

SECURITIES AND EXCHANGE BOARD OF INDIA, MUMBAI
ORDER

**IN THE MATTER OF ACQUISITION OF SHARES OF SURYA
PHARMACEUTICALS LTD. – EXEMPTION APPLICATION FILED UNDER
REGULATION 4(2) OF THE SECURITIES AND EXCHANGE BOARD OF INDIA
(SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVERS)
REGULATIONS, 1997.**

WTMO/TCN/CFD/ /2008

1.0 BACKGROUND

- 1.1 Surya Pharmaceuticals Ltd. (hereinafter referred to as ‘the target company’) is a company incorporated under the Companies Act, 1956, having its registered office at 85, HPSIDC Industrial Area, Baddi, Tehsil Nalagarh, Distt Solan, Himachal Pradesh.
- 1.2 The equity shares of the target company are listed on the National Stock Exchange of India Ltd. and the Bombay Stock Exchange Ltd.

2.0 APPLICATION FOR EXEMPTION

- 2.1 An application dated April 07, 2008 was filed with SEBI on behalf of M/s Futuristic Garments (P) Ltd. (hereinafter referred to as ‘the acquirer’) under regulation 4(2) read with regulation 3(1) (I) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (hereinafter referred to as ‘the Takeover Regulations’). The acquirer has made following submissions in the application:
- (a) The acquirer is a part of the promoter group of the target company.
 - (b) The target company has a paid-up share capital of Rs.14,46,83,380/- divided into 1,44,68,338 fully paid-up equity shares of Rs.10/- each. Out of these, 50,85,913 equity shares are held by promoters and persons acting in concert (hereinafter referred to as ‘PACs’) with them. The target company has issued Foreign Currency Convertible Bonds (hereinafter referred to as ‘FCCBs’) which are due for conversion in the month of September 2008. Upon conversion of these FCCBs, 37,90,813 equity shares shall be issued by the

target company to the holders of FCCBs and accordingly, the paid-up capital of the company will increase to Rs.18,25,91,510/- divided into 1,82,59,151 fully paid-up equity shares of Rs.10/- each.

- (c) IDBI Bank (hereinafter referred to as 'IDBI'), vide its letter dated March 19, 2008 had sanctioned fund-based and non fund-based working capital facilities of Rs.38 crore to the target company with a stipulation that the promoters of the target company shall maintain at least 51% stake in the target company during the currency of IDBI's financial assistance.
- (d) The acquirer has proposed to acquire shares of the target company, directly and indirectly, to increase the shareholding of the promoters in the target company from existing 35.15% to a minimum of 51% of post FCCB conversion paid-up capital. Under the proposed transaction, the acquirer has proposed to acquire control of two companies, viz; Mangal Kamna Buildwell Pvt. Ltd. and Dynamic Finvest Services Pvt. Ltd. which are collectively holding 14.30% shares in the target company and to directly acquire 10.41% shares of the target company from another body corporate viz; M/s Creative Capital Services Ltd. by way of an off-market deal.

2.2 The acquirer has sought exemption from the applicability of regulations 11 and 12 of the Takeover Regulations on the following grounds:-

- (a) That the time given by IDBI is too short for acquiring the shares in the target company failing which the financial assistance sanctioned to the target company is liable to be withdrawn. Due to paucity of time making a public offer is not feasible keeping in view the compliances required to be made by the acquirer and persons acting in concert with it.
- (b) That the conditions of the stock market are not congenial to make public offering at this time due to volatility.
- (c) That the proposed acquisition in the target company is only in view of the stipulation of the IDBI.
- (d) That the proposed acquisitions will not result in any change in management of the company.

- (e) That the proposed acquisition shall not in any way affect the rights of the existing shareholders; rather it shall help the company to run its business more effectively and efficiently by raising the additional finance to meet working capital requirements.

3.0 CONSIDERATION OF APPLICATION AND RECOMMENDATION OF THE TAKEOVER PANEL

3.1 In terms of sub-regulation (4) of regulation 4 of the Takeover Regulations, the aforesaid application was forwarded by SEBI to the Takeover Panel. The Takeover Panel vide its letter dated June 09, 2008 submitted its report. The Panel found that:

- a) The letter of IDBI merely states that the promoters' stake should not be below 51%. It does not say that this has to be done by acquiring the stake as proposed. This can be done by issuing new equity shares as per law. There was no urgency as the FCCB options were to be converted by September 2008. The promoters had sufficient time raise capital. The IDBI was aware that the promoters holding in the target company is 35.15% and the company has accepted the stipulation and has sufficient time to raise promoters' stake.
- b) The acquirer has not indicated the price at which the indirect acquisitions will take place.

3.2 The Panel made following recommendation-

“The ground of exemption based upon the above observation is not proved and as per the last annual report of the Target Company (Surya Pharmaceuticals Ltd.) there were 13,405 shareholders and about 12,800 shareholders has less than 1000 shares. Hence, the panel regrets the application for exemption, as not in the interest of all shareholders.”

4.0 HEARING AND SUBMISSIONS

4.1 An opportunity for hearing was given to the acquirer on July 07, 2008, when Shri Rajansh Thukral, Director of the acquirer, appeared before me and made submissions on behalf of the acquirer. The acquirer, vide its letters dated June 30, 2008 and July 11, 2008 also filed its written submissions.

4.2 The submissions, made in furtherance of the application for exemption, are as follows:

- a) That the IDBI's sanction letter dated February 19, 2008, read with letter dated March 19, 2008 clearly states the intention of IDBI that the promoters' stake should be minimum 51%. That IDBI were seized of the fact that the promoters are holding only 35.15% stake in the company and hence they wanted the promoters/PACs to increase the stake to 51% before the release of facilities.
- b) IDBI had indicated that in the event of inability of the promoters to increase their stake in the target company to 51%, the sanctioned facility could be withdrawn. IDBI has not so far released the sanctioned facility.
- c) The issuance of new equity shares has not been considered advisable. Such issuance will increase the authorized/paid up capital of the company and thus shall change capital structure. This will reduce EPS/Price Earning Ratio and consequentially the share valuation. Further issue is also not feasible at this stage in such a short time as it involves a long issue process in the public issuance. Moreover, the market is not conducive to make public issues keeping in view the down trend of the market, rising inflation and other negative economic indicators. The company may not get adequate pricing resulting into loss to investors if the issue is not subscribed, that would result into loss of reputation besides time and money. No merchant banker is coming forward even to discuss the launching of an equity issue at this stage.
- d) Making of a rights issue of equity shall not increase the promoters' stake. Private placement of shares to promoters and PACs is not exempted under regulation 3(1) of the Takeover Regulations and such placement shall again necessitate exemption from SEBI besides affecting capital structure.
- e) The proposal is not against the interest of the shareholders as the number of paid up equity shares shall remain the same and this shall not affect in any way the EPS/Price Earning Ratio/valuation of the shares. Moreover, the

acquisition shall strengthen the control of the promoters and would be able to offer a better growth and stability for the shareholders.

- f) That the price at which the shares of the private corporate bodies are to be acquired for indirect acquisition of shares of the target company has been worked out by the practicing Chartered Accountants and the valuations for the private bodies corporate are as per the established accounting practices considering, both the assets and liabilities, would be taken over by the acquirer. In respect of the acquisition of shares of the target company from M/s Creative Capital Services Ltd., the price of the shares shall be the price prevailing on the stock exchanges on the date of actual purchase.
- g) The taking over of the private bodies corporate shall not make them as subsidiary of the target company.
- h) If the company is unable to avail the facilities because of the inability of the company to comply with the stipulation of IDBI, it may result into unfavorable circumstances for the company and consequently, to the shareholders.

5.0 FINDINGS

- 5.1 I have carefully perused the application filed for grant of exemption, the oral and written submissions made by the acquirer in this regard, the report of the Takeover Panel and the other relevant materials available on record.
- 5.2 The Takeover Regulations have been framed on the basis of recommendations of Justice Bhagwati Committee. The Committee had recognized that the process of takeover is complex and is inter related to the dynamics of the market place. The cardinal principles behind the Takeover Regulations, as listed by the said Committee, are equality of opportunity to all shareholders, protection of minority interests, transparency and fairness. The Committee had recommended that while on the one hand the Regulations should not impose conditions, which are too onerous to fulfill and hence make substantial acquisitions and takeovers difficult, at the same time, they should ensure that such processes do not take place in a clandestine manner without protecting the interests of the shareholders.

- 5.3 With the above objective, regulation 11 (1) permits consolidation of shareholdings by an acquirer holding 15% or more, but less than 55% by creeping acquisition of 5% in a financial year or (if such acquirer wishes to consolidate his holding by acquiring more than 5%) by making a public announcement to acquire further shares in accordance with the regulations. On the basis of the principles as stated above, regulation 3 envisages the exemptions in certain cases. Regulation 3 (1) (a) (ka) of the Takeover Regulations provides for automatic exemptions in respect of specified acquisitions. These specified acquisitions are those acquisitions which are under a transparent process or by operation of law or subject to approvals and sanctions of High Courts or pursuant to a scheme framed under the Sick Industrial Companies (Special Provisions) Act, 1985 or where shareholders interest is otherwise protected in the transaction or by way of conditions precedent. Under regulation 3 (1) (l) also, the exemptions are granted taking into account the above objectives and the interests of the investors in the target company.
- 5.4 It is an admitted position that the acquirer is part of the promoter group of the target company and that it desires to consolidate its holding in the target company, by directly and indirectly acquiring additional shares, so as to increase the promoters' shareholding in the target company to the extent of 51%. Further, consequent upon such acquisition there will not be any change in control over the target company. Such acquisition would thus trigger regulation 11 (1) of the Takeover Regulations unless exempted under regulation 3. In the present case, the proposed transaction is not covered under the automatic exemption category specified in regulation 3 (1) (a) (ka) of the Takeover Regulations. Therefore, the case has been referred for an exemption under regulation 3 (1) (l) read with regulation 4.
- 5.5 I have considered the submissions and reasons forwarded on behalf of the acquirer. The acquirer has submitted that the proposed transaction has been contemplated in order to comply with the stipulation of IDBI with respect to the financial assistance sanctioned to the target company. From the sanction letter dated February 19, 2008 from IDBI, I note that the IDBI had sanctioned the financial assistance to the target company to the extent of Rs.38 crore. One of the conditions for the grant of such facility is that the stake of promoters in the target company should not fall below 51% during the currency of the said financial assistance. IDBI had not stipulated this

- increase of the promoters' shareholding by way of the transaction as proposed. I note that the acquirer has itself decided to consolidate its holding in the proposed manner in the target company so as to increase the promoters' shareholding to 51%.
- 5.6 For the purpose of consolidation under regulation 11 (1), the mode of acquisition is not relevant. Thus, in the instant case, it is for the target company to decide as to how the promoters' stake may be raised to 51%. If the target company decides to increase its capital through public issue or rights issue of equity shares, the acquisitions pursuant to such issuances would be exempted under regulation 3 (1) (a) and (b) of the Takeover Regulations. Although the target company, in this case, has the option to make the public issue or rights issue, the reasons forwarded by the acquirer for not making such issues are not tenable, and are irrelevant for the purpose of considering the case and those reasons cannot be a factor for not making public announcement to acquire shares in accordance with regulation 11 if acquirer is keen to consolidate its shareholding in the target company by way of proposed acquisition.
- 5.7 I note that the condition as stipulated by IDBI in this case is often imposed by banks for granting such sizable loans to companies. In such cases, the promoters' shareholding may also be increased by issuing new shares to the promoters by way of preferential allotment of equity shares. The acquisition by way of preferential allotment is not exempted automatically; however, in cases where the preferential allotments had been made to satisfy the condition stipulated by banks or lending institutions for raising shareholding of the promoters or under CDR Package, SEBI grants exemptions on a case to case basis, subject to conditions in the interest of investors and to ensure transparency. Such conditions include compliance of Chapter XIII of SEBI (Disclosure and Investor Protection) Guidelines, 2000, necessary disclosures about price, the allottees, consequential change in control, if any, in the explanatory statement in terms of Section 173 of the Companies Act forming part of the Notice of General Meeting with respect to the special resolution under section 81(1A) of the Companies Act, 1956. Further, in respect of the resolution under section 81(1A), the facility of voting through postal ballot for passing of the special resolution as per the procedure laid down for postal ballot in Rule 2A and Rule 5 of Companies (Passing of the Resolution by Postal Ballot) Rules, 2001 should also be provided.

- 5.8 The acquirer has submitted that the preferential allotment of shares to the promoters and PACs is not exempted under regulation 3(1) of the Takeover Regulations and such allotment shall again necessitate exemption from SEBI besides affecting capital structure. However, I note that the company was free to make the preferential allotment to the acquirer for satisfying the stipulation of IDBI and the acquirer if it so desired, could seek exemption under regulation 3(1) (I) before the preferential allotment by the target company. If an application could be filed by the acquirer in respect of the acquisition as proposed in the instant application, nothing prevented the acquirer to seek exemption under the said regulation if a preferential allotment was proposed.
- 5.9 I find that the target company had more than one option for increasing promoters' stake and that the promoters have chosen to do the same by the proposed acquisition. The question that needs to be determined is whether such acquisition merits exemption from the requirement of regulation 11(1) of the Takeover Regulations. In the instant case, it is clear that the acquirer is, directly and indirectly, obtaining voting rights of 10.41% and 14.30%, respectively. Such acquisition is by way of a negotiation between the acquirer and the transferees wherein, the other shareholders do not have any say in the decision. In addition, there are no disclosures to shareholders or public about such consolidation of holdings by the promoters of the target company.
- 5.10 The reasons such as paucity of time and non-congenial market conditions due to market volatility cannot be factors for grant of exemption from requirement of regulation 11 of the Takeover Regulations. If the acquirer was keen to consolidate the promoters' shareholding in the proposed manner, it could do so even by making a voluntary public offer in terms of the Takeover Regulations at any time. Moreover, the acquirer has submitted that the making of public offer is not feasible in view of the compliances required from the acquirer under the Takeover Regulations. I find that compliance of requirements of the Takeover Regulations can not be a reason for grant of exemption. Compliance of law is not a compulsion or limitation for any acquisition. If exemption is granted for the reason that the acquirer is under obligation to comply with the requirements of law, the purpose of requirements would be defeated. The other ground submitted by the acquirer that conditions of the stock

market are not congenial to make public offering at this time due to volatility is also not tenable since if the public offer is made the other shareholders may prefer to tender their shares during such market conditions. Further, even if the shares are proposed to be acquired directly by the acquirer at market rates, the grant of exemption would still not be in the interest of the rest of the shareholders as they will not have the exit opportunity in respect of the proposed acquisition, where the acquirer acquires shares only from few shareholders. In view of the same, I agree with the findings of the Takeover Panel and find that these reasons submitted by the acquirer are not tenable.

- 5.11 The fact that as a result of the proposed acquisition the promoters of the target company would be consolidating their shareholding in the target company to the extent of 51% of the post FCCB paid-up capital cannot be ignored. Further, if the FCCBs, for any reason, are not converted, the shareholding of the promoters of the target company would be even more than 51% after the proposed acquisition. From the point of view of the other shareholders acquisition of shares by the acquirer making it the dominant shareholder in the target company is significant, as that may prompt them to exit from the target company if the public offer is made. If the acquirer is not required to make public announcement to acquire further shares in accordance with the Takeover Regulations, the shareholder will not have opportunity to decide about their investment or disinvestment in the target company. Any exemption in this regard will defeat the objective of 'equality of treatment' to all the shareholders.
- 5.12 The financial assistance by IDBI is for the benefit of the target company and the shareholders as well. However, any exemption from regulation 11 in this case will be benefiting only the acquirer and the promoters of the target company, without protecting the interest of other shareholders who are not party to the proposed acquisition. Therefore, under the facts and circumstances of this case, I agree with the recommendation of the Takeover Panel and find that the proposed acquisition as submitted in the application dated April 07, 2008 does not merit exemption from requirements of regulation 11 of the Takeover Regulations.

6.0 ORDER

- 6.1 In view of the above findings, I, in exercise of the powers conferred upon me by virtue of section 19 of the Securities and Exchange Board of India Act, 1992 read with sub-regulation (6) of the regulation 4 of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 do not exempt the proposed acquisition as submitted by the acquirer in the application dated April 07, 2008, from requirements of regulation 11 of the Takeover Regulations.
- 6.2 If the acquirer is keen to consolidate the promoters' shareholding by way of proposed acquisition, it should comply with requirements of regulation 11 of the Takeover Regulations. The matter is disposed of accordingly.

Place: Mumbai

Dated: September 24, 2008

T. C. NAIR
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA