

M&A Hotline

November 24, 2018

SEBI EASES DELISTING NORMS – MAJOR IMPETUS FOR TAKE-PRIVATE TRANSACTIONS

- *Amendment to the SEBI (Delisting of Equity Shares) Regulations, 2009 (“Delisting Regulations”) notified to, inter alia, implement a proposal described in its June 16, 2018 discussion paper to enable promoters to provide a counter-offer as a part of the reverse book building process.*
- *Reference date for determining floor price for delisting offer is modified.*
- *Grey areas remain on situations where an acquirer may not act in concert with a promoter in a delisting.*

A. BACKGROUND

2018 has seen a phenomenal rise in take-private transactions globally, and private equity spending this year on these transactions is the highest over the last decade.¹ However, despite the global trend, delisting transactions are seldom successful/ initiated in India largely because of the prohibitive pricing involved. The reverse book building process² (a unique price discovery mechanism under the Delisting Regulations, abbreviated as “RBB”) is capable of easy manipulation and as a result, between the financial years 2015-2016 and 2017-2018, only 15 companies have voluntarily delisted in India.³

In order to address this concern and promote a vibrant take-private market, SEBI floated a discussion paper earlier this year (explained below) and identified the key price issues under the Delisting Regulations. Following through on the discussion paper, SEBI has now relaxed the pricing criteria to make delisting more practical and implementable.

B. INCEPTION OF A SOLUTION? SEBI'S JULY 2018 DISCUSSION PAPER

On July 26, 2018, the Securities and Exchange Board of India (“SEBI”) published a discussion paper on delisting of equity shares and review of the RBB process (“Discussion Paper”),⁴ highlighting stakeholders' concerns with the implementation of the RBB process and how the RBB process could thwart genuine delisting attempts.

The key of concerns dealt with in the Discussion Paper are summarized below:

- Arbitrage Seekers and Shareholder Groups:* The delisting price could be influenced by new shareholders who acquired equity shares of the company proposing delisting by acquisition in the secondary market, and then bidding exorbitantly high. Further, existing shareholders had the ability to form groups and collectively submit exorbitantly high bids;
- Promoters selling to complicit ‘friends’:* Promoters could sell a stake in the company to friends, who would then bid at (lower) prices recommended by promoters to influence the RBB price;
- Floor price fixation:* It was noted that this process only prescribed a floor price without prescribing a higher price (i.e. a price band, as used in initial public offers), and did not consider other aspects which could influence the delisting prices such as (a) the company's fundamentals, or (b) market sentiments;
- Book value not considered:* The RBB process under Regulation 8 of the Delisting Regulations did not consider the book value of the listed company, and there were instances where the book value could be substantially higher than the exit / delisting price arrived at using the RBB process.

In the Discussion Paper, SEBI stated that introducing a price band would not be in the interest of investors, and accordingly proposed introducing the ability of acquirers and promoters in a delisting process, who disagree with the reverse book-built price, to make a counter-offer with a price not lower than the book value of the equity shares of the listed company.

C. DELISTING AMENDMENT REGULATIONS

On November 14, 2018, SEBI notified the SEBI (Delisting of Equity Shares) (Second Amendment) Regulations 2018 (“Amendment”) pursuant to which certain key changes (as explained below) were made to the Delisting Regulations.

Introducing a counter-offer, but limited to book value

Earlier, once the RBB price was discovered, the only option available to an acquirer who did not agree with the RBB price was to reject it and withdraw from the delisting. However, with the introduction of the Amendment, acquirers now have an additional option to propose a counter-offer to public shareholders within 2 working days of the RBB price being determined. The only caveat is that the counter-offer price should not be lesser than the book value of the listed company, as certified by a merchant banker.

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This change is certainly a step in the right direction, since delisting offers can no longer be defeated by small groups of shareholders with vested interests by quoting exorbitant prices in the RBB process. Therefore, so long as 90% shareholders are agreeable to a fair price provided by the acquirer, the delisting can still be successful. However, we fail to understand the rationale for restricting the counter-offer price to a price not less than the book value of the listed company. There are two reasons for this:

- a. prescribing book-value as the floor price may not always be beneficial for public shareholders, as there are several asset-light companies (especially in the IT/ ITeS sectors) which are valued significantly higher than their book-value. Similarly, asset-heavy companies may be reeling under extreme losses, and book-value may not be an accurate reflection of a fair price for such companies. Hence, in our view, book-value as a 'one size fits all' floor price should not be mandated;
- b. it is important to note that the counter-offer price is not binding, and shareholders still have the ability to reject it if it does not reflect a fair price. Since shareholders already have this ability, prescribing an additional floor price based on the book-value seems redundant.

Change in the 'Reference Date'

The Delisting Regulations currently provide that the floor price for the RBB process will be determined using the process as per the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**Takeover Regulations**"). Under the Takeover Regulations, the floor price is calculated by identifying the historic price for prescribed look-back periods. The look-back period starts from the date of the public announcement (of a tender offer).

The Amendment now adds an explanation to clarify that the reference date for computing the floor price would be the date on which the recognised stock exchange should have been notified of the board meeting in which the delisting proposal would have been considered. Regulation 29 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 requires a listed company to notify the stock exchange of a board meeting in which a proposal of voluntary delisting from such stock exchange is considered at least 2 working days in advance (excluding the date of the intimation to the stock exchange and the date of the board meeting).

While this concept works well for a delisting initiated by an existing promoter under the Delisting Regulations, for delisting offers initiated by non-promoter acquirers through the Takeover Regulations, this requirement could potentially result in post-announcement price exposure (i.e. increased floor price). Hence, it would be ideal to clarify that for delisting offers through the Takeover Regulations, the reference date will be the date of the public announcement (in line with the principles under the Takeover Regulations).

D. CONCLUSION AND ANALYSIS

The amendments to the Delisting Regulations are undoubtedly game-changing, and will certainly facilitate genuine take-private transactions (as explained above). However, there are still certain grey areas which remain unaddressed.

Firstly, there are several provisions which require an 'acquirer' / 'promoter' to ensure that 'public shareholders' are provided an exit opportunity. In addition, the term 'Public Shareholders' excludes both the 'acquirers' and 'promoters' (along with their 'persons acting in concert'). Given this, in case where the 'acquirer' is not a 'promoter' / acting in concert with the 'promoter/ promoter group', conceptually, the existing promoter should also be a public shareholder and should be given an exit opportunity.

Secondly, there are several provisions which focus on the role of 'public shareholders' (eg: specific 'public shareholder' approval required for delisting, 'public shareholders' need to be sent the letter of offer etc.). In case of a delisting initiated by a third party acquirer as explained above, the existing 'promoters' will fall out of all these protections provided to 'public shareholders'. Hence, appropriate amendments should be introduced to ensure fair treatment of the existing promoters.

Thirdly, and importantly, SEBI should also clarify its stance on how an 'acquirer' who acts in concert with the existing 'promoter' under the Delisting Regulations will be treated under the Takeover Regulations. SEBI in the past has held that 'acquirers' acting in concert with the existing 'promoters' under the Delisting Regulations will also be considered as persons acting in concert with the promoters under the Takeover Regulations (irrespective of whether the 'acquirers' and 'promoters' actually act in concert for any purpose other than for delisting).⁵ This is a major impediment for private equity investors to explore delisting transactions by joining hands with the promoters, and should be appropriately addressed.

— **Shreyas Bhushan, Rohan Singh & Simone Reis**
You can direct your queries or comments to the authors

¹ <https://pitchbook.com/news/articles/pe-is-spending-more-than-ever-on-take-private-add-ons>
² The RBB process fixes the delisting price by considering the price at which the 90% shareholding threshold is achieved in the delisting offer, subject to such price being higher than a prescribed floor price.
³ "Discussion Paper on Delisting of Equity Shares – Review of "Reverse Book Building Process", available at: https://www.sebi.gov.in/reports/reports/jul-2018/discussion-paper-on-delisting-of-equity-shares-review-of-reverse-book-building-process_-39712.html, last accessed on November 21, 2018.
⁴ Ibid.
⁵ Informal Guidance in the case of IDFC Capital Limited, dated August 07, 2012

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