2

PUBLIC ISSUES

2.1 Introduction

Commercially speaking, a public issue may be defined as an offer for subscription by a company of its securities to the general public. Most people are familiar with the concept of a public issue. However, at the same time there are a few misconceptions associated with it. Many people interchange the terms Public Issue and IPO. The term IPO refers to an Initial Public Offer/ Offering. Thus, any company can have only one IPO in its lifetime since it cannot have an Initial Offer time and again. A public issue on the other hand is a much wider term and includes within its purview both IPOs as well as all other subsequent public offerings also known as FPOs or Follow-on Public Offers. An IPO can only be made by an unlisted company whereas an FPO can only be made by a listed company. This is one fundamental difference which should be borne in mind. The public issue by a company is governed by the SEBI (Disclosure and Investor Protection) Guidelines, 2000 also known as the DIP Guidelines. These Guidelines have been framed by SEBI to facilitate and regulate different forms of capital offerings by companies and other related and ancillary issues. The DIP Guidelines are amended from time to time by SEBI.

There are three types of Public Issues by which a public company can raise funds:

(a) IPO: Initial Public Offer, which is once in the Company's lifetime

(b) FPO: Follow-on Public Offers, which a Company can raise any number of times

(c) Rights Issue: When a Company makes an Offer to raise capital from its existing shareholders (for coverage on Rights Issue see Chapter 5).

2.2 Eligibility

2.2.1 The DIP Guidelines define a Public Issue to mean an invitation by a Company to the public to subscribe to its securities offered by a prospectus. Thus, the essential features of a public issue are:

(a) there must be a prospectus
(b) there must be an invitation to the public
(c) the offer must be to subscribe to the securities of the company.

It is important to note that a public issue could be for any security of the company and not just equity shares. Security is defined in s.2(h) of the Securities Contracts (Regulation) Act, 1957 (see para 20.2) and includes within its scope equity shares, convertible preference shares, non-convertible preference shares, convertible debentures, warrants, etc.

2.2.2 The earlier Guidelines contained various stringent conditions for a company to make a public issue. However, SEBI has relaxed these conditions to a great deal. Any company can now make a Public Issue only after:

(a) a Draft Prospectus has been filed with SEBI by the Merchant Banker at least 21 days prior to the filing of the same with the ROC;
(b) SEBI's corrections, if any, have been incorporated in the Prospectus;
(c) The company has made an application for listing of the securities to the Exchanges; and
(d) It has entered into an Agreement for the dematerialisation of its securities with a Depository. There are currently two Depositories in India, namely, NSDL (National Securities Depository Ltd.) and CSDL (Central Securities Depository Ltd.).

In addition to the above, the DIP Guidelines lay down specific conditions for an Initial Public Offer and a Further Public Offer.

2.3 Conditions for making an IPO

2.3.1 As explained above, an IPO means an Initial Public Offer and is made by Unlisted Companies. An Unlisted Company can make a Public Issue/ IPO under any of the two options mentioned below. Under Option-A it needs to fulfill all the conditions. However, under Option-B, it must fulfill any one condition from (a) and any one condition from (b), in addition to (c).

Option-A: If it satisfies the following conditions	Option-B: If it does not satisfy the conditions stated in Option-A
(a) It has Net Tangible Assets ≥ Rs. 3 crores in each of the 3 preceding full years of 12 months each, of which a maximum of 50% can be held as monetary assets. If it has more than 50% of its net tangible assets in monetary assets, then it must have made a firm commitment to deploy such monetary assets in its business or in a project.	(a) The Offer must only be made by way of a Book Building (see chapter 3). Further, at least 50% of the Offering must be allotted to Qualified Institutional Buyers (QIBs), e.g., PFIs, banks, VCs, MFs, etc., failing which the full subscription money must be refunded (see para 2.3.2(e) for a definition of QIBs). OR
(b) It has a minimum networth ≥ Rs. 1 crore in each of the 3 preceding full years of 12 months each	(a)The Project is appraised by FIs/ Scheduled Banks and at least 10% participation comes from the Appraiser and a further minimum 5% from other FIs/ Scheduled Banks. A further 10% must be allotted to QIBs. If these conditions are not met, then the full subscription money must be refunded.
(c) It has a track record of distributable profits for 3 out of immediately preceding 5 years. The distributable profits must be computed under s.205 of the Companies Act.	(b) The minimum post-issue face value (i.e., without considering the premium component) of the capital is Rs. 10 crores. OR
(d) The proposed issue + all other issues made in the same financial year ≤ 5 times the pre-issue networth as per the latest audited balance sheet of the last financial year. While reckoning the issue size, the IPO, any firm allotment and any promoters' contribution made through the offer document/ prospectus are included.	(b) There is a compulsory market-making for 2 years from date of listing. The minimum buy and sell quotes must be for 300 shares and the difference between sell and buy quotes must not exceed 10%. Further, the market maker must keep at least 5% of the issue size as inventory.

(e) In case of a name change in the last one year, at least 50% of the revenue of the last one full year is from the activity suggested by the name. E.g., if XYZ Finance Ltd. becomes XYZ Biotech Ltd., then in the full year preceding the IPO, at least 50% of the company's revenue must arise from biotech activities.	(c) The minimum number of prospective allottees must be 1,000.
(f) The Offer can be by way of a Book Building or by way of a Fixed Price Offer.	
(g) The minimum number of prospective allottees must be 1,000.	

2.3.2 Certain key terms used in Option-A and Option-B are defined below:

(a) Net Tangible Assets means the sum of all net assets of the Company excluding intangible assets as defined in AS 26 issued by the ICAI on Intangible Assets. AS 26 defines an intangible asset as an identifiable non-monetary asset, without physical substance, held for use in production or supply of goods or services, for rental to others or for administrative purposes.

(b) Net worth means Paid-up Equity + Free Reserves (-) Accumulated Losses(-) Miscellaneous and Deferred Revenue Expenditure not written off as per the audited balance sheet. Revaluation reserve is excluded. Thus, preference shares are not to be counted in net worth computation.

(c) If a partnership firm has been converted into a company and the company is making an IPO, then the track record of distributable profits of the firm would be considered only if the financial statements of the partnership business conform to and are revised in the Schedule VI Format under the Companies Act, 1956. Further, they must also comply with the following:

(i) adequate disclosures, as required under Schedule VI, must be made;

(ii) the financial statements must be certified by a CA stating that:

- the accounts as revised or otherwise and the disclosures made are in accordance with Schedule VI; and
- the accounting standards of ICAI have been followed and that the financial statements present a true and fair picture of the firm's accounts.

(d) If an unlisted company is formed out of a division of an existing company, then the track record of distributable profits of the division spun off shall be considered only if the requirements regarding financial statements as specified for partnership firms above are complied with. For example, Tata Consultancy Services earlier operated as a division of Tata Sons Ltd., which was then spun off into a new company before the IPO. In the prospectus, it restated the financial statements in accordance with the above requirements.

(e) Qualified Institutional Buyers or QIBs are a special category of investors. They are institutional investors and comprise of the following investors:
  - (i) Public financial institutions as defined in section 4A of the Companies Act, 1956. These include IFCI, IDBI, LIC, UTI, IDFC, ARCIL;
  - (ii) Scheduled commercial banks. These include commercial banks which are specified in the Second Schedule to the Reserve Bank of India Act;
  - (iii) Mutual funds;
  - (iv) Foreign Institutional Investors or FIIs registered with SEBI;
  - (v) Multilateral and bilateral development financial institutions;
  - (vi) Venture capital funds registered with SEBI;
  - (vii) Foreign venture capital investors registered with SEBI;
  - (viii) State industrial development corporations;
  - (ix) Insurance companies registered with the Insurance Regulatory and Development Authority (IRDA);
  - (x) Provident funds with a minimum corpus of Rs. 25 crores;
  - (xi) Pension funds with a minimum corpus of Rs. 25 crores.

2.3.4 At the time of an IPO, there can be no outstanding warrants or other convertible instruments (other than those relating to ESOPs granted in accordance with the SEBI ESOP Guidelines) which would entitle the existing promoters or shareholders any option to receive equity shares after the IPO.

2.4 Conditions for making a Public Issue/ FPO

2.4.1 As stated above, only a listed company can make a Further Public Offer of equity shares or any convertible security. The conditions for a listed company to make an FPO are as follows:

(a) The proposed issue + all other issues made in the same financial year ≤ 5 times the pre-issue networth as per the latest audited balance sheet of the last financial year. While reckoning the issue size, the IPO, any firm allotment and

any promoters' contribution made through the offer document/ prospectus are included.

(b) In case of a name change in the last one year, at least 50% of the revenue of the last one full year is from the activity suggested by the name. E.g., if XYZ Finance Ltd. becomes XYZ Biotech Ltd., then in the full year preceding the IPO, at least 50% of the company's revenue must arise from biotech activities.

In case a listed company does not satisfy the above conditions, then it can make an issue subject to compliance with the conditions specified under Option-B stated above which apply to an unlisted company which wants to make an IPO.

2.4.2 The conditions specified in para 2.3.1 and 2.4.1 above would not be applicable to a listed company in case of:

(a) a public issue by a Banking Company set up under the Banking Regulation Act;

(b) a public issue by a Public Sector Bank

(c) a public issue by an infrastructure company whose project has been appraised in a certain manner

(d) a Rights Issue.

2.5 Pricing in case of IPO/ FPO

2.5.1 One of the biggest changes made by SEBI is the removal of the pricing guidelines in case of IPOs and FPOs. Pricing of public issues by unlisted companies, listed companies, banks, infrastructure companies, etc., is free and left to the discretion of the company. However, in practice, it is jointly decided with the Merchant Banker. A company files a draft offer document with SEBI and later on it files the same with ROC after incorporating the comments of SEBI. The company can mention a price band when it files the offer document with SEBI with the cap (i.e., the ceiling) being not more than 20% from the floor price. However, the actual price must be determined before the offer document is filed with the ROC. The pricing mechanism in case of book built issues is specified in para 3.3.3.

2.5.2 In case a listed company is coming out with a joint issue of rights as well as public issue, then it can have differential pricing for the two issues.

2.5.3 Differential pricing is also permitted in case of a firm allotment in an IPO/ FPO. However, this price must be higher than the regular category.

2.5.4 The Face Value of shares can also be determined by the companies, e.g., Rs. 10, 5, 2, 1, etc. It cannot be a decimal of a rupee, e.g., Re. 0.50. Further, in case of an IPO the following additional conditions apply:

- if the issue price is Rs. 500 or more then the Company may fix the face Value below Rs. 10 per share but not lower than Re. 1 per share;
- if the issue price is less than Rs. 500 then the Company must have a face Value of Rs. 10 per share.

Existing companies can freely vary the face value of their shares without any conditions.

2.5.5 Companies have the freedom to fix the issue price. Hence, in case of a price higher than the face value of the shares the balance would be treated as share premium. For instance, if the IPO price for a share of Rs. 10 face value is fixed at Rs. 140, then Rs. 130 would be treated as share premium. The provisions of the Companies Act in respect of such share premium would then be applicable (see para 21.11 on Securities Premium).

2.6 Promoters' Contribution

2.6.1 In any public issue, the promoters of the company are required to infuse certain amount of funds in the company by way of promoters' contribution. It is interesting to note that although the DIP Guidelines speak of promoters' contribution, it does not contain a general definition of the term "promoters". One may refer to the definition contained in Explanation I to cl.6.8.3.2(k)–(l) under the Capital Structure to be given in a Prospectus. Although, the Explanation states that the definition is applicable for the purposes specified therein, the definition may be used even for the purposes of determining the promoters' contribution. The term Promoter has been defined to include:

(a) the person or persons who are in over-all control of the company;

(b) the person or persons who are instrumental in the formulation of a plan or programme pursuant to which the securities are offered to the public;

(c) the persons or persons named in the prospectus as promoters(s).

However, persons who are merely professional directors would not be included within this definition.

2.6.2 The requirements for the minimum promoters' contribution is as under:

Issue Type	Minimum PC
IPO by Unlisted Companies	≥ 20% of Post-issue Capital
Public Issue by Listed Companies	≥ 20% of the proposed issue or ensure shareholding of 20% of Post-issue Capital
Rights-cum-Public Issue	≥ 20% of proposed issue or 20% of Post-issue Capital (excluding the Rights Issue) – Option to the Promoters

2.6.3 The key points in respect to promoters' contribution are as follows:

- The requirement of promoters' contribution is not applicable in the case of:
  - issues by companies listed for at least 3 years and which have a dividend track record for at least 3 preceding years;
  - rights issues; or
  - companies where no identifiable promoter group exists, e.g., in the case of professionally managed companies.
- Certain types of capital contribution are ineligible for being considered for the promoters' contribution.
- The entire promoters' contribution must be brought in at least one day prior to the date of the public issue. If it exceeds Rs. 100 crores, then at least Rs. 100 crores must be brought in prior to the issue and the balance on a pro-rata basis but before calls are made to the public.
- Any promoters' contribution in excess of the minimum requirements, is treated as a preferential allotment and the SEBI(DIP) Guidelines on preferential allotment would accordingly apply (see Chapter 7).
- In case of an issue of a convertible security, where the conversion price of the equity component is fixed, then the promoters' contribution, can at the option of the promoters, be in the form of contribution to equity or by subscribing to the instrument.

2.6.4 Practice Pointer: Every allotment of securities to promoters should be by way of a Board Resolution and a Chartered Accountant's Certificate stating that the contribution has been brought in before opening of the issue. This certificate should be accompanied by a list of names and addresses of friends, relatives and associates of the promoters which make up the promoters' contribution. All these details should also be filed with SEBI.

2.7 Lock-in

2.7.1 Lock-in period refers to the period during which the shares are non-transferable. Earlier when the shares were in physical format, they bore an inscription to that effect. Now specific instructions to such effect are given to the depository participant.

2.7.2 The lock-in period for different issues is as follows:

Capital	Lock-in period
Minimum Promoters' Contribution in case of a Public Issue	3 years from the date of allotment in the public issue or the commencement of commercial production, whichever is later
Excess Promoters' contribution in case of a public issue	1 year from the date of allotment of securities
Entire pre-IPO capital of an Unlisted Company	1 year from the date of allotment in the public issue

2.7.3 The lock-in for the pre-IPO capital of an unlisted company does not apply in the following situations:

(a) pre-IPO capital held by SEBI registered Venture Capital Funds and Foreign Venture Capital Funds provided they are held for at least one year prior to the date of filing of the Prospectus with SEBI or the shares are locked-in as per the Venture Capital Regulations;

(b) pre-IPO capital held at least for one year at the time of filing of the draft offer document with SEBI and being offered to the public by way of an offer for sale (see Chapter 8);

(c) pre-IPO capital held by non-promoter employees and issued under an pre-IPO ESOP. However, the requirements of the SEBI Guidelines on ESOPs in this respect must be satisfied (see para 16.2.3);

(d) transfer inter se non-promoter shareholders who are holding such locked-in pre-IPO capital provided that they comply with the SEBI Takeover Regulations and that the balance lock-in continues in the hands of the transferees.

2.7.4 Locked-in securities can be pledged with banks as a collateral security for loans. Further, the case of promoters' contribution which is locked-in can be

transferred inter se the promoters provided that they comply with the SEBI Takeover Regulations and that the balance lock-in continues in the hands of the transferees.

2.8 Minimum Public Offering

One of the key factors to be determined in any public issue is what percentage stake of the post-issue capital should be offered to the public. It is but natural that the company would like to dilute as little equity as possible. The minimum stake which the company must offer is determined by the SEBI Guidelines. The key points in this respect are as follows:

(a) The minimum net offer to the public in case of a public issue would either be 10% or 25% of the post-issue capital.

(b) The normal requirement is that the net offer to the public must be 25% of the post-issue capital. However, a company is allowed to offer only 10% if the following conditions are satisfied:
- A minimum of 20 lakhs securities are offered to the public;
- The size of the offer to the public = Offer Price * number of securities offered to the public = Rs. 100 crores; and
- The issue was made only through the book building method with at least 60% being offered to Qualified Institutional Buyers.

(c) The company can make firm allotments or reservations for specified categories of persons.

2.9 Takeover Regulations

The provisions of the SEBI Takeover Regulations do not apply to an allotment made in a public issue. However, in case of an acquisition pursuant to a firm allotment in excess of the limits specified in the Regulations, certain conditions need to be fulfilled in order to avail of the exemption (see para 18.6.1).

2.10 Grading of IPOs

SEBI has made the grading of all IPOs mandatory. Grading must be carried out by a credit rating agency which is SEBI registered, e.g., CRISIL, CARE, ICRA, etc. The issuer must obtain a rating from at least one such agency. The issuer must disclose all grades obtained by it in the prospectus, advertisements, etc.