RETURN OF QIPs: QUICK MODE OF TAPPING CAPITAL

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Published in

Halsbury's Law (Vol. 03, Issue 08, August 2009-09-25)

National Realty Vol. I, Issue II, July-September 2009

Introduction

Corporate India in the recent times is abuzz with reports of several companies adopting the Qualified Institutional Placement (QIP) route for raising capital. With the UPA government being re-elected for a second term, the markets responded positively and the share prices improved substantially. The real estate companies which were reeling under cash crunch for the past several months due to the overall economic downturn witnessed in the later half of 2008 are looking to tap funds form wherever they can. Currently it seems to be through the QIP route, which had almost vanished following the market crash of 2008. Recently HDIL, DLF, Unitech, Indiabulls Real Estate, HCC, Shree Renuka Sugars, PTC and Sobha Developers have successfully raised capital through QIP route. These companies have cumulatively raised 15,000 crore rupees approximately which could take care of their debt, working capital requirements and other financing obligations to an extent. Since January 2009 as many as 50 companies have announced their plans to adopt the QIP process to raise money.

What is Qualified Institutional Placement (QIP)?

There are broadly two ways by which companies can raise capital from the markets viz. debt and equity. Whereas issuing debt instruments only adds to the financial burden of the company the equity option brings investment in company by making investors partners in the business. Companies intending to raise capital via the equity route have various ways of doing so which include Initial Public Offering (IPO), Follow-on Public Offering (FPO), rights issue, preferential issue of shares or through listing in foreign bourses through American Depository Receipts (ADRs) and Global Depository Receipts (GDRs).

QIP is the latest addition to the already existing modes of equity participation. QIP is a capital raising means, whereby a listed company can issue equity shares, fully and partly convertible debentures, or any securities other than warrants which are convertible into or exchangeable with equity shares to Qualified Institutional Buyers (QIBs).

QIP permits listed companies to collect funds from domestic markets without the need for submitting any pre-issue filings to market regulator, Securities and Exchange Board of India (SEBI). Instead of trying to raise cash from public at large, the companies adopt this route to get funds from a few large investors called Qualified Institutional Buyers. Apart from preferential allotment, this is the only other speedy method of private placement for companies to raise money and a good way for funds / institutions to pick up stakes in a company.

Reasons for Adoption of QIP as a Capital Raising Tool

SEBI introduced the concept of QIP[1] in 2006 to enable listed companies to raise money in a short span of time and with a purpose of preventing them from developing excess dependence on foreign capital. There was a growing concern amongst the government

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[1] vide SEBI Circular No. SEBI/CFD/DIL/DIP/22/2006/8/5 dated May 8, 2006.

authorities and SEBI about the listed companies, which, in view of the complications associated with raising capital in the domestic market, resorted to international funding via floating ADRs and GDRs in the overseas markets. Since it was considered as undesirable export of domestic equity market, QIP process was introduced to encourage Indian companies to raise funds domestically to meet their capital requirements instead of tapping outside markets.

The following kind of securities, which are convertible into or exchangeable with equity shares at a later date, can be issued under QIP:

- Equity shares
- Fully convertible debentures
- Partly convertible debentures
- Non-convertible debentures (NCD) with warrants[2]
- Any other securities (other than warrants).

Securities which are convertible into or exchangeable with equity shares at a later date may be converted/ exchanged in to equity shares at any time within 60 months after the date of allotment.

Who can participate in the QIP issue?

Only QIBs, who are not promoters of issuer or related to the promoters of issuer, are eligible for allotment of the securities via this route. QIBs are generally large institutional investors like banks, insurance firms, mutual funds and foreign institutional investors who have the expertise and financial muscle to evaluate market offerings and invest large amounts in capital market. SEBI has given an extensive list on who are eligible to qualify as QIB.

As per Clause 1.2 (xxiv) (a) of the SEBI (Disclosure And Investor Protection) Guidelines, 2000 (DIP Guidelines) "Qualified Institutional Buyer" means:

- a public financial institution as defined in section 4A of the Companies Act, 1956;
- a scheduled commercial bank;
- a mutual fund registered with the Board;
- a foreign institutional investor and sub-account registered with SEBI, other than a sub-account which is a foreign corporate or foreign individual;
- a multilateral and bilateral development financial institution;
- a venture capital fund registered with SEBI;
- a foreign venture capital investor registered with SEBI;
- a state industrial development corporation;
- an insurance company registered with the Insurance Regulatory and Development Authority (IRDA);
- a provident fund with minimum corpus of 25 crore;
- a pension fund with minimum corpus of 25 crore;
- National Investment Fund set up by resolution no. F. No. 2/3/2005-DDII dated November 23, 2005 of Government of India published in the Gazette of India.

Unlike private placement via the preferential allotment wherein the securities can be issued to promoters or their relatives, in QIP allotment the DIP Guidelines clearly provide that the securities cannot be issued to QIBs who are either promoters or related to the promoters. The DIP Guidelines also clarifies that a QIB who has all or any of the following rights shall be deemed to be related to the promoter(s):

[2] Where the specified security is NCD with warrant, an investor can subscribe to the combined offering of NCDs with warrants or to the individual instruments, i.e., either NCDs or warrants.

- rights under the shareholders agreement or listing agreement entered into with promoters or persons related to promoters;
- veto rights;
- right to appoint nominee directors on the Board of the issuer company.

Conditions and Procedural requirements for participating in the QIP process

To be able to engage in the QIP process, the companies need to fulfill certain conditions and are required to comply with the detailed procedure laid down in the DIP Guidelines.

1. Applicability

   The issuance of securities as QIP is available only to a listed company which fulfills the following conditions:

   a. Its equity shares of the same class are listed on a stock exchange having nation wide trading terminals for a period of at least 1 year as on the date of issuance of notice to its shareholders for convening the meeting of its Board of Directors / Committee of Directors authorised by the Board to decide on the opening of the proposed QIP issue; and
   b. It is in compliance with the prescribed minimum public shareholding requirements of the listing agreement[3].

2. Mutual Funds

   A company is required to allot a minimum of 10 per cent of securities to be issued to mutual funds. However, if no mutual fund is agreeable to take up the minimum portion of 10 per cent, or part thereof, such minimum portion or part thereof may be allotted to other QIBs.

3. Minimum Number of Allottee

   Further it is mandatory for the company to ensure the minimum number of allottees for each placement made under QIP issue is not less than:

   a. Two, where the issue size is less than or equal to rupees 250 crore;
   b. Five, where the issue size is greater than 250 rupees crore.

   Also no single allottee can be allotted more than 50% of the issue size. Further QIBs belonging to the same group or those who are under common control (also defined in the DIP Guidelines) shall be deemed to be a single allottee.

4. Pricing

   SEBI has set a floor price for the companies opting for QIP issue. According to DIP Guidelines an issue of securities shall be made at a price not less than the average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the 2 weeks preceding the date of the meeting in which the Board of the company or the Committee of Directors duly authorised by the Board of the company decides to open the proposed issue.[4] In simple terms the SEBI mandated formula,

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[3] Public shareholding under the listing agreement is of at least 25% (10% minimum public share holding has also been specified for few companies, which meet the criteria as laid down in the guidelines).

[4] Substituted vide SEBI Circular No. SEBI/CFD/DIL/DIP/32/2008/28/8 dated August 28, 2008.

amended in August 2008, allows the price of an issue under QIP to be based on a two-week average share price. Prior to this amendment the pricing was based on higher of the six month or two-week average share price. This acted as a deterrent for investors who would have had to pay substantial premiums over the prevailing market prices.

The modification was basically to make the offer price more realistic since the two-week average price is considered closer to market conditions. The rationale behind the change in pricing norms, as explained by SEBI Chairman, Mr. C. B. Bhave, was that the highly volatile market and the price uncertainty witnessed in the listed stock was rendering it impractical to have a six months average and the amended pricing norm would allow the companies to price the issue as close to the market price as possible. The easing of norms along with the rally in secondary markets has given a chance to the promoters of companies to price their issues in sync with market price.

This SEBI mandated floor price may come in the way of closing some QIP deals as has been witnessed in the last quarter. For an investor, the key concern while evaluating whether or not to participate in the QIP offer is valuation. Many companies face problem when their current market price is lower than floor price (two-week average share price) as in such cases the QIBs are reluctant to take a loss on their books from the very beginning. Though the drastic rises in price of shares of a company wooing the QIBs often complicate matters and the merchant bankers recently were reportedly lobbying on behalf of QIBs for giving more flexibility while pricing QIPs, it is unlikely that SEBI will alter the pricing norms in the near future. The modification which has come by only last year is a move taking us a step closer to global practices. Moreover, if the credentials of the company are sound the investors would not shy away from investing in it at the SEBI mandated floor price despite the volatility of the shares in a reviving market.

5. Pricing of shares on conversion

Where securities which are convertible into or exchangeable with equity shares at a later date are issued, the price of resultant equity shares is to be determined in the same manner as mentioned above.

6. Restriction on Amount Raised

The aggregate of the proposed placement and all previous placements made in the same financial year shall not exceed 5 times the net worth of the issuer company as per the audited balance sheet of the previous financial year.

7. Limitation

For a period of 1 year from the date of allotment, a QIB is not entitled to sell the securities allotted to it except on a recognised stock exchange. The DIP Guidelines clarifies that any sale by way of a bulk or block transaction in accordance with the SEBI procedures and the stock exchange, shall also be treated as a sale on a recognised stock exchange.

Thus, the QIP route allows the allottees an exit mechanism on the stock exchange without having to wait for a minimum period of one year, which would have been the lock–in period had they subscribed to shares pursuant to a preferential allotment.

8. Shareholder's Resolution

A company proposing to offer securities to QIBs through this route has to get a special resolution passed at general meeting of its shareholders. The resolution shall specify that

the allotment is proposed to be made to QIBs and shall also specify the relevant date on the basis of which price of the resultant shares shall be determined.

Further allotment of securities issued has to be completed within 12 months from the date of passing of the special resolution. If the company proposes to make multiple placements then the placements made pursuant to authority of the same shareholders' resolution shall be separated by at least 6 months between each placement.

9. Placement Document

The securities are to be issued on the basis of a placement document which must contain all material information, including the information specified in Schedule XXIA of DIP Guidelines. However, for a company making QIP there is no requirement of pre-issue filing of the placement document with SEBI.

In case of QIPs it is a private document provided to select investors, through serially numbered copies. A copy is also placed on the website of the concerned stock exchange and of the issuer with an appropriate disclaimer to the effect that it is in connection with an issue to QIBs and that no offer is being made to the public or to any other category of investors. The company is only required to file a copy of the placement document with SEBI for record purpose within 30 days of the allotment of securities.

10. Merchant Bankers

The QIP issue and allotment is managed by merchant banker(s) registered with SEBI who is/are required to furnish, to each stock exchange on which the same class of shares or other securities are listed, a due diligence certificate stating that the issue is being made and complies with DIP Guidelines, along with the application made for seeking in-principle approval for listing of the proposed securities.

11. Issuer Certification

The issuer company is required to furnish a copy of the placement document to each stock exchange on which the same class of shares or other securities are listed as also a certificate stating that the issue is being made and complies with DIP Guidelines, along with the application made for seeking in-principle approval for listing of the specified securities.

Benefits of QIPs

Raising funds by means of issuing securities to QIBs provides multi-fold benefits to the issuer companies, investors and economy as a whole. Following is the list of advantages of QIPs as compared to other means of fund raising:

- ✓ Time Saving: QIPs can be raised within shorter span of time as compared to FPO or Right Issue which are time consuming procedures. Even compared to preferential allotment which can even take as much as three months, this is a speedier method of private placement where capital raising can be done in as soon as a week.

- ✓ Simplified Procedure: QIP scores over others methods as there are fewer formalities and requirements as regards rules and regulations and it does not have to undergo the elaborate procedural requirements of fund raising such as the submission of pre-issue filings to SEBI or converting the accounts to International Financial Reporting Standards and the like. Except the 10% reservation for mutual funds, companies can issue securities to QIBs on discretionary basis.

- ✓ Valuation: Barring the SEBI norms regarding floor price the valuation of the issue is decided between the issuer and the buyers and there is no third party interference. This also is another reason for its popularity.

- ✓ Lock-in: It provides an opportunity to investors to buy non-locking shares since they have an exit option on the stock exchange and do not have to wait for a minimum period of 1year.

- ✓ Lower Cost of Capital: QIP route is more cost effective in comparison to other modes which prove to be costly. The cost differential vis-à-vis ADR/GDR in terms of legal fees, listing charges is huge. In a QIP the company has to pay an incremental fee to the stock exchange.

- ✓ Retail Investors: In view of the SEBI mandate to issue 10% of the issue to mutual funds QIP also gives the retail investors a practical and efficient means to further diversify their portfolios.

Conclusion

One of the key concerns in QIP is that unlike the rights issues, it dilutes the stake of existing shareholders. Hence QIP are made by companies with significant promoter holding and promoters with low stakes are reluctant to adopt this route as a further dilution could mean risking its management control of the company. However in difficult times like the current environment where FCCBs and ECBs are not feasible, this option as an interim measure can still prove to be beneficial as it gives the company's business the much needed capital to bail out and sustain itself.

Now, when the global capital market is struggling for revival, QIP is ensuring a turnaround by giving the much need financial impetus to the Indian real estate and infrastructure business while also giving investment opportunities to the cash rich QIBs who have been waiting on the sidelines over the last six months to enter the potential-rich Indian real estate market. But the QIBs are selective as they look at growth prospects of the companies and so companies with strong fundamentals, sound corporate governance and good underlying assets have better ability to tap the QIP market.