ANNEXURE-3

SEBI GUIDELINES - EQUITY SHARES

As per the guidelines issued by Securities Exchange Board of India, new issue can be priced freely in the following cases

1. Issue by new companies set up by existing companies with five years track records of profitability
2. Issue by existing private/closely held companies with three years track records of profitability.
3. Issue by existing listed companies.

A lead manager to the issue or merchant banker will decided offer price in consultation with the issuer In the letter of offer (prospectus), the issuer has to justify the offer price. However, the guidelines do not provide the formula for fixing intial offer price.

The SEBI has made it obligatory for companies to indicate the premium on their shares computed on the basis of the formula followed by the erstwhile Controller of Capital Issue As per SEBI's prescription, it would also be necessary to indicate the premium ammount as per the CCI formula by way of note. To give some indications of the value of their investments to the public the above cited prescription is issued by SEBI While the companies are still free to charge whatever premium they wish, the difference between the premium charged by a company and the premium as it works out on the basis of the CCI formula should give an insight into the worth of share.

Not only that, the companies charging higher premium should also be expected to justify why they are charging more. From investor's point of view, this provision is very much helpful The merchant bankers and the lead managers to the issues have also welcomed this provision Withdrawl of control over premium fixation has resulted in situation where companies have started charging excessive premium on their issues compeletely unrelated to the intrinsic value of share Various issues involved in free market pricing of securities offered tothe public or to existing shareholders by companies under different situations are discussed below.

(1) First Issue of New Company A new company means a company without track record of profitability If such a new company is set up either by a first generation enterpreneure or an established promotor with track record, it may be allowed to freely price it's first issue. But in such a case there is no yardstick for the market as well as investors on which investment decision can be based.

Another option available to such new companies is to go to the market with public issue at par In such case, investors are not expected to bear additional risk. The companies can also opt for OTC exchange listing, where requirement of capital and public offer is lower compared to other stock exchanges. The issue price is decided by sponsor, who has to give undertaking to offer and allot securities to public in fair manner

(2)First Issue by Existing Private Companies Going Public

For such a company there can be three options

(a)These companies can price their first issue freely and get their securities listed on the stock exchange. The advantage of this option is that the market as well as investors have track record of these companies to base the investment decision. Such companies have to observe guidelines for disclosures of true picture from investors protection angle The feasibility of allowing such companies to freely price their issue would have to be examined in the light of the above considerations. As per prevailing practice of international markets such companies are required to have track record of consistent profitability of three to five years.

(b)These companies be allowed to go to the market only at par by existing practice for new companies But restricting such companies to fetch the market only at par means depriving the deserving issuer from taking advantage of the market particularly when such companies have sound track record.

(c)Depending on the size of issue, this type of companies can make public issue on OTC exchange The OTC exchange can provide these issuer with listing conditions different from those of the other exchange The disclosure and investor protection angle would be taken care of by the OTC exchange

(3)Public Issue By Existing Listed Companies:

These companies could be allowed to raise fresh capital by freely pricing their issues subject to their confirming to certain guidelines. These guidelines would not be for getting prior clearance or approval but only for the disclosure and investor protection The determination of the Price should be left to the lead managers and principal underwriter in consultation with the issuers themselves But this would call for a far greater degree of responsibility, high standard of dilligent and competance of the merchant bankers and underwriters, for they would not only have to be competitive among themselves but also to take into account the interest of the issuers as well as the investors. 9

(4)Right Issues and Composite Issues:

If there is right issue without a public issue coming within a period of three months following a right issue, the price for the issue (alongwith premium) would be determined, in the annual general meeting of shareholders If public issue comes within three months, it will be treated as a composite issue If there is composite issue, there is case for allowing the existing shareholders, the benefits for having stayed with the company and giving them equity shares at a price lower than the price forthe public issue Such issue can be priced freely subject to confirmation of certain guidelines for disclosure and investor protection The offer price will be decided by lead managers and pricipal underwriters to the issue in consultation with the issuer themselves

(5)Fully Convertible Debentures:

The fully convertible debenture (FCD) are converted into equity shares at the end of 6 months to 24 months period The premium fix upon conversion is decided by issuer in consultation with the lead managers and merchant bankers. Some of the considerations for free pricing of the FCD issue are as follows .

(a)If conversion is to take place before expiry of six months from the date of allotment, credit rating is compulsory ?

(b)Premium amount to be charged per equity share upon conversion at various stages to be decided at the outset and should be stated in prospectus

(c)There should not be cap or collar on interest rate

(d)Redemption amount, if any, to be indicated at the time of the issue in the prospectus

(6)Partly Convertible Debenture : Here, the debenture is divided into two parts. A part of the debenture is converted in to equity share at a premium to be decided in advance Another part of the debenture remains as non-convertibale portion on which interest is paid by the issuers at predecided rate. Some of the considerations are

(i)Compulsory credit rating

(ii)Premium amount upon conversion into equity shares to be decided in advance and should be stated at the outset in the prospectus

(iii)Period of redemption and amount of redemption should be indicated at the time of issues in the prospectus.

(iv)There should not be any cap or collar on interest rate.

(v)The debenture trust deed has to be executed within six months of the closure of the issue (vi)The discount on “KHOKHAS” or the non convertible portion of the PCD and the procedure for their purchase on spot basis must be disclosed in the prospectus.

While the SEBI guidelines on free market pricing of issues have been generally welcomed by the corporates, the investorsand intermediaries, fears have been expressed in some quarters regarding practicability of some of the guidelines. For Example, while SEBI has laid down rules for new companies which have not completed 12 months of commercial operation as also for existing companies having three years track record of consistent profitability, one year and two year old companies have been left hanging in limbo. SEBI's guidelines have ignored such companies altogether

Similarly there does not appear to be any rational in asking the management of an existing profit making closely held company to subscribe to the public issue which infact is nothing less than a dilution of share capital it already owns in its entirety likewise it is felt that SEBI's insistance on 50% promotor's contribution in the equity of a new company being set upby existing companies could jeopardize capital intensive projects Entry barriers should be high for new companies promoted by those promoters whose track record is unknown. Every company should be allowed to find it's own level with investing public on the basis of which it can price the issue properly