

Corpsec Hotline

March 23, 2007

IPOS: GET REAL, GET RANKED

In a move that could significantly affect the manner in which initial public offerings ("IPOs") would be made, the Securities and Exchange Board of India ("SEBI") has directed the following:

- stricter norms with regard to disclosures of the land banks of real estate companies making an IPO ("Issuer Companies"), and
- the grading of IPOs has now been made mandatory.

Real Estate IPO Disclosures

Background

In order to make themselves more attractive in the eyes of the investors, real estate Issuer Companies may resort to such forms of market valuation of their land banks so as to depict exaggerated valuations. It has been observed that usually these land banks, which are disclosed in the offer documents, may include future projections and lands which are not entirely conveyed in favor of a real estate Issuer Company.

The same could be apparently inferred by observing the share price movements of some of the prominent real estate companies that have recently been listed on the stock exchange(s). The equity shares of some of these companies are currently trading at a price which is lower than their IPO price.

SEBI Directive:

With a view to ensuring greater transparency, SEBI has directed that a real estate sector Issuer Company shall henceforth have to provide specific disclosures pertaining to its land bank in its offer documents, with special emphasis on the status of the ownership of these lands.

SEBI has also directed that only present or current valuations of the land banks should be disclosed in the offer documents.

Moreover, whether the agreements pertaining to such land parcels have or do not have a revocation clause shall have to be disclosed as well. Additionally, all such agreements with regard to the land bank will have to be made available for scrutiny and inspection. Further, to ensure constant monitoring, SEBI has directed continuous disclosures in this regard at the post-listing stage as well.

Implication:

- It has the potential to be an effective investor protection measure as it would reduce the chances of innocent investors being lured into buying shares of a company which does not in fact own, or is yet to own, the large land banks it claims to have in its offer documents.
- On the other hand, it imposes an additional responsibility for the Issuer Companies as well as the merchant bankers, to ensure full disclosure with regard to both true valuation and the status of ownership of the land banks.

Mandatory grading of IPOs

Background

On April 24, 2006, SEBI, through Circular SEBI/CFD/DIL/DIP/21/2006/24/4, had introduced IPO grading for Issuer Companies, at the option of such Issuer Companies. The Issuer Company could choose from any of the credit rating agencies registered with SEBI and the credit rating agency, being an independent and impartial body, would assess the IPO and compare it to other Indian listed companies. Further, the grading would be on a scale of 1-5, where grade 1 stands for the least favorable and grade 5 as the most favorable. This grade would then have to be disclosed in all the offer documents with respect to the issue by the Issuer Company.

This grading however, should not be confused with an investment recommendation, as it does not take into account the price of the issue.

Further, the service charges of the credit rating agency were borne by SEBI and paid from the investor protection fund maintained in this regard. This definitely added to the authenticity and reliability of the grading.

SEBI Directive:

SEBI has, with immediate effect, made grading of IPOs mandatory, and the Issuer Company will now have to bear the charges of the credit rating agency performing the grading of its IPO.

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SEBI also stated that it would be reviewing this policy in the times to come, in order to create a scenario where the equity shares of a company would be graded rather than only for the purpose of a one-time public issue.

Implications:

- The grading will now aid the retail investors, who lack the knowledge, skill and expertise to interpret the bulky and complex data contained in the offer documents, in their investment choices.
- Such grading, however, being based only on the "fundamentals" of a company and which does not take into account the price of the issue at all, is insufficient and could be confused with an investment recommendation such as "buy" or "avoid" by these retail investors.
- If the concept of assessing and grading the total equity shares of a company, as opposed to grading of a specific one-time issue, were to be effectuated, it may also result in an unfair or inaccurate grade. It is quite likely that there may be instances where an Issuer Company may do exceptionally well or conversely, may not do so well, post-issue.

Since this directive has come in so recently, one will have to wait and watch the market and the general reaction to the same.

Sources:

- [The Financial Express, March 22, 2007](#)
- [The Economic Times, March 23, 2007](#)
- [The Economic Times, March 23, 2007](#)

- **Diptee Deshpande & Amrita Singh**

You can direct your queries or comments to the authors

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