is a conversion of loans/ debentures into equity shares pursuant to the Public Companies (Terms of Issue of Debentures and Raising of Loans with Option to convert such Debentures or Loans into Shares) Rules, 1977.

7.3 SEBI Guidelines

7.3.1 Eligibility

7.3.1.1 The SEBI DIP Guidelines apply to a preferential issue of equity shares/ Fully Convertible Debentures (FCDs)/ Partly Convertible Debentures (PCDs) or other convertible instruments such as warrants, convertible preference shares. In case the

instrument is not convertible into equity shares, then these Guidelines would not apply, e.g., in the case of Redeemable Preference Shares. The Guidelines define a preferential allotment to mean an issue of capital made by a body corporate pursuant to a resolution u/s. 81(1A) of the Companies Act. In such cases an offer document would not be filed with the SEBI/ ROC and hence, a separate set of guidelines have been enacted.

7.3.1.2 Preferential issue cannot be made if it is not in compliance with the conditions of continuous listing. According to the latest Press Release from the SEBI, the minimum non-promoter level of shareholding must be maintained at 25% (unless if it was eligible to make an issue at 10% in the first place). Thus, any preferential issue which results in this level falling below 25% would not be permitted.

7.3.1.3 A listed company cannot make a preferential allotment during the period commencing from the submission of offer document to the SEBI on behalf of the company for public or rights issues, till the securities referred to in the said offer document have been listed or the application moneys refunded on account of non-listing or undersubscription, etc.

7.3.1.4 Exemptions

The Guidelines do not apply to:

- An allotment pursuant to a Merger and Amalgamation Scheme approved by the High Court
- An allotment pursuant to rehabilitation packages approved by BIFR (if such person = promoter group, lock-in provisions apply)
- Shares allotted to all India Public Financial Institutions, e.g., IDBI, etc., in accordance with a loan agreement executed prior to 4th August, 1994.

7.3.2 Pricing of instruments

7.3.2.1 The key in any preferential issue is the pricing of the instruments. The Guidelines only lay down what must be the minimum price. Companies are free to specify a higher price than the minimum price.

7.3.2.2 Pricing of shares

The minimum price in case of a preferential issue of shares must be the higher of the:

- Average of the weekly high and low of closing prices during six months preceding the "Relevant date", or
- Average of weekly high and low of closing prices during two weeks preceding the "Relevant date"

The "Relevant date" means the date 30 days prior to the date of the General Meeting held for the passing of the resolution u/ s.81(1A) of the Companies Act. E.g., if the date of the EGM is 31st January, 2006, then the relevant date for considering the above prices considered would be 1st January, 2006. The prices on that stock exchange must be considered on which the highest trading volume has been recorded during the six months prior to Relevant Date.

If the Company has been listed for a period of less than 6 months as on the Relevant Date, then the issue price shall not be lower than the following:

- IPO price
- Value arrived at under a Scheme of Arrangement pursuant to which the shares were listed
- Average of the weekly high and low of the closing prices of the shares during the period they have been listed preceding the Relevant Date
- Average of weekly high and low of closing prices during two weeks preceding the "Relevant date"

Provided however that, once the Company completes 6 months of listing, the company will recompute the price as per the normal formula and if the price at which the shares were allotted was lower than the recomputed price, then the difference shall be paid by the allottees.

7.3.2.3 Pricing of shares arising out of warrants

A company may issue warrants under the preferential issue instead of directly issuing shares. Warrants give a right or an option but not an obligation to the holder to subscribe to equity shares in the company at a predetermined price within a specified period of time. The minimum price of the resultant shares is to be determined in the same manner as specified above in para 7.3.2.2. However, the concept of the "Relevant date" undergoes a change. The issuer company is given the option to consider either the aforesaid date (i.e., 30 days prior to the date of the General Meeting held for the passing of the resolution u/ s.81(1A) of the Companies Act) or a date 30 days prior to date on which the warrant holder become entitled to apply for the shares.

However, whichever option is selected, it must be clearly specified in the shareholders' resolution. However, it is not necessary that the Notice sent to the shareholders must mention the actual issue price. All that is required is that the relevant date on the basis of which the conversion price would be worked out should be stated.

In case of warrants, 10% of the price fixed is payable on the allotment of the warrants. This amount is adjustable against the price payable for acquiring the shares and would be forfeited if the option to acquire shares is not exercised.

7.3.2.4 Pricing of other Convertible Instruments

In the case of a preferential issue of other instruments which are convertible into equity shares, such as, PCDs/ FCDs/ Convertible Preference Shares, etc., the pricing formulae and the conditions are the same as that in the case of warrants.

7.3.3 Tenure

7.3.3.1 Each instrument issued by way of a preferential issue has a tenure of 18 months. In case the instrument is not converted into equity shares within 18 months, then a fresh shareholders' resolution would be required and the entire procedure would have to be followed once again.

7.3.3.2 Further, the shareholders' resolution passed in the General Meeting has a validity period of only 15 days. It lapses after this period and the allotment pursuant to this resolution must be completed within 15 days. If the allotment is pending due to the receipt of approvals from any regulatory authority, e.g., FIPB/ RBI, then it should be completed within 15 days from date of such approval. Further, this rule does not apply in case of an allotment under a CDR (Corporate Debt Restructuring) Scheme. Further, the equity shares or the convertible instruments must be made fully paid-up at the time of issue. However, in case of warrants only 10% of the amount payable must be paid at the time of allotment. This 10% is non-refundable and would be forfeited if the option to subscribe to equity shares is not exercised.

7.3.3.3 Thus, if one reads both these provisions together then it would mean as follows:

- the equity share or the convertible instrument such as warrants, FCDs, etc., must be issued and allotted within 15 days of the shareholders' resolution;
- the equity shares to be issued pursuant to such instruments must be allotted within 18 months from the date of issue of such instruments.

7.3.3.4 Further, the allotment of instruments and the dispatch of certificates must be completed within 3 months from the date of the shareholders' resolution or else a fresh resolution would be required with a fresh pricing. In case the share, etc., is in a demat form, then the credit to the demat account of the investor must be completed within 3 months.

7.3.4 Lock-in

The provisions relating to lock-in applicable to a private placement may be summarised as follows:

- If allotted to the promoters/ promoter group: A maximum of 20% of the "Total Capital" will be locked-in for 3 years from date of allotment. Total Capital includes the equity shares to be issued in future on conversion of the convertible securities/ instruments.
- If allotted to any other person, including promoters: The shares would be locked-in for 1 year from date of allotment
- Lock-in for shares acquired on conversion is reduced to the extent the convertible instruments have already been locked-in
- Lock-in for shares issued pursuant to a scheme approved under Corporate Debt Restructuring framework (CDR) is one year from date of allotment of shares
- Entire pre-allotment shareholding of the proposed allottees is locked-in for 6 months from the date of allotment
- If the proposed allottees have sold their shares within 6 months prior to the Relevant Date then they are not eligible for preferential allotment
- Inter-se transfer amongst promoter/ promoter group or to a new promoter permissible if the lock-in for the balance period continues in the hands of transferee and the SEBI Takeover Regulations are complied with.

7.3.5 Procedural Requirements

The preferential issue requires several procedural requirements to be complied with. Briefly summarised they are as follows:

- The Explanatory Statement u/s. 173(2) to the Notice for the General Meeting must contain several prescribed details.
- Practice Pointer: The Company's Auditor must certify compliance with the SEBI Guidelines. There is no specified format for the same. A copy of such Auditor's Certificate must be placed before the General Meeting held for considering the issue.
- Practice Pointer: If the issue is to promoters, relatives, associates, related entities for non-cash consideration, then a Valuation Report must be obtained from an independent valuer for the valuation of the assets received by the company in return and such Report has to be filed with the Stock Exchanges where shares are listed. The valuer could be a CA or a Merchant Banker.
- Practice Pointer: The proceeds of the preferential issue must be separately disclosed in the Balance Sheet. The utilised amount should be shown under an appropriate head indicating the purpose of utilisation and the unutilised amount under a separate head indicating the form in which it is invested, e.g., mutual fund units, fixed deposits, etc.

7.4 SEBI Takeover Regulations

Earlier acquisition of shares in a listed company by the preferential issue route was exempt from the SEBI Takeover Regulations. This exemption has been withdrawn w.e.f. 9.9.2002. Thus, now if the preferential issue, together with the existing holdings, results in the acquisition of 15% or more of the shares or voting rights in a listed company, then it would require the Acquirer to make an Open Offer (see Chapter 18 on Takeover Regulations). After an open offer commences under the Takeover Regulations, the Board of Directors of the Target Company can issue or allot shares carrying voting rights.

7.5 Unlisted Company Rules

7.5.1 Earlier, there were guidelines (SEBI) for preferential issues by listed companies. However, now there are also Rules for Unlisted Public Companies which desire to make a preferential allotment. These Rules, issued by the Government, are known as the Unlisted Public Companies (Preferential Allotment) Rules, 2003. As the name suggests these Rules only apply to an unlisted public limited company and would not apply to a private limited company.

7.5.2 The Rules are applicable to a preferential allotment of equity shares/ FCDs/ PCDs or any other convertible instrument by an unlisted public company. It also applies to an issue of shares to promoters and their relatives either in a public issue or otherwise.

7.5.3 Conditions

Such an issue must be authorised by the Articles of Association of the Company and by a Special Resolution passed in a General Meeting of the Shareholders. Further, the allotment of the shares/ instruments must be completed within 12 months of the date of the resolution.

7.5.4 Pricing of shares

The Rules allow flexible pricing, i.e., no specific formula has been specified. However, if the issue consists of convertible warrants, then the price of the resultant shares must be determined beforehand. This is a variation from the provisions of the SEBI Guidelines.

7.5.5 Procedural Requirements

The preferential issue requires certain procedural requirements to be complied with. Briefly summarised they are as follows:

- The Explanatory Statement u/s. 173(2) to the Notice for the General Meeting must contain several prescribed details. Several disclosures are required in the Explanatory Statement to the Notice, including the price or price band at which the allotment is proposed. The relevant date on the basis of which the price has been arrived at must be stated. The shareholding pattern pre and post issue must be stated.

- Practice Pointer: The Company's Auditor or a practising Company Secretary must certify compliance with the Rules. There is no specified format for the same. A copy of such Auditor's Certificate must be placed before the General Meeting held for considering the issue.

7.6 FDI Policy

In case the preferential allotment of shares is made to a Foreign Company/ Foreigner/ NRI/ FII, etc., then it would be treated as a Foreign Direct Investment (FDI) since the money would come directly into the issuing company. In such an event, the company would also need to comply with the provisions of the Foreign Exchange Management Act and its Regulations and the FIPB Policy in this respect (see Chapter 19 on FDI Policy). For instance, in case of the print media and newspapers sector, the FDI policy is to restrict foreign investment by all sources, whether FDI or secondary market, at 26% of the capital. In case a company operating in this sector desires to make a preferential allotment to foreign investors, then it cannot exceed 26% of its capital. Similar restrictions applicable in other sectors, such as, telecom, broadcasting, banks, etc., must be borne in mind if the allotment is made to foreign investors.

In the case of real estate companies, there is a raging controversy over whether Pre-IPO private placement to FIIs is treated as FDI or FII portfolio investment. If they are treated as FDI then they would be subject to the lock-in and other conditions. Recently, the Ministry of Finance has taken a decision to treat the same as FDI.

7.7 Qualified Institutional Placement

SEBI has recently introduced the concept of Qualified Institutional Placements which is quite similar to preferential issue. Hence, the two topics have been dealt with under one Chapter. The QIPs is mooted as an alternative to FCCBs/ GDR issues and is expected to provide a boost to domestic capital mobilisation. The important features of this scheme are as follows:

- (a) Specified Securities to be issued
Equity shares/ fully convertible debentures (FCDs)/ partly convertible debentures (PCDs) or any securities other than warrants, which are convertible into or exchangeable with equity shares, can be issued to Qualified Institutional Buyers (QIBs) by a listed company which fulfills the following conditions:
 - (i) its equity shares of the same class are listed on the NSE or BSE for at least one year as on the date on which it issues the Notice for General Meeting ; and
 - (ii) it complies with the minimum public shareholding requirements of Cl.40A the listing agreement.

At least 10% of the issue shall be to mutual funds. If however, they do not agree, then it can be allotted to QIBs. QIBs who are promoters or related to promoter/s cannot be issued securities.

(b) Pricing of shares

The minimum price in case of the issue of shares must be the higher of the:

- Average of the weekly high and low of closing prices during six months preceding the "Relevant date", or
- Average of weekly high and low of closing prices during two weeks preceding the "Relevant date"

The "Relevant date" means the date 30 days prior to the date of the General Meeting held for the passing of the resolution u/ s.81(1A) of the Companies Act. E.g., if the date of the EGM is 31st January, 2006, then the relevant date for considering the above prices considered would be 1st January, 2006. The prices on that stock exchange must be considered on which the highest trading volume has been recorded during the six months prior to Relevant Date.

(c) Pricing of convertible securities

The minimum price of the resultant shares arising out of convertible securities is to be determined in the same manner as specified above. However, the concept of the "Relevant date" undergoes a change. The issuer company is given the option to consider either the aforesaid date (i.e., 30 days prior to the date of the General Meeting held for the passing of the resolution u/ s.81(1A) of the Companies Act) or a date 30 days prior to date on which the warrant holder become entitled to apply for the shares.

(d) Adjustments in price

The prices considered for determination of issue price shall be subject to appropriate adjustments for corporate actions, such as, bonus, rights, stock splits, etc.

(e) Currency of the Security

Each instrument issued has a tenure of 60 months.

(f) Number of allottees

The minimum number of allottees for each placement of specified securities made shall not be less than:

- (i) 2 where the issue size is less than or equal to Rs. 250 crores;
- (ii) 5 where the issue size is greater than Rs. 250 crores.

Provided that no single allottee shall be allotted more than 50% of the issue size.

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- (g) Restrictions on amount raised
The aggregate of the proposed QIPs and all previous QIPs made in the same financial year shall not exceed 5 times the net worth of the issuer as per the audited balance sheet of the previous financial year.
- (h) Lock-in
There is a lock-in of 1 year from the date of allotment, except for sale on a recognised stock exchange. Any sale by way of a bulk or block transaction in accordance with the prescribed procedures shall also be treated as a sale on a recognised stock exchange. Hence, a sale under a buy-back (through tender offer) or an open offer or under a delisting offer within a period of one year is prohibited.
- (i) The SEBI Guidelines on Preferential Issues will not apply to such issues.