Key changes to public offer norms for listed companies

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Cap on use of issue proceeds towards unidentified acquisitions

- Currently, 25% of the public issue proceeds can be earmarked for general corporate purposes. There is no cap on the use of issue proceeds for acquisitions.

- In recent public issues, issuer companies, more specifically, new age tech companies, have earmarked a significant portion of the issue proceeds towards funding inorganic growth initiatives through unidentified acquisitions.

- Now, the Securities and Exchange Board of India (SEBI) has imposed a cap of 35% of the issue proceeds being earmarked for general corporate purposes and unidentified acquisitions. This cap will not apply if the offer document identifies target companies proposed to be acquired using the issue proceeds.

- While the SEBI has attempted to limit uncertainty in utilization of public monies, issuer companies may not be able to identify targets in their offer documents for confidentiality reasons, unless the acquisition documents have already been executed and the deal has been announced. Therefore, the exception may remain largely unutilized.

- With this cap in place, new age tech companies may have a tough time disclosing issue objectives as these companies, typically, do not require funds for capital expansion.

Caps on divestment of stake by significant shareholders in an OFS

- Selling shareholders (not classified as promoters) can divest their entire pre-issue shareholding in case of an offer for sale. Such shareholders' post-issue holdings are not subject to lock-in requirements.

- The SEBI has now imposed caps on divestment of stake by significant shareholders of loss-making companies as follows:

  - shareholders holding more than 20% of the pre-issue capital, including through persons acting in concert, can divest up to 50% of their shareholding; and

  - Shareholders holding below 20% of the pre-issue capital, including through persons acting in concert, can divest up to 10% of their shareholding.

- In addition, shareholders holding more than 20% of the pre-issue capital will be subject to a post-issue lock-in of 6 months. Financial investors including funds will also be subject to such lock-in.

- These norms have been imposed as new age tech companies that have listed in recent months do not have identified promoters and are, primarily, held by financial investors. These norms will ensure that founders and financial investors have continued skin in the game after the offer.

Lock-in on anchor investors' holding

- Currently, anchor investors are subject to a post-issue lock-in period of 30 days.

- <u>Now, the SEBI has extended the lock-in period from 30 days to 90 days on 50% of the post-issue holding of anchor investors</u>.

- Anchor investors have propelled public offers of new age tech companies last year. That said, anchor investors have chosen to exit immediately upon expiry of the lock-in period of 30 days, which has resulted in volatility of share price.

- This change will ensure that anchor investors are obligated to stay on for a longer time period. However, it remains to be seen if anchor investors will be wary of committing significant funds given the increased wait to exit.

Minimum price band in case of book building issue

- Companies undertaking an issue through the book building process have to ensure that the upper end of the price band does not exceed 20% of the lower end of the price band. There is no minimum gap prescribed.

- The SEBI noted that, as no minimum gap is prescribed, the difference between the price range in public issues undertaken in 2021 reduced to 1.5%. This essentially means that, the fixed price got camouflaged as the book building process, because a narrow price range of 1.5% did not leave much room for market investors to assess the final price.

- <u>Now, the SEBI has provided that the upper end of the price should be at least 5% higher than the lower end of the price band but should not exceed 20%</u>.

- This change is important as almost all public issues are being done through the book building process. It will encourage a fair price discovery mechanism.

Thank You

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