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India Inc goes long on preferential issues

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Preferential allotment of shares is back with a bang. Sample this: such allotments have more than doubled to 56 in March this year from just 24 in February. The number was just 15 in January.

They remain the favourite option for promoters who want to increase stake, say experts. Out of the 56 that announced preferential allotments in March, a majority did it in favour of promoters through warrants.

A preferential allotment is issue of shares or warrants to specific entities at a price determined by a formula prescribed by the Securities and Exchange Board of India. These entities can be he promoter, promoter group, a person acting in concert (PAC) or institutional investors. The allotment price is decided on the basis of company's average share price in the past six months or two weeks, whichever is higher.

"Indian promoters are very smart, they know that the share price will move up in the next 18 months. So, by doing a preferential issue now, they will be able to increase their stake at a lesser price. It also gives a strong message to the investors that the promoter is confident about future prospects of he company. Moreover, they have to bring in only 25 per cent upfront, so even if the stock price goes down, they bear loss only to the extent of 25 per cent", said Jaganadham Thunuguntla, CEO, SMC Capital Markets.

Shares allotted through preferential issues have a one-year lock-in period, but that seems to be hardly a deterrent for promoters who think prices would only go up from this level.

Some of the companies which announced preferential allotment of shares in favour of promoters include Radico Khaitan, Tanla Solutions, Padmalaya Telefilms, Rishbhdev Technocable, Nexxoft Infotainment, C&C Construction and Bhoruka Aluminium.

In September 2009, Sebi tightened the noose on promoters who announced preferential allotments but did not go for conversion due to stock prices having fallen below the warrant exercise price. It raised the upfront requirement from 10 per cent to 25 per cent and said that promoters will have to forfeit the upfront payment made on unexercised warrants.

However, increasing promoter stake is not necessarily a good sign, according to some analysts, as it could indicate that institutional funding is not available.

"There are multiple connotations of a preferential issue. On the face of it, it is a statement of intent that the promoter is willing to put money in the company. One of the reasons could be that, if the company is not able to get funds from institutional investors, it might look at getting that from promoters or select HNIs who believe in that company," said Harendra Kumar, Head of Institutional Equities and Global Research at Elara Capital.

QIP FRENZY COOLS OFF

The frenzy around Qualified Ins itutional Placements (QIP) has meanwhile cooled off.

Experts said that smaller companies find it increasingly difficult to do QIPs or follow on offers as there is lack of liquidity and awareness about such companies. Hence, promoter remains the only source of funding for such companies.

India Inc raised Rs 31, 102 crore from 42 QIP issuances during calendar year 2009. However, there have been only 12 issues in first three months of the calendar year 2010, raising a miniscule Rs 4,902 crore. The apetite for QIPs has wilted mainly because of valuations having run up sharply and underperformance of some of the recently concluded QIPs.

" In a preferential issue, in case it is done to institutional investors, the promoter can negotiate certain special rights such as veto rights or the right to appoint board of directors. However, in case of a QIP, all investors are treated on the same footing and there is no discrimination in terms of specual rights. Also, the cost of capital in a QIP is much higher than a preferential allotment because the company has to appoint merchant bankers and intermediaries", explained Siddharth Shah, Partner at Nishith Desai Associates.

(**With Inputs from Deepak Korgaonkar**)

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