# Capital Markets Hotline

November 12, 2013

## LISTING WITHOUT AN IPO FOR SME: SEBI PROVIDES A PLATFORM FOR EXITS BY INVESTORS

- SEBI has allowed SMEs to list their specified securities on the new Institutional Trading Platform ("**ITP**") of a recognised stock exchange without an IPO.
- Pursuant to the listing on the ITP, fund raising by SMEs allowed through private placement or rights issue.
- SEBI Takeover Code not applicable to direct and indirect acquisition of shares or voting rights in, or control over, a company listed on the ITP.
- Nishith Desai Associates, as a legal expert, was on the panel of industry experts constituted by SEBI for framing these regulations.

As a welcome development for the Indian small and medium enterprises ("**SME**"), the Indian securities regulator, Securities and Exchange Board of India ("**SEBI**"), recently allowed listing of SMEs without any requirement of an initial public offering ("**IPO**"). SEBI has notified a new set of regulations called the SEBI (Listing of Specified Securities on Institutional Trading Platform) Regulations, 2013 ("**ITP Regulations**") as a new Chapter to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("**ICDR Regulations**").

### EXISTING FRAMEWORK AND EVOLUTION OF THE ITP REGULATIONS

Chapter XB of the ICDR Regulations provides for issuance of specified securities by SMEs on SME exchange.[1] Broadly, an SME was required to make an IPO without having to file the draft offer document with SEBI. Although, criteria's which were otherwise applicable for listing of companies on the SME exchange, like minimum net worth, profitability and tangible assets, *etc.,* were waived, onerous conditions such as requirement for promoters to dilute 25% of their stake, compulsory market making for three years and underwriting 100% of the issue, with the merchant banker himself underwriting directly up to 15% of issue size still remain. These factors, in addition to the additional qualifications that were introduced by the BSE and NSE, significantly discouraged the issuers from going public on the SME exchange, especially considering the cost of issuance, minimum track record requirements, profitability requirements, *etc.*

Taking a cue from this year's budget speech where the Hon'ble Finance Minister of India announced that a new set of regulations shall be framed for allowing listing of start-ups and SMEs without undertaking an IPO, SEBI, in its Board Meeting held on June 25, 2013, approved the said listing on the ITP without an IPO. In the said meeting, SEBI noted that the ITP Regulations are aimed to provide an easier exit option for informed investors, provide better visibility, wide investor base and greater fund raising capabilities to start-ups and SMEs.

### SALIENT FEATURES OF THE ITP REGULATIONS

SME is defined under the ITP Regulations to mean a public company, including start-up company that complies with all the eligibility conditions specified in the ITP Regulations. Such SMEs may list on the ITP without having to comply with the requirements for listing of securities on a recognized stock exchange under sub-rule (7) of rule 19 from clause (b) of sub-rule (2) of rule 19 of the Securities Contract (Regulation) Rules, 1957 ("**SCRR**"). Hence, listing of specified securities can be achieved without an IPO and the expenses associated with it.

**Following are some of the key facets of the ITP Regulations:**

**Eligibility criteria**: For SME to be eligible to list its specified securities on the ITP, the following requirements should be satisfied:

- *Existence criteria:* The SME should have atleast one full year's audited financial statements for the immediately preceding financial year and should not have completed a period of more than ten years since incorporation;
- *Past conduct criteria*: The promoters, directors or group company of the SME and the SME itself should not be in the list of wilful defaulters of Reserve Bank of India ("**RBI**") as maintained by Credit Information Bureau. No winding up petition against the SME should have been admitted by a competent court. The group companies or subsidiaries of the SME and the SME itself should not have been referred to the Board for Industrial and Financial Reconstruction within a period of five years prior to the date of application. Also, no regulatory action shall have been taken against the SME, its promoter or director, by SEBI, RBI, Insurance Regulatory and Development Authority or Ministry of Corporate Affairs within a period of five years prior to the date of application;
- *Financial criteria:* The revenue of the SME should not exceed INR 1,000,000,000 (Rupees One Billion Only) in any of the previous financial years and the paid-up capital of the SME should not exceed INR 250,000,000 (Rupees Two Hundred Fifty Million Only) in any of the previous financial years; and

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- *Past funding criteria:* SME is required to meet any one of the following criteria – (i) atleast one alternative investment fund, venture capital fund or other category of investors/lenders approved by SEBI should have invested a minimum amount of INR 5,000,000 (Rupees Five Million Only) in its equity shares; (ii) atleast one angel investor who is a member of an association or group of angel investors should have invested a minimum amount of INR 5,000,000 (Rupees Five Million Only) in its equity shares; (iii) the SME should have received finance from a scheduled bank for its project financing or working capital requirements and a period of three years should have passed from the date of such financing and the funds so received have been fully utilized; (iv) a registered merchant banker should have exercised due diligence and has invested not less than INR 5,000,000 (Rupees Five Million Only) in its equity shares which shall be locked in for a period of three years from the date of listing; (v) a qualified institutional buyer should have invested not less than INR 5,000,000 (Rupees Five Million Only) in its equity shares which shall be locked in for a period of three years from the date of listing; or (vi) a specialized international multilateral agency or domestic agency or a public financial institution as defined under section 4A of the Companies Act, 1956 must have invested in its equity capital.

**Information document:** Along with the application to a recognised stock exchange, the eligible SME proposing to list on the ITP shall also be required to file an information document containing certain specific disclosures relating to, *inter alia*, description of business, specified financial information, risk factors, assets and properties, ownership of beneficial owners, details of directors, executive officers, promoters and legal proceedings.

**Restriction on further issue of securities:** Listing of specified securities on the ITP cannot be accompanied by any issue of securities to the public in any manner. Further, the SME cannot undertake an IPO while its specified securities are listed on the ITP.

**Capital raise by an SME listed on ITP:** The SME listed on ITP may raise capital through private placement or rights issue without an option for renunciation of rights. Before raising money through private placement, amongst other stipulated conditions, SME should procure an in-principle approval from the recognised stock exchange and also a shareholders approval by special resolution and subsequently the allotment of securities has to be completed within two months of obtaining such approval. Such an in-principle approval from the recognised stock exchange is also required prior to a rights issue.

**Lock-in of promoters stake:** At least 20% of the post listing capital is required to be held by the promoters of the SME which shall be locked-in for a period of three years from the date of listing on the ITP.

**Ticket size:** The minimum trading lot on the ITP has been set at INR 1,000,000 (Rupees One Million Only).

**Exit from the ITP:** SME listed on the ITP may exit from it if: (i) its shareholders approve such exit through a special resolution with 90% of total votes and the majority of non-promoter votes in favour of such proposal; (ii) the recognised stock exchange where its shares are listed approves such exit.

Further, an SME listed on the ITP shall exit from it if: (i) the specified securities have been listed on ITP for a period of ten years; (ii) the SME has paid-up capital of more than INR 250,000,000 (Rupees Two Hundred Fifty Million Only); (iii) the SME has revenue of more than INR 3,000,000,000 (Rupees Three Billion Only) as per the last audited financial statement; or (iv) the SME has market capitalization of more than INR 5,000,000,000 (Rupees Five Billion Only). However, the stock exchange may grant 18 months' time to the SME to delist from the platform on occurrence of the events specified in this paragraph.

**Non-applicability of the Takeover Code and the Delisting Regulations:** The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**Takeover Code**") has been amended to the effect that the Takeover Code shall not apply to direct and indirect acquisition of shares or voting rights in, or control over, a company listed on the ITP of a recognised stock exchange. Similarly, the SEBI (Delisting of Equity Shares) Regulations, 2009 ("**Delisting Regulations**") has also been amended to the effect that the Delisting Regulations shall not apply to securities listed on the ITP of a recognised stock exchange.

## ANALYSIS

The ITP Regulations should go a long way in providing the necessary stimulus in the growth of SMEs which in turn will help in variety of facets in addition to fostering of innovation. The new platform should aid SMEs in getting access to capital as well as wider visibility. As the mode of exiting from the platform is also relatively simplified, the migration to the main exchange would possibly be much smoother for a company whose specified securities are listed on the ITP of a recognised stock exchange.

As SEBI had indicated in the Board Meeting of June 25, 2013, the ITP Regulations are framed with the intention of allowing easier exit options for the informed investors who risk their capital to support SMEs. Among other things, specifically the conditions specified in 1(d) of this Hotline will enable a number of angel investors and venture capitalists to explore the avenue of getting their eligible portfolio companies listed on this new platform and thereby seek an easy and efficient exit. Further, non-applicability of certain onerous conditions, as in case of listing under Chapter XB of the ICDR Regulations or with respect to listing on the main exchange, will encourage a number of start-ups and SMEs to explore the option of getting their specified securities listed on the ITP. This platform is certainly likely to see some action in the near future due to certain encouraging aspects such as no restriction from raising further capital by private placement or rights issue, non-applicability of Takeover Code and Delisting Regulations to the SME whose specified securities are listed on ITP, *etc.*

– Mukul Aggarwal, Sambhav Ranka & Pratibha Jain
You can direct your queries or comments to the authors

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[1] Regulation 106N(1)(c) of the ICDR Regulations defines 'SME exchange' as a trading platform of a recognised stock exchange having nationwide trading terminals permitted by SEBI to list the specified securities issued in accordance with Chapter XB of the ICDR Regulations and includes a stock exchange granted recognition for this purpose but does not include the Main Board. Regulation 106N(1)(a) of the ICDR Regulations defines 'Main Board' as a recognized stock exchange having nationwide trading terminals, other than SME exchange.

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