KHAITAN & CO
Advocates since 1911

UPDATE

ERGO

Analysing developments impacting business

TO NOT ONLY REGULATE AND PROTECT BUT ALSO PROMOTE – SEBI AIDS PUBLIC & RIGHTS ISSUE DURING TESTING TIMES

27 April 2020

The Covid-19 pandemic has resulted in a near extinction of primary market fundraising by companies in India. While the Indian government and domestic regulators have limited ability to influence resultant flux in valuations, the Securities & Exchange Board of India (SEBI) has arguably met expectations in aiding capital market transactions at such time, predominantly by easing the legal route to accessing public funds. Consistent with such efforts, SEBI has issued two circulars on 21 April 2020 (the Circulars), which have muted the applicability of certain regulations guiding public and rights issues. This article evaluates the Circulars and provides the rationale behind the amendments, which should assist in interpretation.

Making the best of lower demand

At present, the most significant impediment to primary market transactions is an acute shortage of demand. Investors are wary of investing in securities, choosing instead, in most cases, to preserve cash. In order to support corporate finance in such an environment, the Circulars have introduced the following amendments:

Relaxations with respect to minimum subscription in rights issues

Historically, SEBI has insisted that at least 90% of the securities offered through a rights issue be subscribed in order for the issue to be successful. The Circular has reduced such minimum subscription requirements to 75%, keeping in mind the reduced demand in the market. Therefore, a company can successfully close a rights issue and use the funds raised, if at least 75% of the shares offered are subscribed. Such subscription can be undertaken by the shareholders of the company applying in the rights issue, renouncees and/ or SEBI registered underwriters.

However, the issuer company would have to ensure that in case the offer is subscribed anywhere between 75% to 90% of the total offer size, the funds equivalent to at least 75% of the total issue size are required to be utilized for identified objects of the issue, which excludes general corporate purposes. To put it in perspective, if the size of a rights issue is Rs. 1,000 crores and 75% of the offer is subscribed, the company receives Rs. 750 crores and is, consequently, required to spend the entire amount received on identified objects, without any flexibility to use any part thereof, on general corporate purposes.

This relaxation is applicable to right issues that open till 31 March 2021.

Relaxations in relation to reducing the issue size – applicable to both public as well as rights issues

An issuer company is able to assess demand more accurately closer to the opening of the offer period. Therefore, SEBI permits companies to change the fresh issue size by 20% without re-filing the draft offer document. Keeping in mind the lack of demand in the market, the Circular has permitted companies to increase or decrease the fresh offer size by up to 50%, without invoking re-filing obligations, subject to compliance with certain conditions such as there being no change to the objects of the issue, incorporation of necessary related disclosures, etc.

The above relaxation is applicable to issues opening for subscription till 31 December 2020.

Other conditions aiding public market transactions

Extension of validity of SEBI observations

SEBI provides comments on the offer documents/ letters of offer prepared in relation to public and rights issues in the form of SEBI observations. Such comments are valid for a period of twelve months, implying that the issuer is required to open the public or rights issue for subscription within twelve months of receipt of such comments. In order to ease the process during these times, cases in which the issuer company has received comments from SEBI, which have expired or are due to expire, as applicable, between 1 March 2020 and 30 September 2020, the validity of such observations has been extended by 6 months.

This exemption is available subject to the lead managers, providing a confirmation that the issuer company has not breached any other condition specified by the SEBI, which requires re-filing of the draft offer document.

Relaxation of certain eligibility conditions applicable to fast track rights issues

A company in compliance with certain prescribed conditions is permitted to avail the benefits of a fast track rights issue (a rights issue in which SEBI does not review and comment on the letter of offer, resulting in significant reduction of transaction timelines). The Circulars have relaxed such prescribed conditions, allowing companies to raise capital from existing shareholders and renouncees within a significantly shorter time.

The relaxations include, amongst others:

- Requirement of the issuer company to be listed – reduced from three years to 18 months, allowing a relatively newly listed company to raise funds through a fast track rights issue;

- Reduction of the prescribed minimum market capitalization of the issuer company from Rs. 250 crores to Rs. 100 crores – allowing a comparatively smaller company to raise funds through a fast track rights issue;

- Requirement of an issuer to be in compliance with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 – reduced from three years to 18 months – diluting the strictness of the eligibility;

- Companies (including their promoters or whole-time directors) against who adjudication proceedings are pending before SEBI are now permitted to undertake such rights issues, subject to necessary disclosures;

- A company is permitted to undertake a rights issue if it has fulfilled the settlement terms or adhered to directions of any settlement order(s), during the last three years; and

- A company whose accounts are qualified can undertake a rights issue if it restates such financial statements, adjusting for the impact of the qualifications.

These relaxations are applicable to right issues that open for subscription till 31 March 2021.

While India is still one of the fastest growing major economies, the pandemic has adversely affected business operations. Businesses are stressed now more than ever, due to lower revenues and continued fixed expenditures, especially during the lockdown. The Indian government has been active in announcing several measures including relaxations from various procedural compliances and legal provisions with the objective of easing the burden on businesses, promoting financial markets and boosting the economy. These Circulars are a step in the right direction to allow companies to access capital from public markets during such times.

- *Subhayu Sen (Partner) and Aparna Bagree (Associate)*

For any queries please contact: editors@khaitanco.com

Mumbai
One Indiabulls Centre, 13th Floor
Tower 1 841, Senapati Bapat Marg
Mumbai 400 013, India

T: +91 22 6636 5000
E: mumbai@khaitanco.com

New Delhi
Ashoka Estate, 12th Floor
24 Barakhamba Road
New Delhi 110 001, India

T: +91 11 4151 5454
E: delhi@khaitanco.com

Bengaluru
Simal, 2nd Floor
7/1, Ulsoor Road
Bengaluru 560 042, India

T: +91 80 4339 7000
E: bengaluru@khaitanco.com

Kolkata
Emerald House
1 B Old Post Office Street
Kolkata 700 001, India

T: +91 33 2248 7000
E: kolkata@khaitanco.com