

## Regulatory Hotline

June 16, 2014

### OFFSHORE LISTING REGIME: HOW TO RAISE FUNDS AND MONETIZE INVESTMENTS

Government's recent initiative to allow unlisted companies to list on offshore markets through the depository receipt (DR) mechanism without the requirement of simultaneous listing in India is likely to be a major shot in the arm for many sectors, and also offer exits to private equity players looking to monetize their investments. Though offshore listing was permitted later last year by Ministry of Finance, such listings could not happen as SEBI had not prescribed the disclosures for such listings.

Government has only recently prescribed that SEBI shall not mandate any disclosures, unless the company lists in India. Once the air around disclosures to SEBI has been cleared, we can expect offshore listing of DRs to grow on the back of the reasons set out below.

First, offshore listing will offer the opportunity to a slew of young Indian companies to tap the overseas markets, which unlike domestic markets remain quite vibrant. 2012 saw only 3 mainboard listings as against 256 in the US.

Second, offshore listing would allow Indian entrepreneurs the platform to tap investors that have a much better understanding of the value proposition of the business. For instance, innovative tech, biotech, internet services are likely to receive a better valuation on NYSE / NASDAQ as against domestic markets.

Today, markets have become associated with sectors - NYSE / NASDAQ is known for tech, SGX for real estate and infra, LSE/AIM for infra and manufacturing. DR's would allow the opportunity to list on exchanges that are most conducive to the sector.

Third, foreign investors will find it more amenable to invest in DR's denominated in foreign currency as against INR, which has depreciated by more than 50% since 2007. Hedging cost is likely to be an important driver for the growth of DRs. Many private equity players suffered the wrath of their LPs due to the steep rupee depreciation, despite the company outperforming the expectations.

Fourth, while the offshore listing regime is meant for fund-raising (it requires that funds must be brought back into India within 15 days unless utilized offshore for operations abroad), with a little bit of structuring, the proceeds can also be used to provide tax free exits to offshore private equity players.

Since there is no end use prohibition, proceeds of the DR can be structured to retire existing debt or private equity. With a growing number of secondary direct funds looking at India, DRs can be the preferred way to invest in India, retire existing investors and monetize the investment later on the floor of the exchange.

Fifth, from a tax perspective, investors can finally breathe easy. There will be no tax on the sale of DRs on the stock exchange. Hence, investors need not worry about GAAR and substance in the treaty jurisdiction or risk of indirect transfer taxation.

Sixth, listing of DRs is likely to be much cheaper than listing of shares on foreign exchanges and sometimes the compliance costs of ADR / GDR may be lower than the compliance costs of domestic listing.

Seventh, offshore listing would give depth to Indian capital markets as well, and brighten the chances of the company going public in India after having a successful show on the offshore markets.

Eighth, listing on offshore exchanges like NYSE / NASDAQ / SGX has its own snob value and is likely to benefit many of the younger companies in gaining reputation and recognition overseas.

Ninth, an increasing number of acquisitions, especially in the tech space are happening by way of swaps, or in other words, the shareholders of the target company receiving consideration in form of shares of the acquirer company.

This is a common strategy to keep the interests of both the parties aligned post acquisition. With most targets for tech companies being offshore, such swap deals are hard to achieve, as there may be few takers for Indian unlisted shares. To that extent, DRs being dollar denominated can be used as currency for acquisitions.

However, notwithstanding the enormous benefits that the offshore listing regime brings, its success remains circumspect as the scheme has only been allowed for 2 years on a pilot basis. The specter of what will happen after 2 years (6 months of which have already elapsed) and the fear of the government requiring simultaneous listing in India (as was done in 2004) is likely to keep many issuers away. Having said that, offshore listing regime unveils a huge opportunity for fund raising, particularly for young IT / ITES, biotech companies etc. which do not feature on the list of either private equity or banks. What remains to be seen is the if the Government allows for DRs with underlying debt instrument as against equity.

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– Ruchir Sinha & Nishchal Joshipura  
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