Corpsec Hotline

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RECOMMENDED CHANGES TO ELIGIBILITY CRITERIA FOR COMPANIES GOING PUBLIC IN INDIA

Recommended changes to eligibility criteria for companies going public in India The Primary Market Advisory Committee (the "**Committee**") was set up by the Securities and Exchange Board of India ("**SEBI**") to advise it on various matters relating to the primary markets. The Committee has come up with certain recommendations for giving a boost to the capital markets. These recommendations relate to proposed changes to the SEBI (**Disclosure and Investor**) Protection Guidelines, 2000 ("**SEBI DIP Guidelines**") and focuses on changes to the existing eligibility criteria for companies making an Initial Public Offering ("**IPO**") of their securities.

Existing eligibility criteria:

As of date, a prospective issuer is required to meet the following eligibility criteria in order to make a public offering of its shares:

- A pre-issue networth of not less than Rs. 1,00,00,000 in three out of preceding five years with this networth criteria to be compulsorily met with during the immediately preceding two years;
- A track record of distributable profits in terms of section 205 of the Companies Act, 1956 for at least three out of the immediately preceding five years; and
- The issue size (i.e the offer through the offer document including the firm allotment and the promoters' contribution) does not exceed five times the pre-issue networth of the issuing company as per the last available audited accounts, either at the time of filing draft offer document with the SEBI or at the time of opening of the issue.

Prospective issuers who do not comply with all the requirements mentioned above are permitted to make a public offer only through the book-building process where 60% of the issue size is required to be allotted to Qualified Institutional Buyers ("**QIB**").

Recommended changes

The Committee had some concerns over the existing eligibility criteria for potential issuers such as the fact that they are disclosure-based (and as a result the investor is expected to rely on his own examination of the issuer) and they are not market-oriented. The Committee felt the need to strengthen the eligibility criteria as well as provide for alternate mechanisms to enable IPOs of companies which do not fulfill the profitability track record criteria.

In the light of the above, the changes suggested by the Committee to the eligibility criteria are as follows:

- The company, on the date of filing of the draft offer document with SEBI, should have Net Tangible Assets of at least Rs. 3,00,00,000 for the preceding two years, of which 50% or less is held in monetary assets; and
- The company shall have a net worth of at least Rs. 1,00,00,000 in each of the preceding two years; and
- If the issuer company has changed its name within the last one year, then at least 50% of the revenue for the preceding one year shall be accounted for by the activity suggested by the new name; and
- The issue size shall not exceed five times the pre-issue net worth of the company.

If a company is not able to meet any of the criteria above, then it can make an IPO, subject to complying with the following criteria/conditions:

- The issue is made only through the book-building process, with at least 40% of the issue size allotted to QIBs or in case of an infrastructure company its project has at least 15% participation by financial institutions/ scheduled commercial banks, and
- The minimum post-issue capital of the company shall be Rs. 10,00,00,000. If not, then there shall be a compulsory market-making for at least two years from the date of listing of the shares of the company.

Further in an IPO, the company will have to meet with the criteria of having at least 1000 allottees in its issue.

Conclusion

The purpose of these suggested changes to the eligibility criteria is to ensure that there are no fly-by-night operators in the market and to encourage genuine issuers to successfully tap the Indian capital markets. The SEBI is currently inviting public comments on these recommendations.

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A "Qualified Institutional Buyer" means -

- public financial institution as defined in section 4A of the Companies Act, 1956
- scheduled commercial banks
- mutual funds
- foreign institutional investor registered with SEBI
- multilateral and bilateral development financial institutions, and
- venture capital funds registered with SEBI.

Net tangible assets is defined to mean and include all assets of a company other than intangible assets and monetary assets as defined in Accounting Standards (AS 26) on intangible assets.

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