

Public M&A: New Delisting Norms – What is the Excitement Really About?

Key Takeaways

- SEBI's Consultation Paper proposes a comprehensive review of counter-offer mechanism, counter-offer price discovery mechanism, fixed price mechanism, floor price and reference date
- Fixed price delisting, largely regarded as a welcome move, fails to excite us and appears lackluster against the present reverse book building mechanism due to absence of a counter-offer mechanism
- Revised counter-offer price discovery mechanism unlikely to serve the purpose and might result in a price which may be unworkable after all
- Addition of "Adjusted Book Value" as a component for determination of floor price is a positive move for the shareholders of asset-heavy companies where market linked pricing may not always be the best benchmark of floor price
- Adjusting the reference date to coincide with the date of the initial public announcement appears more optimal than using the date when stock exchange(s) were required to be notified of the board's approval for delisting

Introduction

A lot has been written about SEBI's recent consultation paper on voluntary delisting norms ("**Consultation Paper**") on the SEBI (Delisting of Equity Shares) Regulations, 2021 ("**Delisting Regulations**"). The Consultation Paper introduces alternatives to the existing reverse book building ("**RBB**") process for delisting: the much talked about fixed price mechanism and review of the counter-offer mechanism under RBB. SEBI also proposed a change in the reference date for determination of "floor price" and a review of the "reference date" for determination of such floor price.

In this piece, we analyse SEBI's proposals from the perspective of an acquirer. SEBI suggests that a fixed price mechanism offers an advantage to acquirers by providing certainty regarding the exit offer price in advance, facilitating funding arrangement for delisting offers. However, our analysis contends that this mechanism may not really deliver tangible benefits to either acquirers or public shareholders.

"Floor price" is sought to be determined separately under the Delisting Regulations, which would also include "Adjusted Book Value", an additional component. Hence, understanding the nuances of book value¹ versus market value becomes pivotal, particularly in assessing asset-heavy companies and holding companies.

While acknowledging the potential benefits of adjusting the "reference date" for floor price calculation, our view on the counter-offer mechanism is divided. While we support changes in counter-offer thresholds, we challenge the necessity of introducing a price discovery mechanism for counter-offers.

Review of the Fixed Price Mechanism

What is the current framework?

As per the current framework, voluntary delisting provides for the RBB route for discovery of the price at which the exit opportunity is to be provided to public shareholders with a few exceptions.² SEBI observed that the announcement for delisting of the equity shares of a company results in increased volatility and increased speculative activities in the scrip of such company.

¹ Regulation 22(5) of the Delisting Regulations explains that the book value shall be computed on the basis of both consolidated and standalone financial statements as per the latest quarterly financial results filed by the company on the stock exchange(s) as on the date of public announcement for counter offer, and the higher of the values so computed shall be treated as the book value.

² Except in the case of delisting of equity shares of a small companies and delisting of equity shares of a subsidiary company pursuant to scheme of arrangement in accordance with Chapter VI of the Delisting Regulations.

SEBI hence proposed the fixed price mechanism for those companies whose shares are frequently traded³ due to increased volatility and speculative activities post-delisting announcements. Stakeholder representations highlighted the need for an alternative to the reverse book-building process.

What are the proposed changes and will they deliver?

The fixed price route is anticipated to offer certainty regarding the pricing of the delisting offer. Highlighting the advantage for the acquirer, it is noted that knowing the exit offer price well in advance facilitates easier arrangement of funds for delisting offers. The proposed mechanism introduces new challenges rather than resolving existing ones.

RBB as a price discovery mechanism has its own flaws since the shareholders often bid with unrealistic prices, presuming the acquirer has deep pockets. Nonetheless, RBB does incorporate a counter-offer mechanism, affording an opportunity to engage shareholders with competitive bids. The fixed price mechanism, unlike the RBB route, lacks provision for a counter-offer mechanism.

If a fixed price delisting attempt fails, a mandatory six-month cooling-off period applies. On one hand it galvanizes the acquirer to offer a price as high as it could (and naturally park commensurate funds in escrow), but on the other hand lack of counter-offer ability hampers price discovery, proving suboptimal for both acquirers and public shareholders. Acquirers risk failure if shareholder expectations are not met, while shareholders are presented with a singular price option without room for negotiation.

Review of Counter-Offer Mechanism

A. Thresholds

What is it now and what did not work?

Under the current framework, an acquirer intending to delist a company from the stock exchanges is required to provide an exit opportunity to all public shareholders at the floor price or an indicative price offered by the acquirer. Upon conclusion of the RBB process, if the acquirer attains the 90% threshold for post-offer shareholding, combined with the shares tendered by the public shareholders reaching 90% of the total issued shares (“**90% Threshold**”), the delisting

³ Regulation 2(1)(j) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 defines “frequently traded shares” to mean “*shares of a target company, in which the traded turnover on any stock exchange during the twelve calendar months preceding the calendar month in which the public announcement is required to be made under these regulations, is at least ten per cent of the total number of shares of such class of the target company:*

Provided that where the share capital of a particular class of shares of the target company is not identical throughout such period, the weighted average number of total shares of such class of the target company shall represent the total number of shares.”

offer is deemed successful, enabling the acquirer to delist the company at the indicative price.

If the 90% Threshold is reached at a price discovered which is greater than the indicative price (“**RBB Price**”), the acquirer may choose to accept and delist at the RBB Price or make a counter-offer, which shall be at a price higher than the book value of the company. If the acquirer makes the counter-offer, the public shareholders are given an opportunity to tender their shares once more at the counter-offer price. If the delisting offer hits the 90% Threshold, the delisting succeeds. If the delisting process fails, the acquirer is restricted from launching another delisting offer for 6 months.

SEBI noted scenarios where a majority of the public shareholders are in favour and tender their shares in a delisting offer, but due to such high thresholds the delisting doesn’t go through. SEBI has therefore proposed lowering the thresholds to make counter-offers to increase the likelihood of a successful delisting offer.

What are the proposed changes?

If the RBB Price is not accepted by the acquirer or if the 90% Threshold is not met, the acquirer will have the option to make a counter-offer if the bids received are higher of:

- a. the difference between the acquirer’s shareholding and 75% of the total issued shares of the company; and
- b. 50% of the public shareholding.

We can understand the revised counter-offer thresholds through an illustration set out below:

Scenario	Acquirer Shareholding	Public Shareholding	Difference between Acquirer’s Shareholding and 75% of Total Issued Shares of the Company (A)	50% of Public Shareholding (B)	Higher of (A) and (B)
1	25%	75%	50%	37.5%	50%
2	35%	65%	40%	32.5%	40%
3	52%	48%	23%	24%	24%

⁴ Regulation 2(1)(o) of the Delisting Regulations defines “indicative price” as the price offered by the acquirer, which is higher than the floor price, while making the proposal to voluntarily delist the equity shares of the company.

4	68%	32%	7%	16%	16%
5	74%	26%	1%	13%	13%

Illustration 1: Proposed Counter-Offer Thresholds

Let us consider Scenario 2:

In this scenario, the acquirer holds a 35% share, while the public shareholders hold 65%. The difference between the acquirer's shareholding and 75% of the total issued shares would be 40%.

Given that 50% of the public shareholding equals 32.5%, and since 40% is the higher threshold, the counter-offer threshold would be 40% of the public shareholding being tendered.

The revised counter-offer threshold appears to offer optimal advantages in streamlining the delisting process, providing greater flexibility and higher likelihood for successful delisting. By easing the threshold acquirers and shareholders are more likely to capitalize on its benefits effectively.

B. Counter-Offer Price Discovery Mechanism

What is it currently?

As per the current framework, there are no guiding principles for the counter-offer price other than that it shall not be less than the book value of the company as certified by the manager to the offer.

What are the proposed changes? Are they required?

The Consultation Paper proposes guiding principles for the counter-offer price that would reflect the general expectations of the public shareholders tendering their shares and help acquirers make "meaningful" counter-offers.

If the acquirer chooses to make a counter-offer, the counter-offer price will be required to be the higher of:

- a. volume weighted average price (VWAP) of the shares tendered/offered in the RBB process; and
- b. the initial floor price disclosed and calculated for the RBB process.

We can understand the revised counter-offer price discovery through an illustration set out below:

	Bid Price (INR)	Demand (Number of Shares) Volume of Shares Traded	Cumulative Demand (Number of Shares)	Total Traded Value
Floor Price	550	2,50,000	2,50,000	137500000
	565	4,00,000	6,50,000	226000000
	575	2,00,000	8,50,000	115000000
	585	4,00,000	12,50,000	234000000
	595	1,20,000	13,70,000	71400000
90% Threshold	600	1,30,000	15,00,000	78000000
	605	2,10,000	17,10,000	127050000
	610	1,40,000	18,50,000	85400000
	615	1,50,000	20,00,000	92250000
	620	5,00,000	25,00,000	310000000
	Total	25,00,000	NA	1476600000

Illustration 2: Proposed Counter-Offer Price Discovery Mechanism

**In this case, the 90% Threshold has been met. Hence, VWAP is calculated taking into account the shares tendered/offered up to 90%. Had the 90% Threshold not been met, the VWAP would have been calculated taking into account all the shares tendered/offered.*

In this scenario:

The floor price is set at INR 550 per share. This is the minimum price at which shares can be bid for in the delisting offer. The acquirer currently holds 75% of the company's shares. The goal of the acquirer is to reach the 90% Threshold. The required number of shares to reach this threshold is assumed as 15,00,000 shares.

In the given scenario, the calculated discovered price needed to reach this threshold is INR 600 per share.

$$\text{VWAP} = \frac{\text{Total Traded Value}}{\text{Total Volume of Shares Traded}}$$

$$\text{VWAP} = 574.6$$

Here, the initial floor price is INR 550, and thus, INR 574.6 shall be the counter offer price.

From the perspective of the acquirer, the proposed VWAP calculation method appears impractical due to its constraints: first, it limits the acquirer's flexibility in formulating counter-offers, and second, it reflects potentially inflated shareholder sentiments. If the VWAP-imposed counter-offer price is mandated, the acquirer's ability to tailor counter-offers to its financial constraints would be restricted. In a hypothetical scenario outlined above, the acquirer may only offer INR 570, beyond which the acquirer would withdraw from the delisting process. Public shareholders tendering their shares might accept INR 570 as a counter-offer, thereby receiving a premium over the floor price and mitigating artificially inflated sentiments linked to the delisting.

While the Consultation Paper aims to guide counter-offer pricing to reflect shareholder sentiments, fixing counter-offer prices could expose the process to manipulation by public shareholders, who may tender shares at inflated premiums to the floor price to potentially secure a higher fixed counter-offer price. This potential abuse would heighten the risk of delisting offers failing. The current counter-offer price mechanism, which sets a minimum floor price based on the company's book value, offers better flexibility to the acquirer in formulating feasible counter-offers that are conducive to successful delisting. The proposed fixation of counter-offer prices may run counter to the objective of enhancing the feasibility and success rate of delisting.

Review of Floor Price

What is floor price right now?

The term "floor price" under the Delisting Regulations is the minimum price required to be offered by the acquirer in the context of open offers where companies will continue to remain listed.

What are the proposed changes?

SEBI proposed certain provisions for determining the floor price in delisting offers under the Delisting Regulations. An additional parameter, termed "Adjusted Book Value", was suggested to safeguard shareholder interests. This adjustment considers the fair market value of the company's assets, particularly crucial as delisting renders the company no longer publicly listed.

For frequently traded shares, the floor price is determined as the highest among:

- a. the VWAP paid for acquiring shares over the preceding 52 weeks;
- b. the highest price paid for any acquisition of shares over the previous 26 weeks;
- c. the volume-weighted average market price over 60 trading days preceding the reference date; and
- d. the Adjusted Book Value, as assessed by an independent registered valuer, considering consolidated financials.

For infrequently traded shares, the floor price is determined as the highest among:

- a. the VWAP paid for acquiring shares over the preceding 52 weeks;
- b. the highest price paid for any acquisition of shares over the previous 26 weeks;
- c. the price determined by an independent registered valuer, incorporating valuation parameters such as book value and trading multiples;
- d. the Adjusted Book Value, as assessed by an independent registered valuer, considering consolidated financials.

Adjusted Book Value

$$\text{Adjusted Book Value} = A+B+C+D-L$$

Where,

A = Book value of all the assets (other than jewellery, artistic work, shares and securities and immovable property) in the balance sheet as reduced by any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset.

B = Value of jewellery and artistic work determined by a registered valuer

C = Fair market value of unquoted/infrequently traded shares and securities

D = Value of immovable property

L= book value of liabilities shown in the balance sheet, but excluding specific amounts:

- a. paid-up capital for equity shares,*
- b. undistributed dividends for preference and equity shares not declared before the transfer date at a shareholders' meeting,*
- c. reserves and surplus, except those allocated for depreciation, even if resulting in a negative figure,*
- d. provisions for meeting liabilities other than ascertained ones, and*
- e. contingent liabilities except for arrears of dividends on cumulative preference shares*

How are the proposed changes going to affect shareholders?

Generally, market value of a company tends to be greater than the book value of a company since market value takes into account investor sentiments, profitability, growth prospects, etc. Although, this may not be the case in asset-heavy companies, since they often have significant tangible assets such as property, plants, and equipment. As for holding companies, they tend to have significant assets in the form of investments in subsidiaries, associates, or other businesses, which can contribute to a relatively higher book value. In such instances, the inclusion of the “Adjusted Book Value”

parameter is a favourable development for shareholders of such companies, as it anticipates a higher floor price by considering the Adjusted Book Value of the investments.

Review of the Reference Date

What is reference date now?

“Floor price” under the Delisting Regulations is calculated as of a “reference date”. Currently, the reference date to calculate the floor price is the date on which the stock exchanges are required to be notified of the board’s approval of the delisting proposal.

The Delisting Regulations provide for the delisting of a listed subsidiary of a listed holding company where both companies are in the same line of business, wherein the reference date for computing the valuation of shares would be the date on which the stock exchanges were required to be notified of the subsidiary board’s approval of the delisting proposal.

Under the current framework, there exists a potential risk of substantial and abnormal trading activity in the shares of the company between the date on which the initial public announcement is made by the acquirer and the date on which the listed company’s board approves the delisting proposal.

Delisting Regulations	Provision
Regulation 8(1)	On the date when the acquirer(s) decides to voluntarily delist the equity shares of the company, it shall make an initial public announcement.
Regulation 10(1)	Board approval shall be taken within 21 days of the initial public announcement for delisting.
Regulation 20(3)	Reference date for computing the floor price is the date on which the recognized stock exchange(s) was required to be notified of the board meeting in which the delisting proposal was considered and approved. <i>[Note: As per Regulation 30(2) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015: The listed entity shall disclose to the stock exchange(s), the decision on voluntary delisting by the listed entity from stock exchange(s) within 30 minutes of the closure of the meeting.]</i>
Regulation 37(2) (j)	Reference date for computing the valuation of shares would be the date on which the recognized stock exchange(s) was required to be notified of the board meeting in which the delisting proposal of the subsidiary was considered and approved.

What are the proposed changes?

The framework suggests a proposal to change the reference date to be the initial public announcement date or the date on which the prior intimation is required to be given to the stock exchanges, as applicable.

If the initial public announcement is made during market hours, then the date of such initial public announcement will be the reference date. If the initial public announcement is made after the market hours, then the next day will be the reference date.

We view this as a positive development. The initial public announcement is likely to trigger significant market reactions affecting the company's share price. Calculating the floor price from the initial public announcement would allow for computation based on an undisturbed price. Awaiting the date of the board's approval for the delisting would allow for significant price flux to be factored into the floor price.

Conclusion

The RBB mechanism provides a counter-offer provision that enhances the flexibility of acquirers to negotiate for a successful delisting, while the fixed price mechanism imposes constraints on both acquirers and shareholders. With the fixed price mechanism, acquirers have only one opportunity to delist the company, and if unsuccessful, they must wait six months before launching another delisting offer. This cooling period leads to a period of inactivity and uncertainty that may not be in the interest of the acquirer and the shareholders.

The proposed revision in the counter-offer thresholds presents a promising prospect for successful delisting, as it provides acquirers with a fairer opportunity to negotiate a price acceptable to shareholders. However, the introduction of a price discovery mechanism for counter-offers may be seen as rather prescriptive, as it restricts an acquirer's commercial flexibility and fails to address artificially inflated shareholder sentiments during price calculation. If the VWAP of shares tendered/offered in the RBB process fixes the counter-offer price, the acquirer may not be able/willing to offer such price. Had it not been for this price discovery mechanism, the acquirer could have offered a premium over the floor price, while having flexibility to keep it below the price "discovered" through the RBB process, ultimately enabling shareholders to receive a fair price while also considering the acquirer's commercials.

The inclusion of Adjusted Book Value parameter in calculation of floor price may have a significant impact on asset-heavy and holding companies. It presents a favourable scenario for shareholders of these companies, as it may give them a higher floor price. Lastly, adjusting the reference date to coincide with the initial public announcement date, rather than board approval dates, is a favourable move as it allows for the calculation of the floor price based on undisturbed share prices.

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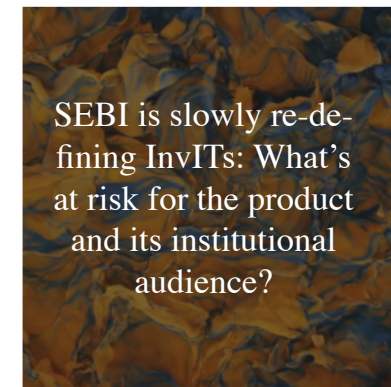
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