

“Review of SEBI (DIP) Guidelines 2000- Proposals - Series II”

1. This discussion paper, entitled “review of SEBI (DIP) Guidelines 2000- Proposals – Series II” contains the recommendations made by the Primary Market Advisory Committee (PMAC) of SEBI, which was set by SEBI to advise SEBI on matters relating the primary market. The recommendations cover the eligibility norms for public/rights issues of securities, both through IPOs and further offerings and other incidental matters. This paper does not reflect the views of SEBI, nor has SEBI formed an opinion on these recommendations. The paper is being hosted on the website for the purpose of eliciting public comments. SEBI would take cognizance of the public comments received, before taking a final view on the issues mentioned in the paper.
2. Comments on the recommendations may be sent to the Primary Market Department, SEBI or emailed to Ms. Sangeeta Uchil, AGM, at Sangeetau@sebi.gov.in or Ms. Neelam Bhardwaj, DGM, at neelamb@sebi.gov.in or faxed to 91-22-22045633 on or before April 05, 2003.

**REPORT OF THE GROUP TO REVIEW ELIGIBILITY NORMS FOR PUBLIC
AND RIGHTS ISSUES SET UP BY PRIMARY MARKET ADVISORY
COMMITTEE (PMAC)**

BACKGROUND

The PMAC had set up a sub-group to review the present eligibility norms and suggest changes, if any. The sub-group submitted the report to PMAC, which accepted the recommendations, with some modifications. The modified report is reproduced in the following pages.

PREAMBLE

1. After abolition of the CCI Act, SEBI issued its first set of DIP Guidelines in June, 1992 to usher in the era of free pricing in the primary market. Ever since, SEBI has endeavored to maintain the “currency” of the guidelines to keep pace with the developments in the market, increasing sophistication of the issuer companies and exposure to best international practices.
2. Initially, new companies were allowed to issue their shares only at par i.e at face value of Rs 10/- while companies having operational history were allowed to freely price their shares. As a large number of companies flooded the market with poor/mediocre issues, SEBI revised the Eligibility Norms in 1996. To ensure that only companies with an established track record, as against just being in incorporated existence, are allowed to charge a premium, SEBI prescribed a 3-year dividend payment track record as a precondition to charge a premium. For new companies, SEBI mandated that these should have at least 10% equity or debt participation from a bank before they could make an IPO. Stringent as these conditions were, SEBI in 1999, among other things, relaxed the 3- year dividend track record and changed it to a 3-year profitability record.
3. Over a period of time, the concept of “par” was deemed to be redundant in the era of free pricing. As such, SEBI decided to allow all companies to freely price their issues. SEBI also allowed companies which were not satisfying the 3-year profitability record to make an IPO provided the issue is through a book building process and at least 60% of the issue is subscribed to by QIBs.
4. Thus, the definition of operational history, track record of company and other parameters of Eligibility Norms have undergone many changes over the 10-year history of SEBI.
5. The extant Eligibility Norms are placed at Annexure 1.

TERMS OF REFERENCE

6. The Group was constituted in order to review the Eligibility Norms with a view to rationalising the same as also to strengthen them so as to ensure that while raising of capital through public issues is facilitated for good companies, the incidence of undeserving companies to access the market is restricted.
7. In keeping with the need to constantly upgrade the regulations, the Group has sought to rationalise and strengthen the existing Eligibility Norms and introduce new requirements, wherever necessary, so as to ensure:
 - i. better quality of issuer companies,
 - ii. consequent increase in secondary market trading, and
 - iii. restrictions on sub-standard issuers through objective criteria.

DELIBERATIONS OF THE GROUP

8. The Group agreed with the present disclosure-based philosophy of SEBI and was of the view that anyone with full and complete disclosure should be allowed to access the primary market. The Group, however, deliberated on ways and means to upgrade the guidelines so as to ensure quality of issues.

IPOs OF EQUITY

9.0 The primary concern of SEBI and of the Group was to review the Eligibility Norms for companies approaching the market for the first time i.e. initial public offerings by unlisted companies. This concern was justified on several counts:

- i. Information about unlisted closely held companies (unlike listed companies which are required to make full and adequate disclosures on a continuing basis), is rarely available in the public domain. Hence, the prospectus is often the only document on which the investor is expected to take an informed decision.
- ii. SEBI's policy is disclosure - based and hence it expects the investors to rely on their own examination of the issuer/issue and thereafter decide on investing in the issue. To this extent, attempts are made to provide complete disclosure in the offer document. However, SEBI tries to ensure that lay investors are not exposed to unnecessary risks at the hands of 'fly-by-night' operators and has accordingly prescribed Eligibility Norms in order to minimise risks on this count.
- iii. At the same time, there is a concern in some quarters that the Eligibility Norms for IPOs are not 'market-oriented' and thus, along with the general economic downturn coupled with investors apathy, have resulted in a significant fall in the number of equity IPOs, as can be seen from the following table. Phase I relates to pre-SEBI DIP Guidelines. Phase II covers issues made under the initial set of DIP Guidelines. Phase III covers the period after Malegam Committee in 1996 came out with very stringent eligibility norms. In Phase III, except for the year 1999-2000 and 2000-2001 which saw some renewed activity courtesy entirely the boom in the IT sector, the IPO market was very small. In Phase IV, the IPO market has become almost non-existent.

YEAR	NO. OF IPOs	ISSUE AMOUNT (Rs. Crore)
Phase I		
1989-1990	158	504
1990-1991	109	632

1991-1992	158	724
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Phase II

1992-1993	467	3673
1993-1994	693	7650
1994-1995	1231	9919
1995-1996	1350	5260
1996-1997	715	4346

Phase III

1997-1998	51	883
1998-1999	18	379
1999-2000	52	2594
2000-2001	114	2474

Phase IV

2001-2002	6	1082
2002-2003 (April-November)	4	983

- iv. Right issues are made to the existing shareholders, who are considered to be adequately informed about the company.

9.1 In view of the above, the Group decided to first concentrate on the Eligibility Norms for unlisted companies, with special emphasis on IPOs of equity.

9.2 The ICAI representative suggested that SEBI should debar issues of dubious promoters. While the other members broadly concurred, they pointed out to the difficulty in drawing up a list of criteria/ conditions that would be objective and comprehensive enough to define dubious promoters. It was informed that this issue of debarring issuers with dubious credentials has already been considered in the Malegam Committee which has proposed formation of a panel for deciding as to whether the persons/companies with dubious track record should be allowed to come out with an issue and if not, how should SEBI stop such issues without inviting criticism regarding selective bias.

9.3 The representative of ICAI also dissented with the Group in respect of the following aspects of the SEBI (DIP) Guidelines:

- 1.Requirement of due diligence to be done by merchant bankers
- 2.Debarring of issues
- 3.Free pricing guidelines of SEBI

9.4 The dissent note in this regard is placed at Annexure 2. The views of the other members of the Group on these issues are also given therein.

REVIEW OF THE PRESENT ELIGIBILITY NORMS

9.5 The present Eligibility Norms for an IPO of equity are summarized below:

- ? A company meeting the track record/profitability criteria can come with an issue through fixed price or book built route provided that the size of the issue is not more than 5 times of its pre issue net worth
- ? However, a company which is not fulfilling the track record-profitability criteria or where the issue size is more than 5 times its pre-issue networth can make an issue provided the same is through book building route with 60% of the issue to be mandatorily subscribed by QIBs.

9.6 The Group deliberated on the following aspects of the existing eligibility norms and concurred that there is a:

1. need to strengthen the existing norms by stipulating higher net worth/ re-defining net worth.
2. need to identify other eligibility parameters viz post issue capital, minimum public float, market capitalization, net tangible assets etc
3. need to provide for alternate mechanisms to enable IPOs of companies which do not fulfill the profitability track record criteria.

9.7 While doing this, the Group examined the eligibility norms existing in various other countries like Australia, USA and Hong Kong. The underlying principle in the discussion was that while there was a need to encourage more companies to approach the primary market by providing a wider platform of entry points, there was simultaneously a need to ensure that the Eligibility Norms also act as deterrents to fraudulent companies.

9.8 The Group deliberated extensively on the validity of the existing criteria of profitability track record. It observed that

- a) profitability as an eligibility criterion induces fraudulent companies to resort to “creative accounting” in order to show “profits” while many do not show the impact of the notes to accounts on their profitability.
- b) there is no way of guaranteeing profitability post listing. In fact share prices of most of the companies with a pre-issue profitable track record have fallen significantly below their offer prices.
- c) as the regulation can not provide a relationship between amount of profit earned and the premium charged on the issue price, there have been instances of companies charging very high premium during buoyant times, despite miniscule profits and as such the profitability track record loses significance.
- d) Investment in equity is done substantially on future expectations and a company’s past record and future potential is ideally captured in its issue price.
- e) A profitability track record conversely brings in complacency in the investor as he automatically believes that the issue is above a threshold.

- f) there exists a large population of companies, many funded by venture capital, who are either currently in losses or have not had 3 years of profitability but are good prospects.
- g) the Eligibility Norms of several other countries rarely prescribe profits as a criteria, and the greater emphasis is on liquidity.
- h) a loss-making company can become profitable with fresh infusion of funds and therefore should not be denied the opportunity of raising money to turn around.

9.9 As a major departure from the past, the Group decided to replace the existing profitability criteria with other parameters, which are described below.

9.10 As a major alternative, the Group suggested the criteria of Net Tangible Assets (NTA). It was agreed that tangible existence of a company, for a reasonable period, is a good eligibility norm, as it would also eliminate fly by night operators. The Group also deliberated at length on the current net worth requirement and also whether the same can be replaced/augmented by “net tangible assets” (NTA). This criterion came into focus while reviewing the eligibility norms in other countries. The Group was of the view that SEBI should consider this as an additional criterion for eligibility, particularly in view of the fact that while net worth ensures a base size of operations for the company, the NTA criteria shall further ensure the physical existence of the company over a longer term and also ensure that the company is engaged in a genuine business activity.

9.11 Regarding definition of NTA, it was noted that the Indian Accounting Standards define “intangible assets” and it was, therefore, agreed that all assets except intangible assets may be considered for this purpose.

9.12 While debating this issue, some of the members were concerned that a company may have excess cash in its books and the same would be deemed as an “asset” for the purposes of calculating NTA. Hence, it was suggested that not more than 50% of a company’s NTA may be held in monetary assets, provided that if more than 50% is held in monetary assets, the company should have firm commitments to deploy such excess monetary assets in its business/project.

9.13 The Group also discussed the dilemma of those companies in the small-medium enterprise category that do not fulfil the track record criteria and also because of their issues being of smaller size are unable to attract QIBs whose primary concern is a large float. The Group discussed as to whether an alternative can be provided to mandatory book building for companies without a track record. The following criteria were considered:

- i. Minimum operating history of company for a suitable period to ensure that the company does not turn out to be a ‘fly- by- night’ operator.
- ii. Minimum post issue capital so as to ensure a minimum size of operations.
- iii. Minimum public float so as to ensure adequate liquidity in the scrip, post listing.

- iv. Any other criteria/deterrent so as to prevent potential “vanishing companies” as also dubious companies which change their names.

RECOMMENDATIONS OF THE GROUP

9.14 After deliberations and also analysis of the past data, including market capitalization of issuer companies and number of applicants in the issues (Annexure 3) and keeping in mind the underlying principle, the Group recommends the following main Eligibility Norms for IPOs:

(A) ELIGIBILITY NORMS FOR INITIAL PUBLIC OFFERING OF EQUITY

9.15.1 A company can make an IPO, subject to the following:

- (a) As on date of filing of the draft offer document with SEBI, the company shall have Net Tangible Assets of at least Rs. 3 crore in each of the preceding 2 full years (of 12 months each), of which not more than 50% is held in monetary assets, (provided that if more than 50% are held in monetary assets, the company should have firm commitments to deploy such excess monetary assets in its business/project.). *(To ensure verifiable existence of the company).***

AND

- (b) The company shall have a Net Worth of at least Rs. 1 crore in each of the preceding 2 full years (of 12 months each) *(To ensure a minimum worth of the company)***

AND

- (c) In case the issuer company has changed its name within the last one year, atleast 50% of the revenue for the preceding 1 full year shall be accounted for by the activity suggested by the new name. *(To ensure that the company does not change its name with the sole purpose of its new name reflecting the latest “sunrise sector” without actually having any operations in that area)***

AND

- (d) The issue size shall not exceed 5 times the pre- issue net worth of the company. *(To prevent the company from raising unmanageably large amounts)***

9.15.2 In case ANY of the criteria (a, b, c & d) specified at 12.14.1 above is not met, the company can make an IPO, subject to the following:

(I)(a)The issue shall be made only through the book-building process, with at least 40% of the issue size allotted to the Qualified Institutional Buyers (QIBs), failing which the full subscription monies shall be refunded. *(Participation of QIBs lends credibility to the issue.) (60% brought down to 40% in view of the present reluctance of the thinly-numbered QIBs to invest in IPOs as also to encourage greater retail participation).*

Or

(b) The “project” should have at least 15% participation by FIs/scheduled commercial banks, of which at least 10% should come from the appraiser(s). *(Participation by FIs/ banks lends credibility to the issue)*

AND

(II)(a)The minimum post-issue face value capital of the company shall be Rs. 10 crore *(To ensure that for these types of companies, there is a reasonable size of listed capital to ensure liquidity.)*

Or

(b) There shall be a compulsory market-making for at least 2 years from the date of listing of the shares. *(To ensure continuous liquidity.)*

9.15.3 In addition to the criteria specified at (1) & (2) above, the company shall also satisfy the criteria of having at least 1000 allottees in its issue *(to ensure public character and wider holding).*

[For the above,

A. NTA shall mean and include all assets of a company other than intangible assets, not eligible to be recognized as assets, as defined in terms of Accounting Standard on Intangible Assets (AS-26) provided that for this purpose Net Tangible Assets would exclude Monetary Assets as defined by AS26.

B. Net Worth shall mean

(See Annexure 4 for views of ICAI on calculation of Net Tangible Assets and Net Worth)]

(B) ELIGIBILITY NORMS FOR ISSUES OF EQUITY SHARES OTHER THAN IPOs

10.1 The Group also deliberated upon the Eligibility Norms for equity issues other than IPOs.

10.2 The Group recommends the following:

1. There shall not be any entry restrictions on any further issue, whether public or rights, by an already listed company, except in the following circumstances:

a. In case the issue size in a further public issue is more than 5 times the pre-issue net worth, the issuer company shall be required to comply with the eligibility criteria specified at A (1) or (2) above.

b. In case there is a change in the name of the issuer company within the last 1 year (reckoned from the date of filing of the offer document) and the revenue accounted for by the activity suggested by the new name is less than 50% of its total revenue in the preceding 1 full-year period, the issuer company shall be required to comply with the criteria specified at (A) (2) above.

10.3 The aforesaid Eligibility Norms shall also apply to Offers for Sale made by unlisted companies, to the extent applicable.

(C) ELIGIBILITY NORMS FOR ISSUES OF INSTRUMENTS OTHER THAN EQUITY SHARES

11.1 The Group noted that the existing Eligibility Norms are applicable uniformly to issuance of equity shares, instruments convertible into equity at a later date, and non-convertible instruments.

11.2 The Group recommends that its recommendations pertaining to equity shares should apply mutatis mutandis to all convertible instruments.

11.3 In the case of issuance of debt instruments, the Group recommends that the following norms should also be stipulated. These are in addition to the provisions already present in the Guidelines:

1. The issue of debt instrument should receive at least an “investment grade” rating.

2. The company should have 2 credit ratings, irrespective of the issue size.

3. **The company should not be in the list of willful defaulter of RBI, as on date of filing draft offer document with SEBI.**
4. **The company should not be in default of any public debentures in terms of either interest or principal.**
5. **The debentures should be fully secured.**

11.4 In terms of number of allottees, the Group recommends 50 allottees (as against 1000 in case of equity issues).

11.5 The Group discussed Clause 8.2.1(b) of the Guideline and was of the opinion that promoters' contribution of 20% of the project cost to be brought in the form of equity is a very onerous requirement and perhaps explains why no issue has come under these guidelines. The Group argued that this requirement is advisable in IPOs of equity in order to ensure a minimum level of promoters' commitment in the company for a continuing period, since investment in equity IPOs is made primarily on the basis of the promoters' strength and on his contribution to the company's future performance. It was pointed out that the promoter can exit the company only in case an acquirer buys out his stake in terms of the provisions of SEBI Takeover Regulations. In contrast, investment in debt is seldom based on the promoters' track record. It is based on the ratings of the debentures, security creation etc. and hence promoters' contribution is not relevant in debenture issues.

11.6 The Group, therefore, recommends that the requirement of 20% promoters' contribution in the case of debt issues be deleted.

11.7 However, the Group conceded that in the absence of promoters' stake and its lock-in, the rights of the debenture holders in case the promoter was to sell his equity stake in the company could be adversely affected. The Group feels that in such cases, the debenture trustees should be required to play a proactive role. The Group suggests that promoters be asked to subscribe to at least 25% of the debentures issued through the offer document locked-in for 1 year or till the sale of the company, whichever is later, with a view to ensure promoters commitment in the same instrument. **The Group also recommends that this issue may be referred to the Takeover Department for further deliberations.**

11.8 Regarding Clause 8.2.1(c) i.e continuous disclosures in terms of listing agreement, the Group recommends that the continuing disclosures may be filed with EDIFAR.

11.9 The Group recommends that Clause 8.2.1(d) i.e prior consent of NCD holders for change in shareholding pattern, capital structure etc may be deleted as this would be contrary to the Companies Act provisions.

11.10 The Group recommends deleting Clause 8.2.1(e) i.e no partly paid up shares and no outstanding convertibles for an IPO subject to certain safeguards, as discussed below under the head : " Chapter II of the DIP guidelines".

OTHER RELATED ISSUES

12. The Group deliberated on the following other related issues:

Chapter II of DIP Guidelines

13.1 As on date, rights issues not exceeding Rs.50 lacs are exempted from the provisions of SEBI (DIP) Guidelines.

13.2 The Group felt that while SEBI may not need to give observations on rights issues of up to Rs. 50 lacs of an already listed company, it is desirable that even such companies prepare the letter of offer in accordance with the disclosure requirements prescribed in the SEBI (DIP) Guidelines, 2000 and file the same with SEBI for information.

13.3 The Group also considered whether the existing limit may be increased from Rs. 50 lacs to Rs 2 crores. However, the **Group recommends retaining Rs 50 lacs limit.**

13.4 **Group also recommends that even in respect of rights issues of upto Rs.50 lacs , the offer document must be prepared in compliance with SEBI DIP Guidelines and filed with SEBI for information purpose only and put on SEBI Website (Clause 2.1.2)**

13.5 **Group recommends that Clause 2.1.4 should specify that the company should have made an application for listing and also obtained in-principle listing approval from the stock exchanges, which is to be submitted to SEBI within 15 days of submission of draft offer document to SEBI. (This requirement is presently in Clause 5.6.2. It was felt that this should appear in the chapter on eligibility norms)**

13.6 **The Group recommends that in Clause 2.1.5, “a” may be replaced by “all” as the company is required to enter into agreements with all depositories.**

13.7 The Group was of the view that the current definition of “QIBs” may be expanded as the actual participation comes only from very few of the entities included therein presently.

13.8 **The Group recommends that the following may be added to the list of QIBs:**

- i. Pension funds, provident funds, superannuation funds and gratuity funds. (With minimum corpus under management of Rs. 25 crores)**
- ii. Port trusts (With minimum corpus under management of Rs. 25 crores)**
- iii. Portfolio managers registered with SEBI (With minimum corpus under management of Rs. 25 crores)**
- iv. Insurance companies registered with IRDA**

- 13.9 **Regarding Explanation 1(ii) to Clause 2.2.2 regarding restating of accounts of erstwhile partnership firm, the Group recommends that this should be applicable to entities arising out of reorganisation of any type of entity whether sole proprietorship, partnership firm or a combination of companies.**
- 13.10 Regarding clause 2.4.1 (iii) dealing with appraisal of infrastructure issues by PFIs, the Group noted that the appraisal is allowed to be done by only 4 organisations, of which ICICI Ltd. is now a bank and hence no longer eligible. The Group recommends that banks be also allowed to carry out appraisal and participation. However, in order to restrict this to only such banks which have the expertise of appraisal, the **Group recommends that only such banks as fall in the list of scheduled commercial banks as defined by RBI be allowed to appraise and participate in such projects.**
- 13.11 Regarding Clause 2.6 and 2.7 (IPO not allowed pending outstanding warrants and partly paid shares), the Group feels that some of the companies, especially those in the software or infotech sector frequently enter into agreements with other entities wherein they allot convertible instruments to these entities. The instruments are converted at a future date, depending upon the performance of the company or achievement of pre-agreed/predefined milestones e.g. placement of orders of certain value or achievement of certain turnover etc. Such agreements are very common in these sectors and it becomes difficult for such companies to undo these allotments prior to their IPO. **Hence, the Group recommends that this restriction (IPO not allowed pending outstanding warrants and partly paid shares) should be removed, with necessary safeguards, to ensure that genuine commercial transaction are not required to be unwound on account of IPO.** The safeguards like existence of a formal agreement delineating this requirement, instruments are held by persons other than promoters, may be stipulated.

Chapter X of DIP Guidelines

- 14.1 **Modify/delete Clause 10.2.1 in view of the recent changes in the Companies Act, which require appointment of trustees for all issues of debentures. (Section 117B of the Companies Act)**
- 14.2 **Modify Clause 10.2.5 to prescribe a suitable asset cover for the debentures to ensure 100% security for the debentures. Also, the clause should state “issuer’s bankers” and not “their bankers”.**
- 14.3 **Delete/ modify Clause 10.3 regarding DRR as the same has been adequately prescribed under Section 117 of the Companies act, 1956.**
- 14.4 **Modify Clause 10.2.6 (a) and (b) to cast an obligation on the trustees to collect the report from the lead bank/agency, as lead bank/agency is presently not answerable to the trustees.**

- 14.5 Delete Clause 10.2.6 (d) (talks about prohibition for making debenture issues for investing in group companies etc).
- 14.6 In Clause 10.2.4(a) replace “new” by “all”. Dividend distribution by all companies should require approval of a debenture trustee. SEBI should also examine whether this clause can be replaced with a direction that a company cannot declare any dividend in case of “default” in payment of interest and redemption proceeds. (“Default” can be suitably defined e.g. any outstanding for more than 6 months.)
- 14.7 Delete Clause 10.2.4 (c).
- 14.8 Delete Clause 10.6.3 as it is redundant as requirements regarding creation of security, period available for creating the security and assorted requirements are provided in the Companies Act. Moreover, the company cannot utilize the monies out of the issue in case of non creation of security.
- 14.9 State explicitly in the Guidelines that unsecured debentures cannot be issued.
- 14.10 Restate Clause 10.7 as per the suggestion made by the Debentures Trustee Committee.
- 15. The Group also recommends that the words “at the time of filing draft offer document with the Board” in clause 4.14.2 (ii), be replaced by “at the time of opening of the issue”.



In addition to the recommendations made in the report, the Primary market advisory Committee recommended that :

- 16.1 **The QIB requirement may be diluted to 40% across all book building issues, not only in case of mandatory book building.** The existing SEBI guidelines require mandatory participation from QIBs to the extent of 60% in case of companies not fulfilling the eligibility criteria.
- 16.2 Even in case of companies which fulfill the eligibility criteria and wish to make the issue through book building mechanism, the companies are required to allocate 25% to retail investors and 15% to non-institutional investors, thereby leaving 60% available for allocation to QIBs. The committee felt that this should be brought down to 40% on account of the following :
 - a. A larger part of the issue would then be available to retail and non-institutional investors, and
 - b. 40% participation by QIBs would be sufficient indication of their interest in the issue and also for price discovery.

17.1 SEBI may consider allowing the existence of “partly paid shares”-called and unpaid but not uncalled.

17.2 SEBI guidelines state that “No company shall make a public or rights issue of equity share or any security convertible at later date into equity share, unless all the existing partly paid-up shares have been fully paid or forfeited in a manner specified in clause 8.6.2.”

17.3 The committee felt that the company may be allowed to come out with a further issue with outstanding partly paid shares, where it has issued the call notice but the shareholders have not paid. In such cases, the company should not be restrained on account of non-action on the part of the shareholders. Moreover, forfeiture of such shares may take time. Hence, the company may proceed with its issue related plans, pending final action on unpaid calls.

EXISTING ELIGIBILITY NORMS

IPO of equity

2.2.1 An unlisted company shall make a public issue of any equity shares or any security convertible into equity shares at a later date subject to the following: -

- i. It has a pre-issue networth of not less than Rs.1 crore in three (3) out of preceding five (5) years,
with a minimum networth to be met during immediately preceding two (2) years; and
- ii. It has a track record of distributable profits in terms of section 205 of the Companies Act, 1956,
For at least three (3) out of immediately preceding five (5) years.

Provided that the issue size (i.e. offer through offer document + firm allotment + promoters' contribution through the offer document) does not exceed five (5) times its pre-issue networth as per the last available audited accounts, either at the time of filing draft offer document with the Board or at the time of opening of the issue.

2.2.2 An unlisted company can make a public issue of equity shares or any security convertible into equity shares at a later date, only through the book-building process if ,

- i. it does not comply with the conditions specified in clause 2.2.1 above, or,
- ii. its proposed issue size exceeds five times its pre-issue networth as per the last available audited accounts either at the time of filing draft offer document with the Board or at the time of opening of the issue

Provided that sixty percent (60%) of the issue size shall be allotted to the Qualified Institutional Buyers (QIBs), failing which the full subscription monies shall be refunded.

Offer for sale

2.2.3.1 A company, whose equity shares or any security convertible at later date into equity shares are offered through an offer for sale, shall comply with the provisions of Clause 2.2.

Issue by listed company

2.3.1 A listed company shall be eligible to make a public issue of equity shares or any security convertible at later date into equity share.

Provided that the issue size (i.e. offer through offer document + firm allotment + promoters' contribution through the offer document) does not exceed five (5) times its

pre-issue networth as per the last available audited accounts either at the time of filing draft offer document with the Board or at the time of opening of the issue.

2.3.2 A listed company which does not fulfil the condition given in the proviso to clause 2.3.1 above, shall be eligible to make a public issue only through the book building process.

Provided that sixty percent (60%) of the issue size shall be allotted to the Qualified Institutional buyers (QIBs), failing which the full subscription monies shall be refunded.

IPO of debt

In addition to fulfilling the requirements as at clause 2.2 (as applicable) the company shall comply with the following:

[8.2 Public issue and listing of non-convertible debt securities (hereinafter referred to as NCDS) and Debt Securities convertible into equity after allotment (hereinafter referred to as DSCE).

8.2.1 An unlisted company making a public issue of NCDS may, subject to other applicable provisions of these guidelines, make a public issue and make an application for listing its NCDS in the Stock Exchange/s without making a prior public issue of equity and listing thereof, if the following conditions are fulfilled:

- a) The NCDS shall carry a credit rating not below investment grade at-least from one Credit Rating Agency registered with the Board. Where the issue size of the NCDS is Rs. 100 crores or more, such rating shall be obtained from at least two Credit Rating Agencies.
- b) The promoter's contribution of atleast 20% of the project cost i.e. objects proposed to be inter alia financed through the issue shall be brought in the form of equity. Where the promoters contribution exceeds Rs. 100 crores, the promoters shall bring in Rs. 100 crores before the opening of the public issue and the remaining promoters' contribution shall be brought in on pro rata basis, before calls on the NCDS are made. The promoters' contribution of 20% of equity shall be locked in for a period of 3 years from the date of allotment in the public issue of NCDS.
- c) The issuer company shall agree to comply with the requirements of continuing disclosures as specified under the listing agreement to be entered into with concerned stock exchanges as is applicable for listing of equity shares.
- d) The issuer company shall agree to obtain prior consent of the holders of the NCDS through special resolution to be passed at the general meeting of the NCDS holders for change in terms of issue, change in capital structure and change in shareholding pattern.
- e) There shall be no partly paid up shares/other securities at the time of filing of draft offer document with the Board.
- f) The issuer company may come out with a public issue of equity/security convertible into equity after allotment during the currency of the NCDS or thereafter, only after

complying with the guidelines applicable for an initial public offering of such securities.

- g) The equity held by the promoters or others at the time of issue of NCDS may be listed only when an initial public offer of equity/securities convertible into equity after allotment is made after complying with the applicable provisions of these Guidelines.

8.2.2 A Municipal Corporation which has no share capital may be subject to the provisions of sub-clauses (a), (b) and (c) of Clause 8.2.1, make a public issue of NCDS and list the same on the stock exchange/s.

8.2.3 An unlisted company making a public issue of DSCE may, subject to other applicable provisions of these guidelines make a public issue and make an application for listing on the stock exchanges without making a prior public issue of its equity and listing thereof, if the following conditions are fulfilled:

- a) The provisions of clauses (a) to (e) of clause 8.2.1 shall be mutatis mutandis complied with.
- b) An issuer company making an initial public offer of DSCE may come out with a subsequent public issue of equity/security convertible into equity after allotment during the currency of the DSCE only after complying with the guidelines applicable for an initial public offering of such securities.

Provided that the provisions of Clause 2.6 shall not be applicable for an Initial Public Offer of such securities if the floor price for conversion of DSCE is determined and disclosed in the offer document for issue of DSCE.

- c) The equity held by the promoters and others may be listed along with the listing of equity in initial public offering of equity/security convertible into equity after allotment or at the time of listing if equity arising on conversion of the DSCE .
- d) If the equity shares held by the promoters is proposed to be listed on conversion of DSCE, it shall be ensured that the number of equity shares allotted to the public (after excluding the allotment of equity shares to holders of DSCE issued on firm allotment/reservation basis) as a percentage of the total paid up equity capital after conversion and listing of the promoters equity, is not less than the percentage specified in clause (b) of sub-rule (2) of Rule 19 of Securities Contracts (Regulations) Rules, 1957.

8.2.5 The lead merchant banker can mention a price band of 20% (cap in the coupon rate/ price band should not be more than 20% of the floor coupon rate/price) in the offer document filed with the Board and the specific coupon rate/price can be determined by an issuer in consultation with the lead manager at a later date before filing of the offer document with the RoC/s.

DISSENT NOTE OF ICAI**1. FILING OF OFFER DOCUMENT**

- A.** The present system of filing of offer document only through an eligible Merchant Banker has not served appropriately. Even Securities and Exchange Commission USA is examining very actively that various functions combined in Merchant Bankers creates a conflict of interest. The Merchant Banker or lead manager or co-lead manager and advisors to the issue involved in the marketing of a public issue on behalf of the promoters should not be undertaking –

- (a) research
- (b) due diligence
- (c) filing or sponsoring a public issue.

The company should be free to opt for any Merchant Banker or Investment Banker to market the public issue which should not be involved with the due diligence or other fiduciary relationship with the company in any manner.

- B.** The responsibility to undertake detailed disclosures after detailed examination of books of accounts, visit to establishments, proposed site, examination of records, documents and other supporting papers, information and explanation and due diligence can be undertaken by a merchant banker or a law firm or a firm of Chartered Accountants.
- C.** The Securities and Exchange Board of India may obtain a panel of Chartered Accountant firms from ICAI as per norms as may be decided by SEBI in consultation with ICAI for appointment of Independent firm of Auditors.
- D.** The Independent firm of Auditors should not only vary and certify financial figures as required now but can also undertake verification / certification of full contents of the prospectus / offer document.
- E.** The due diligence and certification that all norms laid down by SEBI has been complied with should be issued by the Merchant Banker or a Law firm or a Chartered Accountant firm.
- F.** The aforesaid due diligence agency may be appointed by SEBI out of an independent panel or selected by the company out of 3 names short-listed by SEBI.

2. COMPANIES BARRED NOT TO ISSUE SECURITY

- A.** This paragraph may contain a proviso as follows :

Provided further that the SEBI Board or a panel appointed by them may, lay down such parameters as would disentitle the Companies from accessing the Capital Market in the interest of investors in general or public interest.

Provided further that the panel so appointed would, as assisted by SEBI Secretariat or professionals retained on outsource basis for this purpose, may review the prospectus filed by the companies for accessing capital market and may disapprove companies which do not meet the SEBI norms or parameters as laid down or such other reasons, as may be recorded in writing, based on which the companies are debarred from accessing the capital market.

The order of the panel would be appealable to the Board or to Securities Appellate Tribunal.

- B.** A list of circumstances or parameters as per which the companies be barred from accessing capital market is given below :

SEBI Guidelines to prohibit undesirable promoters and companies, can include:

- i) Company or promoter or Directors or management found / responsible for :
 - a) Criminal prosecution with imprisonment above years / months or fine above Rs. Lakhs any time during last 5 years by a court and is confirmed at second appellate level;
 - b) Categorised as willful defaulter or responsible for siphoning of funds, or diversion of funds, by their banks or RBI ;
 - c) Defaulted in any of the Company in :
 - (i) repayment of debentures for more than 1 year ;
 - (ii) repayment of Fixed deposit
 - (iii) payment of dividend duly declared & passed
 - (iv) redemption of preference shares ;
 - (v) SSI dues for more than 1 year ;
 - (vi) Loans payable to any bank, Financial Institution or NBFC or any multilateral or bilateral funding agencies
 - d) is director / has been director or promoter or in management control of any such companies or companies who are under compulsory winding up / settled dues with secured and / or unsecured creditors
 - e) failed to file for more than 3 years returns under Income Tax Act, Companies Act
 - f) responsible for insider trading, manipulation of market.

3. Para 2.1.4 Application for listing.

SEBI should prescribe broad parameters and scope of Stock Exchanges monitoring. This should also provide that the post issue size of the issue or market cap or other conditions should be prescribed in a manner that SSI Companies and SMEs Companies are able to access the capital market subject to SEBI guidelines and parameters.

4. GUIDELINES FOR ISSUING SHARES AT PREMIUM

The norms identified in the meeting held on 24th September 2002 may be adopted with following provisions:

- (ii) In case of shares to be issued at a premium the following additional conditions are to be met :
 - a. Shares at premium can be issued only by profit making companies for at least 2 years out of at least 3 years with a minimum profit of Rs. 1 crore or 20% of pre-issue capital (excluding only issue size).
 - b. The profitability track record should justify at least one-third of the proposed premium amount based on valuation as per any of the following methods:-
 - i) Profit Earning Capacity Value based on existing earnings or
 - ii) Intrinsic Value or
 - iii) Average Market Value during last 6 months
 - iv) Discounted Cash Flow Method.

VIEWS OF OTHER GROUP MEMBERS ON THE ABOVE

Regarding SEBI adopting a merit -based approval and judging the quality of issues approaching the market, the members were of the opinion that investing in equity issues was the riskiest form of investment and investors should rely on their own judgment instead of expecting SEBI to sit in judgment on every issue. Moreover, it was not feasible to develop any set of guidelines which will ensure that only very good issues enter the market. The members overwhelmingly agreed with the present disclosure-based philosophy of SEBI and were of the view that any entity should be allowed to access the primary market with full and complete disclosure.

Regarding debarring issues of dubious promoters, the Group's view is contained in the main report.

Regarding due diligence for issues not to be handled by the merchant banker lead managing the issue on the ground the merchant banker may not be able to do an impartial job in view of the fact that his remuneration depends on the company, and the same be conducted by an independent entity, not appointed by the company, the members strongly dissented with this view as they were of the opinion that the obligation cast by SEBI on the merchant banker was stringent enough in terms of checks and balances and moreover, a single point responsibility for both diligence and marketing is essential. The members also pointed out that due diligence internationally is done by the merchant banker and that appointing a second body for diligence would also increase the time and cost of the issue.

Regarding the premium allowed to be charged to be based on some formula, the members rejected this outright based on the premise that price is a matter of consideration of the market/ investors and not the regulator.

ANNEXURE 3**Post-Issue Market Capitalization of Companies**(in Rs.
crore)

PERIOD	< 3	3 TO 5	5 TO 10	10 TO 25	25 TO 50	50 TO 100	>100
				—	—	—	—
1999-2000	-	1	8	13	6	6	22
2000-2001	-	3	33	49	7	2	21
2001-2002	-	-	2	2	-	-	2
2002-2003	-	-	-	-	-	-	1

Data on number of Valid Applications in Public Issue

YEARS	3-4 lacs	1-3 lacs	50000-1 lac	25000-50000	10000-25000	5000-10000	1000-5000	<1000	TOTAL
1999-2000	2	20	11	9	7	6	-	1	56
2000-2001	-	3	-	4	-	15	73	11	115
2001-2002	-	1	-	1	-	-	2	2	6
2002-2003*	1	-	-	-	1	-	-	-	2
TOTAL	3	24	11	14	8	21	75	14	179

* April – August

VIEWS OF ICAI ON CALCULATION OF NET TANGIBLE ASSETS

C. Net Tangible Assets as well as Net Worth or Profits of a company would be determined as per Accounting Standards and guidance notes issued by the Institute of Chartered Accountants of India. While computing Net Tangible Assets and Net Worth of the Company, the following shall be given effect to :

- i) Consider the impact of audit qualifications including those which could be quantified by the company by reasonable effort;**
- ii) Consider the impact of non-adherence to Accounting Standards and Guidance Notes issued by the Institute as well as generally accepted accounting principles in India.**
- iii) Exclude ascertained liabilities other than those which are disputed up to second appellate level and are pending disposal, which in the opinion of the Company and the due diligence agency are not expected to arise and need not to be provided;**
- iv) Exclude provisioning required for Non Performing Assets as per guidelines issued by RBI for Banks and NBFCs or by any other relevant authority for others from time to time.**
- v) Exclude intangible assets, which should not be recognised as assets in terms of AS26.**
- vi) Investments are to be valued in accordance with AS13.**
- vii) Deposits with stock exchanges and value of the card of a stock exchange and all other assets are to be recognized at carrying cost subject to Accounting Standard on Impairment of Assets (AS28).**
- viii) No benefit of increase in value of assets beyond cost is to be given unless the same is permitted to be recognized in terms of Accounting Standards and Guidance Notes issued by ICAI as may be applicable to an enterprise. The fair value or market value concept is not recognized by Indian as well as International Accounting Standards issued by ICAI.**

- ix) To evaluate Net Worth and Net Tangible Assets as per consolidated financial statements in terms of AS21, AS23 and AS27.**
- x) To not to exclude pledged assets from Net Worth, as pledging of assets do not affect Net Worth unless ascertaining liabilities arising there from are not considered in the financial statements.**
- xi) To exclude bad and doubtful debts and advances in terms of Generally Accepted Accounting Principles in India.**
- xii) To exclude the impact of unusual accounting practice or impermissible financial engineering or accounting jugglery as may be identified by auditors or any other relevant authority.**