

Capital Markets Hotline

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ISSUERS PERMITTED TO REVISE FCCB CONVERSION PRICE

Introduction

In a move to ensure parity between Foreign Currency Convertible Bonds ("FCCBs") issued prior to November 27, 2008 and those issued after it, the Ministry of Finance in its Press Release dated February 15, 2010 ("Press Release") has now permitted the conversion price of FCCBs issued prior to November 27, 2008 to be in line with the pricing norms applicable to FCCBs issued after November 27, 2008.

Prior to November 27, 2008, FCCBs could not be issued at a price less than the higher of the 2 week or the 26 week high and low of the prices of the underlying shares. With the markets declining, representations were made by industry associations to revise the pricing norms to be as closely linked to the prevailing market conditions. The Ministry of Finance ("MoF") taking cognizance of the bearish market conditions, issued the Press Release dated November 27, 2008 obviating the need for issuers to procure the 26 week average and permitted the FCCBs to be simply priced at a price not less than the average weekly high and low of the underlying share prices for the 2 weeks prior to the date of the board meeting issuing the FCCBs ("Revised Pricing Norms").

The Revised Pricing Norms were, however, only applicable to prospective FCCB issuances and FCCBs issued prior to November 27, 2008 were not afforded the benefit of revising their conversion price per the Revised Pricing Norms. The Press Release now permits the conversion mechanism of FCCBs issued prior to November 27, 2008 to be revised in line with the Revised Pricing Norms.

Background

The Revised Pricing Norms were initiated when the bourses were just beginning for the decline, with the probable intent of giving an alternative to the bondholders to convert into the underlying shares at a higher conversion ratio rather than redeeming them immediately.

However, several representations were made to the Government and the Reserve Bank of India seeking the permission to revise the conversion prices of FCCBs issued prior to November 27, 2008 per the Revised Pricing Norms, as the minimum conversion price for such FCCBs still remained the issue price, that is, higher of the weekly average for 26 weeks and 2 weeks reckoned from the date of shareholders' meeting held for issuance of FCCBs.

Most of these FCCBs were issued at ambitious redemption prices based on the assumption that the markets will continue to rise and the bondholders would naturally, upon maturity, chose to convert the FCCBs into the underlying equity shares rather than opting for redemption. The situation, much to the disappointment of these issuers, changed drastically with the decline of the markets in late 2008 with redemption becoming the natural choice of the bondholders.

With the redemption demand soaring much higher than expected, Government periodically initiated measures to ease the redemption pressures, such as the Revised Pricing Norms and the most recent FCCB buyback scheme that permitted FCCBs to be bought back at substantial discounts prior to maturity. The Press Release is yet another step in the same direction, which has been opened up for a limited period of 6 months, probably time enough until the bourses reach the expected levels.

The Change

1. Press Release now permits companies FCCBs issued prior to November 27, 2008 to revise their conversion ratios to factor in the Revised Pricing Norms in respect of conversion into the underlying equity shares for a limited of 6 months from the date of the Press Release if the issuing company:
2. ensures that the revision of price and consequent issue of shares shall not breach FDI limit;
3. takes prior approval from its Board as well as from its shareholders;
4. enters into a fresh agreement with the FCCB holders in terms of renegotiation of the conversion price; and
5. takes prior approval of the Reserve Bank of India.

Conclusion

The Press Release opens up an avenue for FCCB issuers to retain their liquidity for a later time by offering the bondholders a larger portion of the underlying equity shares per the revised conversion prices. With the markets now stabilizing, it seems the bondholders may also be more amenable to accept the higher conversion ratio rather than redeeming the FCCBs. Though the revised conversion price, if opted for, will allay the redemption pressure, the promoters will be assuming the risk of diluting their own shareholding in the trade off.

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