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No way out

Mahesh Nayak June 6, 2016

On May 16, India's premier bourse, the National Stock Exchange (NSE), declared a hefty dividend of Rs 73 per share for its shareholders. The total payout aggregated to almost Rs 330 crore - close to 75 per cent of the exchange's total profit of Rs 439.33 crore for FY2016. The huge dividend was paid despite a 44 per cent fall in net profit, although a cash pile of around Rs 1,200 crore did help. Some say the dividend was a move to woo the disgruntled shareholders. If so, the tactic hasn't worked, because some of NSE's investors continue to be upset at not being given an exit option by having the exchange listed on its rival bourse, the Bombay Stock Exchange (BSE).

CROSS-TALK

WHAT INVESTORS SAY	WHAT NSE SAYS
NSE should list on BSE and give investors an exit route	Might lose competitive advantage if listed on a rival exchange; will list only on NSE if allowed by SEBI
Investors not clear on how listing on BSE would impact NSE's competitiveness	If NSE lists on BSE, the listing agreement and bylaws can give BSE the powers to audit its books at any time as well as get information from NSE that could impact its business
Refusal to list raises bigger question on NSE's corporate governance standards	Investors are thinking short term while NSE has to think medium- to long-term

"I never thought our investment in NSE would be so troubled," says Sohil Chand, ManagingDirector at Norwest Venture Partners (NVP) India. In the past seven years, Chand has seen his 2.11 per cent stake in NSE jump over 50 per cent on a notional basis to Rs 380 crore on an investment of Rs 250 crore. But he is upset that India's premier stock exchange isn't ready to get listed. When NVP had invested in NSE in 2009, the exchange was valued at Rs 11,925 crore. Today, NSE is valued at Rs 18,000 crore on the grey market. "Lack of transparency in sharing information, corporate governance issues and inability to find an exit for their stake in NSE has seen the exchange being the worst portfolio investment for private equity players," says Pratibha Jain, Partner with Nishith Desai Associates, who has been representing a few shareholders against NSE.

On its part, NSE declined to comment on record to a questionnaire sent by Business Today. But speaking off the record, an official said NSE had valid reasons for not listing. One, it doesn't want to list on BSE, because it fears that would give its rival access to its books and confidential, competitive information. Two, it wants to list on its own platform, for which it needs clearance from market regulator SEBI. There are other reasons, too, but more on that later.

Is NSE's fear genuine or stalling tactics?

Ravi Adusumalli, Managing Partner, SAIF Partners (Photo: Vivan Mehra)

This February, goaded by investor pressure, NSE formed a listing committee comprising board members, shareholders and management representatives to accelerate the process of listing. Apart rom the issue of listing, the committee is engaging with NSE shareholders on the issue of proposed restructuring of the bourse. According to sources, on May 12, the listing committee, chaired by S.B. Mathur, who retired in April as NSE chairman, reiterated the exchange's stand that it would only list if it receives approval for self-listing, and that it would not list on the rival exchange.

"We have issues relating to disclosure of information, abuse of information and liquidity concerns of our stocks on the rival exchange," says an official at NSE on condition of anonymity. "Investors are getting impatient, but they are thinking short-term while we as a market infrastructure provider have to think for medium to long term."

But this argument doesn't wash with investors. "It's highly ironic that the management at NSE refuses to adhere to the same standards of corporate governance that it requires of companies listed on it," says Ravi Adusumalli, Managing Partner at SAIF Partners. "An IPO would enable liquidity and price discovery for all shareholders that currently own the exchange." Adusumalli points out that SEBI has made it clear that self-listing is not an option, and questions NSE management's fears on listing on BSE. "What information would BSE receive that it doesn't already have? Why will this impair NSE's ability to compete? We've asked these questions several times to the management team and have yet to get a detailed response," says Adusumalli.

NSE says it has three concerns. First, it wants to self-list, because it fears losing competitive advantage if listed on a rival exchange. "Listing NSE on BSE is like State Bank of India being regulated by Bank of Baroda, or Coca-Cola being regulated by PepsiCo in terms of products and strategy," says the spokesperson of NSE. Officials at NSE are concerned that if they list on BSE, the listing agreement and bylaws can give BSE the power to audit NSE's books at any time as well as get information from NSE that could impact its business. So, NSE wants that apart from SEBI, no one should have the right to regulate it even if it lists on a rival exchange.

Second, NSE wants SEBI to allow its shares to be traded on its own exchange, which is not permitted today. The third issue is on the restructuring of the exchange. NSE wants the regulated exchange business to be separate from the commercial businesses, which include its subsidiaries such as the index business. So, it wants to divide the company into two separate entities. "Until the restructuring takes place at NSE, we don't want to get listed. We have to keep the regulated business separate from our commercial activity business. We can't leave that for a future date," says an official of NSE on condition of anonymity.

However, shareholders have opposed the restructuring proposal, which was first presented to them last year in November. "NSE wants to shift cash and other assets of the exchange into an unlisted entity. This will dilute the valuation of NSE, as investors will demand a holding company discount," says Vinit Bodas, Managing Partner & CIO of the US-based Deccan Value Investors L.P., which holds a 2 per cent stake in NSE. "Further, cost of money in India is high and the value loss due to any delay as a result of the restructuring process will significantly outweigh the benefit of the listing, and we aren't ready for that."

"It's bizarre of NSE to not get listed on the rival exchange," says Jain of Nishith Desai Associates, adding that sharing or dissemination of information will only bring more accountability and transparency to the exchange, and NSE's stance is just a delaying tactic. "In fact, exchanges themselves do not have the teeth to govern. SEBI is the regulating agency, which will continue even after listing," she says. "While you get listed on BSE, you still have dual trading platform and the stock of NSE can still get listed on NSE, so the question of liquidity doesn't arise."

In fact, the desperation of getting NSE to list has also seen shareholders losing sight of corporate governance issues. NSE didn't publish the appointment and remuneration of managerial personnel in its annual report of FY2014/15 on its website - perhaps inadvertently - though the information was very much there in the hard copy of the report. While the exchange later published the information on its website as well, it says publishing the information is not necessary as it is an unlisted entity.

"It was a violation of SEBI regulations for a long time before the issue was addressed," a senior corporate lawyer told BT on condition of anonymity. "As per Regulation 35 of SECC

Regulations, 2012, all disclosure requirements and corporate governance norms as specified for listed companies shall mutatis mutandis apply to a recognised stock exchange and the same shall be confirmed by the stock exchange in writing to SEBI on a half-yearly basis. So, regardless of the presence of the section in the physical copy, it is mandatory that the same be also disclosed fully on the NSE website." When contacted by this magazine, both Goldman Sachs and Morgan Stanley refused to comment on the issue. "We (PEs) didn't go to SEBI because it could further delay the process of listing," says Jain.

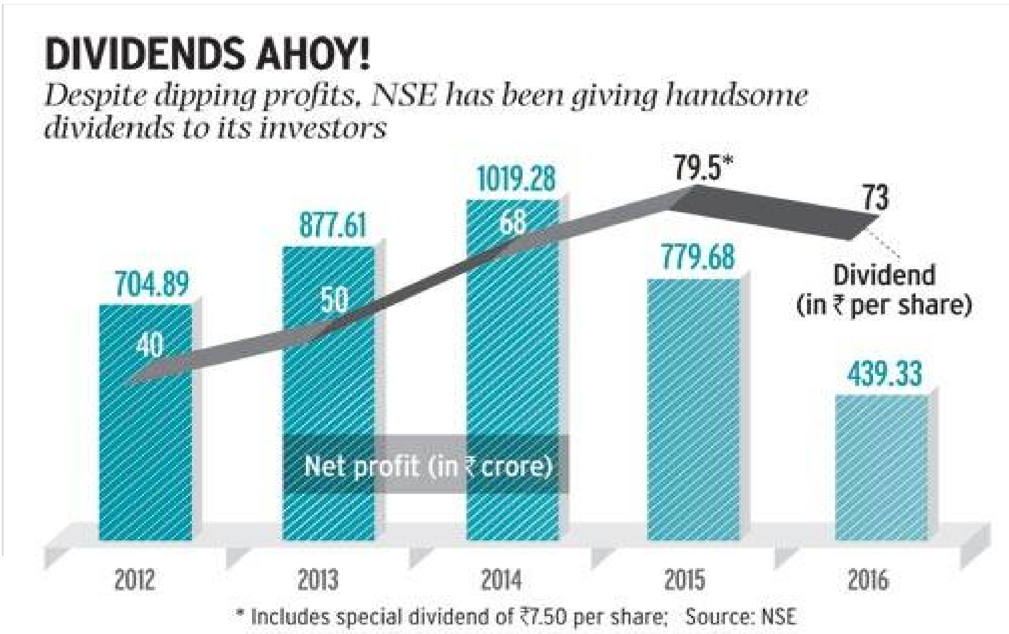
Sohil Chand, Managing Director, NVP INDIA

Blame It on MCX

Since most of the stake sales to PEs were secondary sale, NSE doesn't have any obligation towards its new shareholders in terms of immediate listing. But earlier investors have an issue. "There was

an implicit understanding that NSE would go in for listing when norms around regulatory and commercial separation were clarified by SEBI," says Chand of NVP. "Though this has happened, NSE management keeps finding new excuses to delay the listings. It's more than a decade since some of us have invested in NSE."

As NSE delays the listing process, it is creating further doubt in the minds of investors, especially on its insistence on self-listing. "Why has it taken four years for NSE to dissent to cross-listing when SEBI made it clear in 2012 that they had an objection to self-listing and that exchanges should go in for cross-listing," questions Chand. Adds Jain: "Not adhering to shareholders' request is creating issues on corporate governance." A senior PE fund manager who has been an investor in NSE on condition of anonymity said: "Not having a written exit clause has been our biggest mistake. The irony is that in smaller deals we even decide the exit date and price, and in a prized investment like NSE we took the exchange's word on face value, thinking they maintain high corporate governance standards and won't go back on their words."



The listing of exchanges was never on the cards till lobbying by Jignesh Shah managed to get commodity exchange MCX listed on the domestic bourse. Earlier, NSE was

assured by the fact that the Bimal Jalan Committee report recommended not allowing exchanges to get listed, plus it received support from the previous government and listing of stock exchanges took a back seat. But that assurance evaporated when the current government favoured listing of exchanges to give state-run institutions an opportunity to monetise their holdings. This raised hopes of NSE getting listed on the domestic bourse.

Amit Gupta, Partner at NewQuest Capital Partners, which picked up 1 per cent stake in NSE last November, says: "NSE has a wide shareholder base. Listing will help provide better price discovery and liquidity for shareholders. I don't agree that self-listing is must to list. While management may prefer to self-list, using that as a reason to delay liquidity for shareholders is unacceptable. Instead, management should work constructively with SEBI to ensure regulatory concerns are resolved and that the stock should be permitted to be traded on NSE also." NewQuest Capital Partners picked up stakes from the UK-based private equity fund Actis for Rs 178 crore at almost the same valuation at which Actis had acquired the stake in 2007.

It is clear that PEs are desperate in an environment where making money is difficult. But till the deadlock is unravelled, they have no choice but to hold on to their treasured investment