

The pre-IPO dilemma for fast growing companies

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Companies seeking to list their shares through public offerings often receive offers from investors for private placements prior to the public offering (Pre-IPO placement). Such investments enable the company to generate confidence in the pricing of its shares and also enable it to raise funds for ongoing business. These investments have become more complex in recent times with stringent norms applicable to companies seeking to list on stock exchanges.

An unlisted public company, desirous of raising capital through a public issue of its securities (Issuer) is required to file its draft offer document with the Securities and Exchange Board of India (SEBI) for review, in terms of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (the ICDR).

In terms of Regulation 19 of the ICDR, an Issuer is not permitted to make any issue of its securities in any manner between the date of filing the draft offer document with SEBI until the listing of its securities on the stock exchange or refund of the application money, unless the Issuer makes full disclosures in the draft offer document of the total number of securities proposed to be issued and the aggregate amount proposed to be raised from such issue.

Accordingly, heretofore, Issuer companies requiring funding for expansion projects could raise capital by further issuances of their securities by merely disclosing 'the maximum number of securities proposed to be allotted through such Pre-IPO placement and the aggregate amount to be raised therefrom'. If an Issuer successfully completes the Pre-IPO placement, the amount raised through such Pre-IPO placement would be reduced from the public issue size. However, if the same remained unsubscribed, it would be added back to net offer to be made to the public in the public issue thereby retaining the basic commercials relating to the Issue.

However, in recent times SEBI has interpreted the aforesaid provision very strictly and has directed Issuers to disclose

the precise number of securities proposed to be issued and the precise amount to be raised through such issue.

Such a narrow interpretation by SEBI has dissuaded Issuer companies from raising capital after filing the draft offer document with SEBI, as it is generally difficult for an Issuer to identify an investor and to determine the precise number of securities and the precise amount to be raised at the stage of filing the draft offer document itself. Generally, the time lag between the filing of the draft offer document with the SEBI and the ultimate listing of the securities on the stock exchange is about six-to-eight months or even more leaving enough room to raise capital through such Pre-IPO placements. However, given the aforesaid interpretation of the provisions of the ICDR, an Issuer with an urgent requirement for funds during this period is forced to fund its expansion plans from internal accruals or is required to approach banks or financial institutions for such funds. This may have an adverse effect on private equity investments in companies proposing to make a public issuance of their shares.

The present uncertain and volatile market makes it difficult for companies to pre-determine the precise date for their public offerings. At the same time, the need for funds by fast growing businesses cannot be ignored. Pre-IPO placements are a healthy sign and help small investors to gauge the fundamentals of the Issuer and at the same time enable Issuer companies to fulfill their on-going requirement for funds. The Regulator should reconsider its interpretation of the ICDR so as to once again open up this avenue of investment.

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