

SEBI ON VALUATION, CONFIDENTIAL FILINGS, END USE MONITORING AND MORE

1. INTRODUCTION

The Securities Exchange Board of India (“SEBI”) has, in its meeting held on September 30, 2022, approved certain changes to the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, amended (“SEBI ICDR Regulations”) including those requiring disclosure of additional information linked to the basis for valuation in an Initial Public Offer (“IPO”), introduction of confidential pre-filing of draft offer document in an IPO, review of existing framework for Offer for Sale (“OFS”), monitoring of utilization of issue proceeds raised through preferential issue and Qualified Institutions Placement (“QIP”) and certain changes in the alternative investment spaces like Real Estate Investment Trusts (“REITs”) and Infrastructure Investment Trusts (“InvITs”). In addition to the above, SEBI has also approved certain other changes, including amendments in SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“Takeover Regulations”) and Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018, and other regulations, however this note will largely focus on the changes in relation to IPOs and private placements and offers outlined above. Pursuant to this meeting, SEBI has issued a press release¹ (“SEBI PR”), summarizing these decisions.

2. UPCOMING CHANGES

2.1 Valuation and KPIs

The end of the calendar year 2021 sparked a debate on the valuation of IPO bound companies. Historically, the SEBI ICDR Regulations have required disclosure of select financial ratios as the basis of IPO price (net asset value per equity share, return on net worth, earning per share). However, over the last several months SEBI has also sought justification for the IPO valuation based on the valuation considered for recent pre-IPO private investment rounds. As per the SEBI PR, SEBI board has approved a proposal to make mandatory disclosures of Key Performance Indicators (“KPIs”), price per share in transactions (primary and secondary) in the 18 months preceding the IPO, and other share acquisition price-based data. In terms of procedure, a committee of Independent Directors of the issuer will now need to recommend the IPO price band based on certain KPIs and the historic share price data mentioned above. The SEBI PR is silent on whether these new disclosure requirements will apply, regardless of threshold, to (a) all categories of issuers, regardless of sector or financial track record; or (b) existing transactions where the draft red herring prospectus has already been filed. We await the notification of this amendment, which will hopefully give some clarity on these questions. A diligence implication linked to these additional KPI disclosure requirements is whether they will be comforted by the statutory auditor or a peer reviewed independent chartered accountant. Big-4 auditors continue to push back against generally covering KPIs and this remains an active discussion with them on most of the deals.

¹ SEBI Press Release no. 29/2022 dated September 30, 2022.

These proposed changes have been approved following release of a consultation paper dated February 18, 2022, on 'Disclosures for 'Basis of Issue Price' section in offer document under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018' ("**KPI Paper**"). While the KPI Paper gave context and specific scope for applicability of these amendments, the SEBI PR does not address them. For example, the KPI Paper suggests a de-minimis threshold of 5% for disclosure of transactions under (b) above, which the SEBI PR is silent on. If not incorporated, this could pose a logistical challenge for companies with widespread shareholding or multiple secondary transfers by pre-IPO shareholders.

2.2 Confidential filing for IPOs

The SEBI board has also approved a proposal to introduce the option of confidential filing of the Draft Red Herring Prospectus ("**DRHP**") for main board IPOs. While the contents of the DRHP will remain confidential, the fact of filing of such DRHP may be required to be disclosed to the public. This amendment is aimed to help issuers looking to get formal and confidential regulatory feedback on disclosures before making them available to the public. This proposal was also preceded by a consultation paper dated May 11, 2022, on 'Pre-filing of Offer Document in case of Initial Public Offerings' which provided indicative timeline for the various stages of documentation and feedback that effectively added to the IPO timeline. However, while the intent is to give benefit to issuers of pre-cleared disclosures without compromising on confidential competitive information, this route will elongate the IPO timeline and issuers are more likely to run the risk of losing the market. It will be interesting to see if issuers will take up this route and whether additional time will be a fair barter to pre-clearance of sensitive disclosures.

2.3 Monitoring proceeds from preferential issue & QIPs

As per the SEBI PR, the SEBI board has also approved the proposal to introduce monitoring the use of proceeds raised from a preferential issue by listed issuers and QIPs each with size over INR 1,000 million. Historically, the SEBI ICDR Regulations only envisaged external/ third-party monitoring of proceeds raised from public and rights issues. Under current law², listed issuers are required to submit statements of deviation to the stock exchanges in case there is a deviation from the use of proceeds stated in the offer documents. With this new amendment, SEBI will add an additional safety net to use of money raised on a private placement basis from select sophisticated investors as well.

2.4 Modification in offer for sale through stock exchange mechanism for facilitating greater flexibility

To ensure greater efficiency and flexibility in the framework for offer for sale, SEBI board has approved certain modifications in the current offer for sale mechanism through the stock exchanges.

Existing mechanism of OFS route allows only promoters and shareholders who are holding more than 10% of shares to use the OFS route. Now the OFS route can also be used by any shareholder as long as they are selling shares of at least INR 25 crores, though it is unclear if is based on face value or market price. Also, the cooling-off period needed between the two offers for sale, which was 12 weeks earlier, is now reduced to 2 weeks. By all these changes SEBI is trying to widen the 'spectrum of available instruments', which will ultimately result in greater participation of the investors and larger volume of transactions. Use of an OFS route is likely to gather more attention from private equity investors as it is a good alternative to block deals on account of flexibility in pricings.

² Regulation 32, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended.

In addition, SEBI has approved the proposal to allow retain investors to bid for unsubscribed portion of the non-retain segment in an OFS and has also approved extending the OFS mechanism for unit holders of REITs and InvITs.

2.5 SEBI simplifies compliances for REITs and InvITs

SEBI has reduced the sponsor and sponsor group's minimum holding requirement in case of REITs from current 25% to 15%. This reduction is proposed by SEBI by way of amendment in SEBI (Real Estate Investment Trusts) Regulations, 2014. With this change, the holding sponsor holding requirement in relation to REITs is brought at par with InvITs. This reduction in REITs should encourage investors and developers to monetizing their assets through a structure of REIT with lower capital commitment.

The SEBI board has also approved the proposal to scrap the separate framework of the unlisted InvITs.

2.6 Online bond platform and reduction in privately placed debt's face value

SEBI board has approved a framework for regulating and facilitating the providers with online bond platform for trading in listed debt securities. As per this framework, online bond platforms should be registered with SEBI as stockbrokers (debt segment) or will be regulated or operated by brokers registered with SEBI. This step is intended to increase the investor's confidence, especially the non-institutional investors, as these platforms will be provided by intermediaries regulated by SEBI. A procedural circular will be issued which will detail the mechanics and specifics of the operations of these platform providers. SEBI board also decided to reduce the face value of listed debt securities which are privately placed.

2.7 Other changes

SEBI board has approved procedural amendments to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('**SEBI LODR Regulations**') by (i) introducing a provision for scheme of arrangement for entities which have listed non-convertible securities of listed entities that are not 'companies' under the Companies Act, 2013. Scheme of arrangement is to be filed with stock exchange for obtaining No Objection Letter (NOC) with requisition fees; and (ii) approving the amendment to the procedure for appointment and removal of independent directors of listed entities.

The board has also approved certain procedural amendments to (a) SEBI (Alternative Investment Funds) Regulations, 2012 in relation to the timeline and tenure of the scheme; (b) SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, in relation to strategic divestments in public sector undertakings and consideration payable; (c) SEBI (Prohibition of Insider Trading) Regulations, 2015, for inclusion of units of Mutual Funds under the framework of the regulations; (d) Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 in relation to winding down of critical operations and services of a clearing corporation; (e) SEBI (Mutual Funds) Regulations, 1996 in relation to payment timeline for pay out for redemption and dividend distribution to unitholders; and (f) cash segment settlement and physical settlement of futures and options on net basis.

3. CONCLUSION

While these amendments aim to address much spoken about challenges on valuation and disclosure related sensitivities, they may also create new hurdles for issuers to consider and adapt to. The additional disclosures in relation to valuation will add to the quantitative basis for valuation, however, for an offer made to public, issuers will run the risk of flooding smaller investors with information they are not equipped to digest.

Likewise, while confidential filing will provide some comfort to issuers on select sensitive disclosures, it will likely add to the gestation period of an IPO. We will have to wait for the amendments to be notified to assess the specific nuances to the changes brought in and hope the amendments will address some if not all of issues highlighted above.

Authors: Manshoor Nazki | Priyadarshini Rao | Anuj Kumar Gupta

Practice Areas: Capital Markets | Corporate and Commercial

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