

PREFERENTIAL ISSUE
OF SHARES UNDER
COMPANIES ACT,
2013

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METHODS TO RAISE CAPITAL

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- Capital can be raised by any of the following ways:
 - Preferential Allotment
 - Private Placement
 - Rights Issue
 - Bonus Issue
 - Public Issue (IPO/FPO)

Let's study some more
aspects of
Preferential
Issue...



Applicable Regulations/Provisions

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- **Section 62 (1) (c)** of the Companies Act, 2013 (Further Issue of shares)
- **Section 42** of the Companies Act, 2013 (Private Placement)
- The Companies (Share Capital & Debentures) Rules, 2014 : **Rule 13**
- Rule 13(1) state that Such issue of shares on preferential basis should comply with conditions laid down in Section 42 of the Act
- The Companies (Prospectus and Allotment of Securities) Rules, 2014
Rule 14 (Rules of Private Placement)
- **Section 55** of the Companies Act, 2013 (Preference Shares)
- **Section 71** of the Companies Act, 2013 (Debentures)
- Foreign Exchange Management Act, 1999 & Rules framed thereunder

Cont..

- In case of Listed entities some of the additional applicable regulations are as follows:
 - ❖ The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
 - ❖ The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015
 - ❖ The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.

Few Concepts....

- **'Preferential Offer'** as defined under Rule 13 of the Companies (Share Capital and Debentures) Rules, 2014 means an issue of shares or other securities, by a company
 - to any select person or group of persons on a preferential basis
 - and does not include shares or other securities offered through a public issue, rights issue, employee stock option scheme, employee stock purchase scheme or an issue of sweat equity shares or bonus shares or depository receipts issued in a country outside India or foreign securities;

Cont...

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- **“shares or other securities”** as defined in Explanation to sub-rule (1) to Rule 13 of the Companies (Share Capital and Debentures) Rules, 2014 means equity shares, fully convertible debentures, partly convertible debentures or any other securities, which would be convertible into or exchanged with equity shares at a later date.

Cont...

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- *Offer to single person ?? Persons?? Income Tax provisions ??*
- *Whether the provisions will apply to issue of redeemable preference shares ??*

They are shares but not convertible into equity shares.?? CCPS/OCPS ??

Refer to Section or Rule.....

Section 62 states that Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered

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- *Whether the provisions will apply to issue of Non-convertible debentures ??*

Not convertible ??

- *Whether share warrants covered ??*
- *Other securities convertible into equity....*

Cont..

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- Whether the conversion of loan into equity is covered under Section 62???
- Nothing in this section shall apply to the increase of the subscribed capital of a company caused by the exercise of an option as a term attached to the debentures issued or loan raised by the company to convert such debentures or loans into shares in the company:
- Provided that the terms of issue of such debentures or loan containing such an option have been approved before the issue of such debentures or the raising of loan by a special resolution passed by the company in general meeting.

Prior preparation...

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- Exact fund requirement and scrutinizing available options to raise the funds..
- Objects of the issue..
- Checking the provisions of the Articles of Association...
- Checking the existing Authorized Capital of the Company
- Checking the clauses of Shareholders Agreement if any ...

Cont...

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□ Deciding Issue Price of Shares (Section 62 (1) (c) & Rule 13

❖ Provisions regarding pricing

1. The price of shares to be issued on preferential basis is to be determined by the valuation report given by a registered valuer.

2. Provided further that, the price of shares to be issued on a preferential basis by a listed company shall not be required to be determined by the valuation report of a registered valuer.

Cont...

4. the price of the shares or other securities to be issued on a preferential basis, either for cash or for consideration other than cash, shall be determined on the basis of valuation report of a registered valuer.
5. where convertible securities are offered on a preferential basis with an option to apply for and get equity shares allotted, the price of the resultant shares pursuant to conversion shall be determined-

Cont..

(i) either upfront at the time when the offer of convertible securities is made, on the basis of valuation report of the registered valuer given at the stage of such offer, or

(ii) at the time, which shall not be earlier than thirty days to the date when the holder of convertible security becomes entitled to apply for shares, on the basis of valuation report of the registered valuer given not earlier than sixty days of the date when the holder of convertible security becomes entitled to apply for shares:

Provided that the company shall take a decision on sub-clauses (i) or (ii) above at the time of offer of convertible security itself and make such disclosure in the Explanatory Statement.

Cont...

6. where shares or other securities are to be allotted for consideration other than cash, the valuation of such consideration shall be done by a registered valuer who shall submit a valuation report to the company giving justification for the valuation;

7. The price of shares or other securities to be issued on preferential basis shall not be less than the price determined on the basis of valuation report of a registered valuer.

Cont...

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- *Different requirements under different regulations??*

Companies Act ,2013 :Registered valuer

Foreign Exchange Management Act : Chartered Accountant or

SEBI Registered Category I Merchant Banker

SEBI ICDR Provisions ?????

- *Finding the registered valuer ????*

Class of assets for which valuer is registered...

Availability

Fees.....

Requirements.....

Class of assets for which valuer is registered...

Cont...

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- *Appointment of the registered valuer??*

Whether resolution is required to be passed??

Appointment letter to be issued???

- *Requirements of the registered valuer ??*

Financials.....

Projections....

Details of activities undertaken...

Fundraising plan...

Conversion terms...

Cont...

- *Time required for valuation ??*
 - Method of valuation....*
 - Clarity of requirement/ information...*
 - Compilation of the documents...*
 - Valuation of other assets involved...*

- *Validity of valuation report ??*
 - No specific mention in the provisions..*
 - Standard followed.. Six months...*

Approvals required

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- Board Approval
- Member's Approval be way of Special Resolution.
- Stock Exchange Approval (in case of listed entities)
- Terms of lending institutions if any
- Specific authority approvals such as IRDA , RBI

Points to be considered...

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- Proposed time within which allotment is to be completed....
- Following points to be considered ..
 - ✓ The special resolution passed is valid for a period of 12 months. **Rule 2(e)**
 - ✓ Time mentioned in explanatory statement ???
 - ✓ A private placement offer cum application letter shall be in the form of an application in PAS-4 serially numbered and addressed specifically to the person to whom the offer is made and shall be sent to him, either in writing or in electronic mode, within thirty days of recording the name of such person pursuant to sub-section (3) of Section 42.

PAS-4 is not required in case if the offer is made to existing members only..

Cont...

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- ✓ Time agreed if any as per Investment Agreement if any...
- ✓ Specific requirement of SEBI regulations

Cont...

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- **Separate account in a scheduled bank.... Section 42(6)**

Additional formality...

Minimum deposit....

Opening new account

Existing unused account...

Drafting Documents ...

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- Explanatory Statement pursuant to Section 102 to contain the disclosures as mentioned in Rule 13 (2) of the Companies (Share Capital & Debentures) Rules, 2014
- Additionally the following disclosures are required to be in order to comply the requirement of Section 42:
 - particulars of the offer including date of passing of Board resolution
 - kinds of securities offered and the price at which security is being offered
 - name and address of valuer who performed valuation
 - amount which the company intends to raise by way of such securities
 - material terms of raising such securities, proposed time schedule, purposes or objects of offer, contribution being made by the promoters or directors either as part of the offer or separately in furtherance of objects; principle terms of assets charged as securities

Cont...

- In case of Issue of Preference shares following are the some additional disclosures required to be made in order to comply with Section 55
- the nature of such shares i.e. cumulative or non - cumulative, participating or non - participating , convertible or non – convertible
- the terms of issue, including terms and rate of dividend on each share, etc
- the expected dilution in equity share capital upon conversion of preference shares

Cont...

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- Special Resolution to contain the following disclosures
 - Relevant Applicable Sections, Rules and Regulation..
 - Authority to the Board/Committee..
 - Number of shares/securities
 - Face value per shares
 - Premium per share
 - Name of Allottee /Number of shares to be allotted
 - Conversion terms if any applicable
 -

Cont...

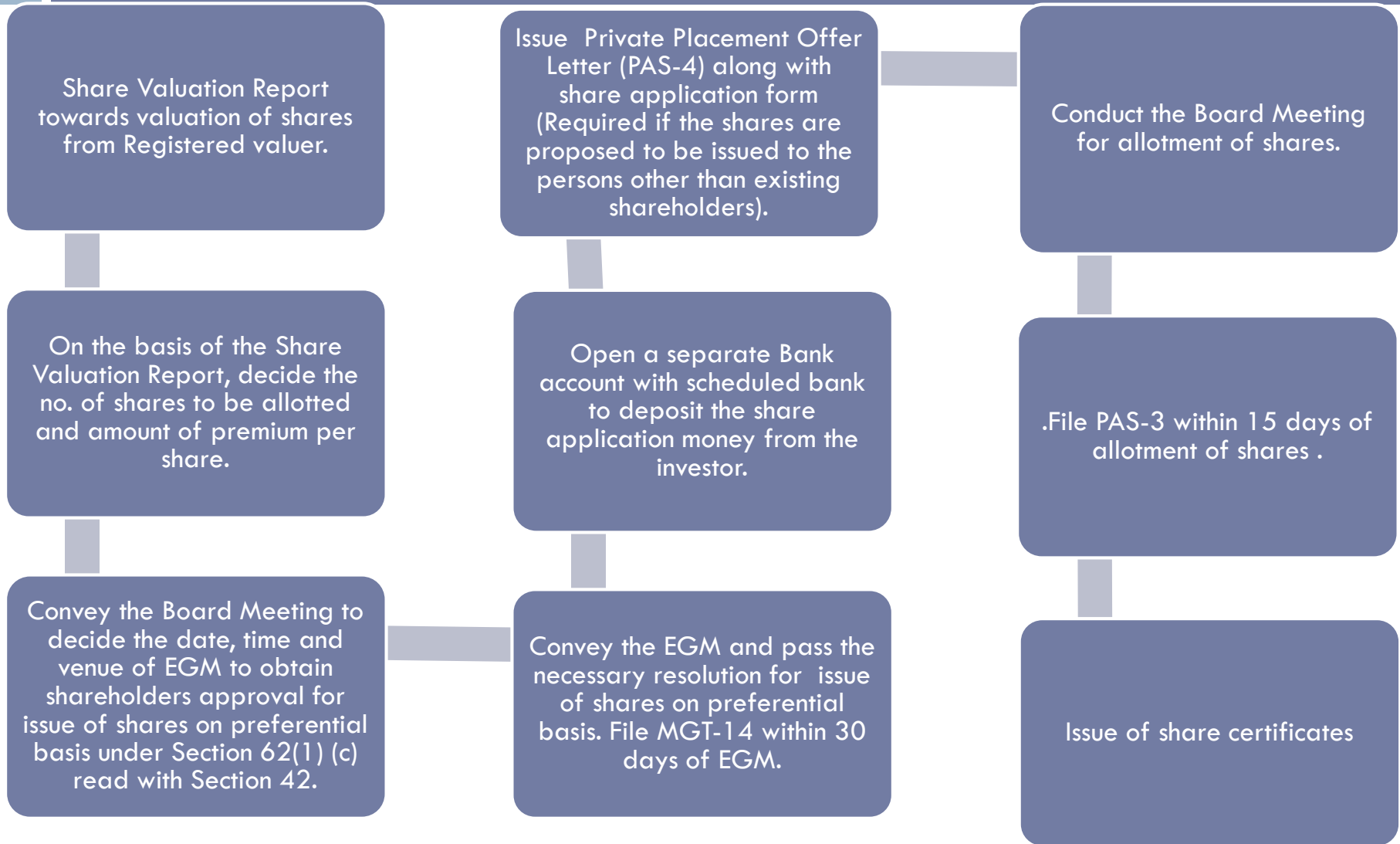
- Company issuing preference shares shall set out following matters in the special resolution:
 - (a) the priority with respect to payment of dividend or repayment of capital vis-a-vis equity shares;
 - (b) the participation in surplus fund;
 - (c) the participation in surplus assets and profits, on winding-up which may remain after the entire capital has been repaid;
 - (d) the payment of dividend on cumulative or non-cumulative basis.
 - (e) the conversion of preference shares into equity shares.
 - (f) the voting rights;
 - (g) the redemption of preference shares.

Cont...

- **Offer Letter** Rule 14(3).... Section 42
- Required if the shares are proposed to be issued to the persons other than existing shareholders...
- Offer letter shall be in form PAS-4...
- Check all the disclosures are properly made...
- To be dispatched only after filing MGT-14 for passing special resolution ...

Procedure for issue of Shares on Preferential basis

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Remember

- Issue offer letter (PAS-4) only after filing of MGT-14.
- Application money has to be taken in the separate Bank account.
- Filing of PAS-3 within 15 days of allotment of shares.
- Amount can be utilized only after filing PAS-3.
- Refund of excess share application money received if any.

Cont...

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- Share certificate to be issued within 2 months of allotment.
- Payment of stamp duty on share certificate.
- Physical/ Online
- Grass/ ESBTR
- Rate of stamp duty on shares & debenture (0.005%)

Listed entities... some provisions...

- Chapter V of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 deals with preferential issue.

- “preferential issue” means an issue of specified securities by a listed issuer to any select person or group of persons on a private placement basis in accordance with Chapter V of these regulations and does not include an offer of specified securities made through employee stock option scheme, employee stock purchase scheme or an issue of sweat equity shares or depository receipts issued in a country outside India or foreign securities;

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□ Provisions of chapter shall not apply to issue of equity shares to :

- i. Conversion of loan or an option attached to convertible debt instruments into equity in terms of Companies Act, 1956/ 2013.
- ii. scheme approved by a High Court under section 391 to 394 of the Companies Act, 1956 or approved by a tribunal or the Central Government under sections 230 to 234 of the Companies Act, 2013, as applicable .
- iii. a qualified institutions placement in accordance with Chapter VI of these regulations
- iv. preferential issue of specified securities is made to the lenders pursuant to conversion of their debt, as part of a debt restructuring implemented in accordance with the guidelines specified by the Reserve Bank of India

Cont...

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- **Preferential issue shall not be made to :**
 - to any person who has sold or transferred any equity shares of the issuer during the six months preceding the relevant date.
 - Where any person belonging to promoter(s) or the promoter group has previously subscribed to warrants of an issuer but has failed to exercise the warrants, the promoter(s) and promoter group shall be ineligible for issue of specified securities of such issuer on preferential basis as prescribed.
 - An issuer shall not be eligible to make if any of its promoters or directors is a fugitive economic offender

Cont...

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□ Conditions for preferential issue

- i. Fully paid –up at the time of allotment

- i. Special resolution

- i. Allotment in dematertlised form

- i. the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the stock exchange where the equity shares of the issuer are listed

- ii. Allottees are having PAN except for those who are exempt .

Cont....

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□ Relevant Date :

- i. in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue.
- ii. in case of a preferential issue of convertible securities, either the relevant date as above or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.

□ Tenure of convertible securities :

18 months from the date of allotment

Cont...

□ Disclosures to shareholders

- In addition to disclosures as under Companies Act,2013 , following disclosures are required
- ✓ identity of the natural persons who are the ultimate beneficial owners of the shares proposed to be allotted and/or who ultimately control the proposed allottees, the percentage of post preferential issue capital that may be held by them and change in control, if any, in the issuer consequent to the preferential issue
- ✓ undertaking that the issuer shall re-compute the price of the specified securities in terms of the provision of these regulations where it is required to do so .
- ✓ undertaking that if the amount payable on account of the re-computation of price is not paid within the time stipulated in these regulations, the specified securities shall continue to be locked- in till the time such amount is paid by the allottees

Cont....

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- ✓ disclosures specified in Schedule VI, if the issuer or any of its promoters or directors is a wilful defaulter
- ✓ The special resolution shall specify the relevant date on the basis of which price of the equity shares to be allotted on conversion or exchange of convertible securities shall be calculated.

PRICING OF FREQUENTLY TRADED SHARES

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Listed on Recognised Stock Exchange for a period of 26 weeks or more [164(1)]:

Price of Equity shares shall not be less than higher of the following-

- a. Average of weekly high and low of volume weighted average price of equity shares during 26 weeks preceding the relevant date

OR

- b. Average of weekly high and low of volume weighted average price of equity shares during 2 weeks preceding the relevant date.

Listed on Recognised Stock Exchange for a period of less than 26 weeks [164(2)]:

Price of Equity shares shall not be less than higher of the following-

- a. IPO Price or Value of share as per Scheme of Compromise, Arrangement or Amalgamation

OR

- b. Average of weekly high and low of volume weighted average price of equity shares during the period of share listed preceding the relevant date

OR

- c. Average of weekly high and low of volume weighted average price of equity shares during 2 weeks preceding the relevant date.

Cont...

- Preferential issue to not exceeding 5 QIBs shall be made at price determined under Regulation 164(1)(b).
- “Frequently traded shares” means traded turnover on any recognised stock exchange during the 12 calendar months preceding the relevant date, is at least 10% of the total number of shares of such class of shares of the issuer.

PRICING OF INFREQUENTLY TRADED SHARES

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- Price to be determined by taking into account Valuation parameters like:
 1. Book value
 2. Comparable trading multiples
 3. Such other parameters as are customary for valuation of shares of such companies
- Issuer shall submit a certificate stating that the issuer is in compliance of this regulation, obtained from an independent valuer to the stock exchange where the equity shares of the issuer are listed.

Cont...

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□ Lock in

Type of securities	Promoters or promoters group	Other than promoter
Specified securities <i>up to 20% of the total capital of the issuer</i>	three years from the date of trading approval granted	one year from the date of trading approval.
Specified securities <i>In excess of 20% of the total capital of the issuer</i>	one years from the date of trading approval granted	NA
the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis	three years from the date of trading approval granted	one year from the date of trading approval.
convertible securities or warrants which are not listed on stock exchanges	one year from the date of allotment	one year from the date of allotment

Cont...

- The equity shares issued on a preferential basis pursuant to any resolution of stressed assets under a framework specified by the Reserve Bank of India or a resolution plan approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code 2016, shall be locked-in for a period of one year from the trading approval .
- The entire pre-preferential allotment shareholding of the allottees, if any, shall be locked-in from the relevant date up to a period of six months from the date of trading approval.

Cont...

□ Consideration

- Full consideration of specified securities other than warrants, shall be paid by the allottees at the time of allotment of such specified securities except in case of shares issued for consideration other than cash .
- In the case of warrants, an amount equivalent to at least twenty five per cent. of the consideration determined in terms of regulation 164 shall be paid against each warrant on the date of allotment of warrants and the balance seventy five per cent. of the consideration shall be paid at the time of allotment of the equity shares pursuant to exercise of options against each such warrant by the warrant holder.

Cont...

□ Allotment

- Allotment pursuant to the special resolution shall be completed within a period of fifteen days from the date of passing of such resolution except in following cases:
 - i. application for exemption from the applicability of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 or any approval or permission by any regulatory authority or the Central Government for allotment is pending
 - ii. Board has granted relaxation to the issuer in terms of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, shall be made by it within such time as may be specified by the Board in its order granting the relaxation
 - iii. allotment of specified securities on preferential basis pursuant to any resolution of stressed assets under a framework specified by the Reserve Bank of India or a resolution plan approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code 2016.

Proposed Changes ...

As per consultation paper issued by SEBI On 26th November,2021

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- Applicability of chapter V to conversion of a loan or an option attached to convertible debt instruments.

Additional compliance....

- Reduction of the condition of ineligibility period for a person who has sold or transferred equity shares from six months preceding the relevant date to 60 trading days preceding the relevant date.

Easing the restrictions...

Cont...

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- Issuer shall not have any outstanding dues to the Board, the stock exchanges or the depositories.

Only compliant companies can assess the option...

- only swap of shares backed by a valuation report may be considered as “other than cash”

Better compliance Valuation based....

Cont...

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- Issuer company must apply to the Stock Exchanges for in-principle approval under regulation 28(1) of SEBI LODR Regulations on the same day as dispatch of AGM / EGM / PB notice to shareholders.

Saving time....

- Conditions as to prior holding of the allottee in dematerialized form and proposed allottee must have PAN to be complied with at the time of making an application to Stock Exchanges for in-principle approval.

Avoid future problems...

Better compliance...

Cont...

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- Pricing changes as follows:
 - ✓ Replacement of average of weekly high and low VWAP of 26 weeks with VWAP of 60 trading days and replace average of weekly high and low VWAP of 2 weeks with VWAP of 10 trading days.
 - ✓ For equity shares listed for a period of less than twenty six weeks as on the relevant date, to replace average of weekly high and low of VWAP of 26 weeks with VWAP of 60 trading days
 - ✓ *Change as per change in trade settlement period....*
 - ✓ *Pricing is possible at nearest time ...*

Not to forget

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- Interpretation...
- Cross section principle...
- Help menu of forms....
- Being conservative....
- Legal consequences, social consequences...

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