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From public to private – the road less travelled

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Under current market conditions where stocks of numerous listed companies are being undervalued or turning illiquid, the option of going private (where publicly listed companies decide to delist and become public unlisted or private companies) is starting to look up – now more than ever.

Falling stock prices and bearish markets aren't the only luring factors to take a company private. Listed companies in India are required to follow elaborate corporate governance norms that are largely similar to those found worldwide. These norms are provided under the listing agreement entered into between listed companies and stock exchanges in India, and a host of other regulations and guidelines issued by SEBI. The listing agreement stringently regulates, among other things, the constitution of the board of directors, audit committees, and disclosure standards.

Going private may thus reap benefits and may provide greater flexibility to the company to carry out its business and fuel its expansion plans and growth expectations.

So why are going private transactions practically unheard of in India?

The hurdles to overcome in a delisting transaction in India – many of which were placed by SEBI's Delisting Guidelines 2003 – are largely attributable to the limited number of such transactions that India has seen. SEBI has recently revised delisting laws by introducing the Delisting Regulations 2009 for delisting equity shares. On the one hand, the Delisting Regulations have simplified the delisting process by significantly reducing the timelines, relaxing the procedure for smaller companies, and so on. Regrettably, the exit opportunity to be provided to public shareholders and the minimum participation required for a successful delisting have been made all the more tedious and may continue to dissuade promoters from taking the delisting route. As a result, going private, though desirable, may continue to remain a mere option that at the end of the day is rarely chosen. We now look at some of the conditions that make it difficult to delist a company.

Promoters given the backseat

The recently introduced Delisting Regulations, though intended to boost the number of going private transactions, may see results to the contrary depending on the shareholding structure of the company. This is on account of the level of control granted to public shareholders (shareholders other than promoters) under the new Delisting Regulations making it more shareholder-driven.

Shareholder Approval – To get started, getting the go ahead from public shareholders is not a simple task. Shareholder approval under the Delisting Regulations constitutes the passing of a 'special resolution' (a resolution passed by at least a 75% majority) through postal ballot. 'Postal Ballot' simply means voting by shareholders by post or email instead of voting personally in a general meeting of the company. While most corporate actions are required to be authorised by a special resolution, the Delisting Regulations go a few steps further. They require the votes cast in favour of the resolution by public shareholders to be at least two times the votes cast by public shareholders against the resolution.

Minimum Acceptance – More importantly, even if the shareholders approve, for a delisting of a company to be successful the process should result in the promoters acquiring the higher of either 90% of the entire shareholding (post all acceptance) or 50% of the delisting offer size.

Squeeze Outs – Under Indian law, the right to forcibly acquire shares of dissenting minority shareholders (the right to squeeze out the minority) is rarely exercised because of onerous conditions that are to be satisfied under law. These include achieving a 90% majority, and buying out the minority on the same terms at which the other shareholders' stake were purchased. The existence of impracticable squeeze out provisions commonly poses an inconvenience to the promoter where there is a continued presence of a minority following the delisting offer. Notwithstanding the promoter's control, this is because minority shareholders invariably

have some continued rights. Thus, getting shareholder approval and reaching the required threshold isn't all that makes life hard for promoters who wish to delist their companies.

Pricing – The exit price is book built where the promoter quotes a floor price (required to be the higher of 26 weeks/ two weeks average of weekly high and low of closing prices) and shareholders in turn quote prices at which they are willing to tender their shares. The price at which the maximum number of shares is tendered by the public shareholders will be regarded as the final offer price. While the promoter has the discretion to reject the final price, allowing shareholders to fix the price may encourage them to quote unrealistic premiums thereby frustrating the delisting process.

In the recent past, several listed companies have opted to go private by buying out their public shareholders at a fair and sometimes considerable premium to the floor price. For example, in the delisting of Hyderabad-based Matrix Laboratories, the floor price was Rs92.88 (US$2). However, the maximum number of shares was offered at Rs211 (US$4.53), which is more than a 100% premium on the minimum price required to be offered under law. Despite the high premium demanded by the shareholders, Matrix Laboratories was recently delisted from the stock exchanges in the last week of August 2009. In the same month last year, the promoter company of GE Capital Transportation Financial Services accepted an exit price of Rs110 per share from the public even while the delisting offer was made with a floor price of Rs66.80 per equity share (which is almost a 65% premium).

The other side of the coin

The conditions imposed under the Delisting Regulations isn't bad news for everyone. In general, public shareholders can better protect their interests in listed companies on account of their rights and degree of control over the delisting process. Pre delisting negotiations are also likely to tilt in favour of the single largest public shareholder in terms of getting shareholder approval, determining the final exit price, and so on.

Further, small companies (defined to mean companies having 300 shareholders or less who hold less than Rs10 million of the company's capital) can delist with greater ease as such companies have been exempted from providing the exit opportunity to the public as described above (under the book building route). The promoters are given the flexibility to simply fix the exit price in consultation with the merchant banker appointed for the delisting. However, certain conditions are required to be met most important of which is getting 90% of the public shareholders' to agree to delist.

Transaction structures

Going private transactions may take a variety of forms such as a merger, tender offer, and reverse stock split. In India, the promoter typically makes an offer to buy out the public shareholders in accordance with the Delisting Regulations. Given the level of control granted to public shareholders, companies are sometimes inclined towards reducing the public float prior to kick starting the delisting process. However, it is important to note that the law prohibits a company from diluting its public shareholding with the intention of delisting. For example, a company cannot delist pursuant to a buyback of its shares from its shareholders. Under the new Delisting Regulations, a company has also been prohibited from delisting pursuant to a preferential allotment resulting in the public float falling below 25% / 10%. Consequently any measures taken that may dilute public shareholding would need careful consideration.

Despite legal considerations and regulatory concerns, with companies running out of reasons to stay public delisting transactions may be on the rise. However, for such transactions to see the light of day, promoters and public shareholders would need to see eye to eye on the final exit price – which is the decisive criterion to go private successfully.

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