

Sebi may allow cos to issue convertible bonds with IPOs

Reena Zachariah, ET Bureau Oct 29, 2013, 06.47AM IST

MUMBAI: The Securities & Exchange Board of India (Sebi) may allow companies to issue convertible debentures along with equity shares during the time of their initial public offering. This way, retail investors can either go for straight equity shares or subscribe to convertible debentures if they are risk-averse.

"One alternative that they (Sebi's primary market advisory committee) are currently debating is of allowing corporates to issue convertibles," Sebi chairman UK Sinha told reporters on the sidelines of a conference on 'Investor Protection in Capital Markets', jointly organised by Sebi and the German Federal Financial Supervisory Authority on Monday. "So they (companies) issue convertibles and after a certain time, they necessarily have to be converted into equity or they are treated as debt instrument," Sinha added.

Sebi is contemplating this move following strong views against the so-called safety net proposal, where issuers have to compensate retail investors if the share price falls drastically within a few months of listing. "There were two very strong views on safety net. One was that the [IPO](#) is a risk investment, so how can any one assure a capital protection on that. This goes against the whole idea of raising risk capital and if Sebi insists on this, then, going forward, there would be a problem. The other view was that what's Sebi going to do if two-thirds of the IPOs are trading below issue price for months," Sinha said. "We have got more responses against the safety net than for it," he added.

An optionally convertible debenture is a bond issued by a company which typically comes with a fixed tenure and a fixed coupon rate, which can either be redeemed or converted into equity shares at a pre-determined price on a future date. At present, Sebi's rules on issue of capital have provisions for such innovative instruments. Prithvi Haldea, chairman of Prime Database, thinks that a convertible debenture will protect small investors who are not ready for the risk.

"Small investors get unnerved with the steep fall in IPO prices post-listing. This, therefore, takes into cognizance the current mindset of small investors driven more by safety than returns," Haldea added. Merchant bankers, however, said this may not be a feasible option for companies with huge debt on their books such as infra, power and real estate, but could be a good move for service providers such as information technology companies which are under-leveraged. "Any potential structure, whether it is a safety net or a convertible debenture, would finally require the issuer company to keep aside adequate funds to meet such obligations. This could be in direct conflict with the objects of the issue where funds may be required to be deployed towards business purposes," said Mehul Savla, director, **Ripple-Wave Equity** Advisors. "Issuers may have to amend the objects of the issue to include potential redemption of debentures or for safety net commitments," Savla added.

Bankers said if retail investors are provided free insurance from potential loss, the premium cost, which can be fairly high, will ultimately have to be borne by the issuer company which, in turn, will affect its shareholders- both existing as well as the IPO investors who are being covered. This mechanism needs to be viewed in the context of the government's move to allow listing by Indian companies in overseas markets. Issuer companies may be tempted to seek overseas options considering the constraints and total cost of listing in India, investment bankers said.