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UPDATE

ERGO

Analysing developments impacting business

SEBI ICDR REGULATIONS AMENDMENT OF NOVEMBER 2022 | PART II | SEBI MANDATES DISCLOURE OF KPIS AND FILING OF OFFER DOCUMENTS WITH SEBI HEAD OFFICE

15 December 2022

Facts and Background

The Securities and Exchange Board of India (**SEBI**) has amended the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 (**SEBI ICDR Regulations**) through its notification SEBI/LAD-NRO/GN/2022/107 dated 21 November 2022 (**Amendment**), pursuant to which, SEBI has *inter alia* introduced mandatory disclosure of key performance indicators and filing of offer documents with SEBI head office. The Amendment is pursuant to the SEBI's discussion in its board meeting, described in our KCO Ergo Newsflash dated 14 October 2022 which is accessible here.

In addition to the changes highlighted in part-I of our KCO Ergo dated 2 December 2022 which is accessible here, the following key changes have been made to the SEBI ICDR Regulations by way of the Amendment:

1. **Disclosure of key performance indicators (KPIs) in the offer documents**:

   KPIs are disclosed in offer documents to indicate different aspects of the issuer company's (**Issuer**) operational performance. Prior to the Amendment, there was no regulatory framework for disclosure of KPIs and accordingly, SEBI, *vide* the Amendment, has introduced certain requirements for the disclosure of KPIs of an Issuer in its offer documents. The salient features are given below:

   i. ***Definition and explanation of KPIs***: KPIs disclosed in the offer documents are required to be defined in simple terms and consistently throughout the offer document, to enable easy understanding of the KPIs. Further, disclosures shall be included to explain the way in which the KPIs have been historically used by the management to analyse or track the operational and/or financial performance of the Issuer.

   ii. ***Certification of KPIs***: KPIs are required to be certified by the statutory auditor of the Issuer or a peer reviewed chartered accountant or a peer reviewed cost accountant. The certificate issued in this regard shall be a material document available for inspection after the filing of the red herring prospectus till the offer closing date.

   iii. ***Period of disclosure of KPIs***: KPIs are required to be disclosed in the offer document for the same period for which the restated financial information

(**RFS**) is disclosed in the offer document. Typically, RFS is disclosed for the last three full financial years along with a stub period, if applicable.

iv. ***Impact of acquisition or divestment:*** In case the Issuer has undertaken a material acquisition or divestment of assets and/or business for the period for which the KPIs are disclosed, the KPIs shall reflect and explain the impact of such acquisition or divestment.

v. ***Role of the audit committee***: Each of the KPIs disclosed in the offer document are required to be approved by the audit committee of the Issuer. This is being considered as a step towards imparting credibility to the KPI disclosures, however the audit committee consists of a majority of independent directors who are not involved in day-to-day operations of the Issuer and are now required to take responsibility for historic KPIs.

vi. ***Basis for Issue Price section***: In the '*Basis for Issue Price*' section of the offer document, the Issuer shall, *inter alia,* disclose the following:

- ***KPIs disclosed to investors in the preceding three years***: All the KPIs disclosed to the investors of the Issuer during the three years preceding the date of filing of the draft red herring prospectus / red herring prospectus. The audit committee is required to confirm that verified and audited details of all the KPIs disclosed to the investors in the preceding three years are being disclosed in the section. This is expected to facilitate information symmetry between information provided by the Issuer to investor(s) in the past and information being provided to prospective investors in the initial public offer.

- ***Relevant and material KPIs***: Any other relevant and material KPIs which have a bearing on arriving at the basis for issue price. Further, a cross-reference to KPIs in other sections of the offer document is required to be included.

- ***Listed peer companies***: Comparison of the KPIs of the Issuer with the KPIs of Indian listed peer companies and/or global listed peer companies. Peer companies shall include companies with comparable size, from the same industry and with similar business model.

vii. ***Continuous disclosure post listing***: The KPIs disclosed in the '*Basis for Issue Price*' section in the offer document shall continue to be disclosed by the Issuer post listing, at least once in a year and for a duration of at least (i) one year after listing date; or (ii) till the utilisation of issue proceeds per the disclosures made in the prospectus, whichever is later. While disclosing the KPIs post listing, any changes in the KPIs shall be explained by the Issuer.

viii ***Price based on primary and secondary transactions***: The Issuer shall be required to disclose the price per share of the Issuer based on: (a) primary issuance of shares (equity / convertible securities) to all shareholders; and (b) secondary sale / acquisition of shares (equity / convertible securities) involving the promoter, promoter group entities or selling shareholder or shareholders with a right to nominate directors during the 18 months preceding the date of filing the draft red herring prospectus / red herring prospectus. For this requirement, only those transactions where the issuance or acquisition / sale of shares, respectively, is equal to or more than 5% of the fully diluted paid-up share capital of the Issuer, in a single transaction or multiple transactions over a period of 30 days, are required to be considered.

In case there are no transactions under (a) and (b) above, then the information regarding the price per share of the Issuer based on last five primary or secondary transactions undertaken in the three years preceding the date of filing the offer document, irrespective of size, is required to be disclosed.

ix. ***Weighted average cost of acquisition*** (***WACA***): WACA based on primary and secondary transactions as disclosed in point (viii) above shall be disclosed, along with a ratio against the floor price and cap price, in the price band advertisement. Detailed explanation is required to be included for ratio of WACA based on primary and secondary transactions against the issue price/ cap price along with comparison of Issuer's KPIs and financial ratios and any external factors which may have influenced the issue price.

x. ***Role of committee of independent directors***: Going forward, a recommendation from the committee of independent directors of the Issuer that the price band is justified based on the quantitative factors / KPIs disclosed in the '*Basis for Issue Price*' vis-à-vis the WACA shall be required. While independent directors shall be approving the price band as part of the board of directors of the Issuer, this is an additional responsibility imposed on them.

Remarks:

The primary intent of SEBI mandating disclosure of KPIs is to increase transparency in disclosures to the investors. In recent times, the share prices of certain companies have declined sharply on listing. Since SEBI mandates a disclosure-based regime and does not dictate pricing norms in initial public offerings (**IPO**), this is a welcome step towards facilitating information symmetry between investors prior to the IPO and prospective investors.

While the Amendment is a logical step towards providing detailed disclosures to the investors, the Issuers may face certain challenges while complying with the requirements of the Amendment, for example: (i) some strategic/ commercially sensitive information which may have been disclosed to investors prior to the IPO on the assumption that it will remain confidential will now need to be disclosed to the public; and (ii)getting the cost accountant to certify certain operational KPIs which are specific to the nature of the business.

2. **Monitoring of proceeds of preferential issue and qualified institutions placement:**

i. ***Position prior to the Amendment***: Issuers were required to appoint a monitoring agency to monitor the utilisation of proceeds of a public issue, rights issue and a preferential issue of companies with stressed assets.

ii. ***Preferential issue and qualified institutions placement (QIP)***: By way of the Amendment, SEBI has introduced the monitoring of utilisation of proceeds of: (a) a preferential issue of more than INR 100 crore by all listed companies; and (b) a QIP of more than INR 100 crore (excluding the offer for sale by selling shareholders in the said QIP) by all listed companies. The proceeds shall be monitored by a credit rating agency registered with SEBI. The provision is not applicable to issuance of securities by bank, public financial institution or insurance company.

iii. ***Report of the monitoring agency***: The monitoring agency shall be required to submit a quarterly report to the Issuer till 100% of the proceeds have been utilised. The board and management of the Issuer shall provide their comments on the findings of the monitoring agency. Thereafter, the Issuer shall upload monitoring agency's report on its website and submit it to the stock exchanges on which its equity shares are listed, within 45 days from the end of each quarter.

iv. ***Rationale for the Amendment***: The above changes have been made to monitor the issue proceeds of fund raise by a listed company and for better transparency and accountability. For instance, since mutual funds use public money to make such investment, it was important to safeguard such investments as well as the interest of other shareholders.

v. ***Further development***: Pursuant to the Amendment, BSE Limited *vide* circular dated December 13, 2022 has prescribed certain guidelines for disclosing the 'object of the issue' in the placement document for QIPs and notice to the shareholders for preferential issue and such guidelines will be applicable for all QIPs and preferential issues which are approved by the board of directors of the Issuer on or after December 13, 2022. The guidelines, *inter alia*, prescribe that:

- each object of the issue must be stated clearly and cannot be kept vague/ open ended;

- the timeline for utilisation of issue proceeds and the amount proposed to be utilised against each object must be clearly stated and if the exact amount of funds to be used cannot be quantified, a reasoned broad range of amount with realistic estimation and a range gap of +/-10% can be provided in the objects of the issue; and

- The amount reserved for specific objects cannot be utilised for general corporate purposes (**GCP**) and the funds to be used for GCP shall not exceed 25% of the funds to be raised in the issue.

3. **Filing of the offer documents with the head office of SEBI:**

i. ***Position prior to the Amendment***: Issuers were required to file the offer documents with the relevant regional office of SEBI under the jurisdiction of which the registered officer of Issuer is located if the offer size was up to INR 750 crore.

ii. ***The Amendment and its rationale***: To achieve standardisation and harmonization in processing of offer documents SEBI has, by way of the Amendment, mandated that offer documents for initial public offer, further public offer and rights issue, irrespective of the issue size, shall be filed with its head office only.

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