

# Book building



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**Study & analyze the concept of Reverse Book building, implications. Along with examples of past & current issues**

### **MEANING OF BOOK BUILDING**

Book Building is essentially a process used by companies raising capital through Public Offerings-both Initial Public Offers (IPOs) and Follow-on Public Offers (FPOs) to aid price and demand discovery. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer. The process is directed towards both the institutional as well as the retail investors. The issue price is determined after the bid closure based on the demand generated in the process.

#### **The Process:**

- \* The Issuer who is planning an offer nominates lead merchant banker(s) as ‘book runners’.
- \* The Issuer specifies the number of securities to be issued and the price band for the bids.
- \* The Issuer also appoints syndicate members with whom orders are to be placed by the investors.
- \* The syndicate members input the orders into an ‘electronic book’. This process is called ‘bidding’ and is similar to open auction.
- \* The book normally remains open for a period of 5 days.
- \* Bids have to be entered within the specified price band.
- \* Bids can be revised by the bidders before the book closes.

- \* On the close of the book building period, the book runners evaluate the bids on the basis of the demand at various price levels.
- \* The book runners and the Issuer decide the final price at which the securities shall be issued.
- \* Generally, the number of shares is fixed; the issue size gets frozen based on the final price per share.
- \* Allocation of securities is made to the successful bidders. The rest get refund orders.

### **Guidelines for Book Building**

Rules governing Book building are covered in Chapter XI of the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines 2000.

### **BSE's Book Building System**

- \* BSE offers a book building platform through the Book Building software that runs on the BSE Private network.
- \* This system is one of the largest electronic book building networks in the world, spanning over 350 Indian cities through over 7000 Trader Work Stations via leased lines, VSATs and Campus LANS.
- \* The software is operated by book-runners of the issue and by the syndicate members, for electronically placing the bids on line real-time for the entire bidding period.

\* In order to provide transparency, the system provides visual graphs displaying price v/s quantity on the BSE website as well as all BSE terminals.

### **What is reverse book building in simple terms?**

Reverse book building gives the seller a right to decide the price at which he wishes to exit, and the buyer, the option to decide whether he wants to accept or reject the same. The acquirer would determine the average price of 26 weeks before the date of announcement of public announcement, and the shareholders are allowed to tender at/ or above this floor price. The process of price discovery is undertaken as in normal book building process, and the cut off price /final price is the one at which maximum shares are tendered. If the acquirer accepts the price, the shares are tendered to all those who have bid lower than that, and if the acquirer rejects the price, then the shares are returned to the shareholders

### **More about reverse book building?**

#### **About Reverse Book building**

Securities and Exchange Board of India has issued the SEBI (Delisting of Securities) Guidelines 2003 for delisting of shares from stock exchanges which provide the overall framework for voluntary delisting by a promoter or acquirer through a process referred to as Reverse Book Building.

The promoter or acquirer shall appoint trading members for placing bids on the online electronic system. Investors may approach trading members for placing offers on the on-line electronic system. The shareholders desirous of availing the exit opportunity shall deposit the shares offered with the trading members prior to placement of orders. Alternately, they may mark a pledge for the same to the trading member.

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The final offer price shall be determined as the price at which the maximum number of shares has been offered. The promoter / acquirer shall have the choice to accept the price. If the price is accepted, the acquirer shall be required to accept all offers up to and including the final price. If the quantity eligible for acquiring securities at the final price offered does not result in public shareholding falling below the required level of public holding for continuous listing, the company shall remain listed.

At the end of the book building period, the merchant banker to the book building exercise shall announce the final price and the acceptance (or not) of the price by the promoter / acquirer.

### **Difference between book building and reverse book building**

Book building process is the process of securing the optimum price for a company's share. The issuing company decides the price of the security by asking investors how many shares and at what price they would be interested in an initial public offering (IPO) or divestment of company.

SEBI guidelines, 1995 defines Book building as “ a process undertaken by which a demand for the securities proposed to be issued by a body corporate is elicited and built-up and the price for such securities is assessed for the determination Of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memoranda or offer document.” Book building process is common practice used in most Developed countries for marketing public offer of equity shares of a company. However, Book building acts as scientific as well as flexible price discovery method through which consensus price of IPOs May be determined

by the issuer company along with the Book Running Lead Manager (i. e. merchant banker) on the basis of feedback received from individual investors as well as most informed investors (Who are institutional and corporate investors like, UTI, LIC, GICI, FII, and Society)? The method helps to make a correct evaluation of company's potential and the price of its shares. To define, a merchant banker, according to SEBI (Merchant Bankers) Regulations, 1992 “ is a person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to

Securities as manager, consultant, adviser or rendering corporate advisory services in relation to Such issue management”. Merchant bankers render services to meet the needs of trade, industry and also investors by performing as intermediary, consultant and a liaison. Merchant banking is a service oriented industry specialising in investment and financial decision making, assisting in making corporate strategies, assessing capital needs and helping in procuring the equity and debt funds for corporate Sectors and ultimately helping in establishing favourable economic environment. The reverse book building is an efficient price discovery mechanism of de-listing of securities, which is provided for capturing the sell orders on online basis from the shareholders through respective BRLM? In the reverse book-building scenario, the acquirer or promoter of a company offers to get backshares from the shareholders. It's a mechanism where, during the period for which the reverse book building is open, offers are collected at various prices, which are above or equal to the floor price from the shareholders through trading members appointed by the acquirer or

promoter of a company. The reverse book building price (i. e. final price/ exist price) is determined by BRLM in consultation with the acquirer promoters of the company after the offer closing date in accordance with the SEBI (De-listing of Securities) Guidelines, 2003.

### **Exit opportunity available for investors in case of De-listing.**

SEBI (De-listing of Securities) Guidelines, 2003 provide an exit mechanism, whereby the exit price for voluntary-listing of securities is determined by the promoter of the concerned company which desires to get de-listed, in accordance to book building process. The offer price has a floor price, which is fixed for de-listing of securities below which no offer can be accepted. The floor price is the average of 26 weeks traded price quoted on the stock exchange where the shares of the company are most frequently Traded preceding 26 weeks from the date of public announcement is made. There is no ceiling on the maximum price. In case of infrequently traded securities, the offer price calculated as per Regulation 20 (5) of SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997. For this purpose, infrequently traded securities are determined in the manner as provided in Regulation 20 (5) of SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997. The Company does not have to provide exit offer to those shareholders whose securities continues to be listed on the BSE / NSE having nationwide trading terminals because shareholders can exit any time they decide to so by way of selling shares in NSE/BSE.

### **De-listing process through ‘ Reverse book building’**

It is now felt that the reverse book-building process would provide the transparent and fair mechanism to determine an exit price for de-listing of

securities and would ensure investors' participation in the whole de-listing process. Rational investors are supposed to quote the reasonable premium in the book building.

The main parties who are directly associated with de-listing of securities through reverse book building method are the acquirer/ promoter of company, the BRLM, the trading members and existing shareholders of the company. The style of process, which is usually followed in the reverse book building mechanism in accordance with the SEBI (De-listing of Securities) Guidelines, 2003 can be summarised below:

(i) the book building processes to be made through an electronically linked transparent facility.

(ii) The number of bidding centres should not be less than thirty, including all stock exchange centres and There must be at least one electronically linked computer terminal at all bidding centres.

(iii) 100 per cent of the estimated amount of consideration calculated on the basis of the floor price indicated And the number of securities required to be acquired should be deposited by the promoter in an escrow account.

[Escrow account is the trust account established by a broker/ promoter / others under the provisions of the License law for the purpose of holding funds on behalf of the broker's principal or some other person until the consummation or termination of a transaction.] The provisions of clause 10 of the SEBI (Buyback of Securities) Regulations, 1998 shall be applicable mutatis mutandis to such escrow account.



(iv) The offer to buy shall remain open to the security holders for a minimum period of 3 days. The security Holders shall have a right to revise their bids before the closing of the bidding.

(v) The promoter or acquirer shall appoint ' trading members' for placing bison the on-line electronic System.

(vi) Investors may approach trading members for placing offers on the on-line electronic system. The Format of the offer form and the details that it must contain shall be specified.

(vii) The security holders desirous of availing the exit opportunity shall deposit the shares offered with the trading members prior to placement of orders. Alternately they may mark pledge for the same to the Trading member. The trading members in turn may place these securities.

### **Criticism on Reverse Book**

#### **Building Method**

It should not be acceptable blindly with the SEBI's guidelines relating to offer price /floor price (which is calculated on the basis of the average of 26 weeks traded price quoted on the stock exchange) for an open offer for de-listing incise of frequently traded securities while the reverse book building method adopted for determination of an exit price for de-listing of securities also suffers from certain limitations. Therefore, the objections and criticisms against-listing procedure can be summed up as under: 3 under depressed market conditions, the floor price arrived on the basis of SEBI prescribed principle does not adequately compensate the shareholder for the permanent loss of investment opportunity, especially in a company whose

shares are regarded as value investment. 3 Though the investors would not have reason to complain that the exit price is unfair to them as they themselves arrived at the price through a participative process, unlike in an IPO which is open to the general public, reverse book building process operating in a restricted audience, raises doubts about the efficacy of the concept in a limited universe; and hence makes the process prone to manipulation. 3 Any open offer for delisting should indicate the price that the buyer is willing to pay. The requirement in case of reverse book building requires generating offers from the sellers (existing shareholders) who have no indication of the buyer's intention, or the price that the buyer is willing to pay for the strategic value of the company. The only indication is the floor price. 3 this asymmetry of information places the shareholders At a distinct disadvantage, which may cause them to peg their offer at low price, particularly in weak markets? If the price quoted by the shareholders is low, then the offer would go through, but there is a distinct possibility that the investor would not have got as high a price as the buyer was willing to pay, which works against the shareholders' interest. 3 A few shareholders who do not have the motivation to offer their shares can derail the process through manipulative bidding at unrealistically high prices. 3 Further, thoes builds in conditionality as regards the price as well as the occurrence of the transaction itself. There is no guarantee that the buyer/ acquire will accept the book built price, in which case the deal falls through, thus depriving shareholders who would have otherwise exited at reasonable offer price. Therefore, it questionable that whether a reverse book building process will bring about a more efficient price discovery to ensure the investors in having a fair exit price. It is fact that listing and de-listing are commercial decisions

and should be based on business considerations. So long as de-listing has the approval of the shareholders and the minority shareholders are adequately compensated; there cannot be any objection to de-listing.

Investors' interest would therefore be better served if the available safeguards in the case of de-listing are further strengthened and the exit pricing is fair, transparent and not detrimental to the investors' interest.

### **Types of Delisting:**

Compulsory delisting refers to the permanent removal of securities of a listed company from a stock exchange as a penalty Measure at the command of the stock exchange. The violations maybe:

- Non-compliance with the listing agreement for a period of 6 months,
- Failure to maintain the minimum trading level at the exchange,
- Promoters' Directors' track record especially with regard to insider trading, manipulation of share prices, unfair market Practices, etc,
- When the company becomes sick and is unable to meet current debt obligations.

The promoters need to compensate the shareholders of the company by purchasing the shares at its fair value, subject to their Option to remain as shareholders with the company. The stock exchanges allow trading for a period of one year after delisting.

Voluntary delisting occurs when a listed company decides solely to remove its securities from the stock exchange, provided that the shares are listed for

3 years on any stock exchange. This happens mainly due to the Mergers&Acquisitions, or the non-performance

Of the shares on the exchange or if the promoters voluntarily want to be delisted. In these cases, the companies need to get prior approval from the shareholders of the company and appoint a merchant banker to look after the proceedings.

After this, the company should make a public announcement as per the guidelines and then make an application to the delisting agency. Also they need to comply with the additional conditions as per the stock exchange.

Regulatory view: The exit price for voluntary delisting of securities is determined by the promoter/acquirer of the concerned Company in accordance to the reverse book-building process. SEBI under the delisting of securities guidelines-2003 proposed Guidelines to the company for the exit price, whereby,

- In case of voluntary delisting, the offer price has a floor price, which is the average of 26 weeks traded price and with no Ceiling on the maximum price. The acquirer is required to allow a further period of 6 months for any of the remaining Shareholders to tender securities at the same exit price.

- In case of compulsory delisting, it is not mandatory to provide an exit opportunity for the shareholders as the company can Continue to be listed in NSE/BSE for a maximum period of one year. If the promoter/acquirer is not satisfied with the proposed price discovered through reverse book building, than he would not apply for delisting. However, he should ensure that the

public shareholding is brought up to the minimum limits specified Under the listing conditions within a period of 6 months from the date of such decision by issue of new shares, or making an Offer for sale of his holding, or by selling his holdings in the secondary market.

### **IMPLICATIONS OF REVERSE BOOK BUILDING**

For the uninitiated, delisting is a procedure via which a company's shares are removed from the stock exchange. As a result, the trading in the company's shares is stopped on that stock exchange. There are two circumstances under which a company goes for delisting. First, when a company fails to comply with various requirements of the stock exchange. As a measure of punishment then the company's shares can be removed from the SE. The process is known as compulsory delisting. In the other case, which is voluntary delisting, a company willingly decides to remove its shares from the stock exchange.

In case a company in which you hold shares gets delisted, you have two options. Either you can hold on the shares and wait for relisting or exit the shares when the company gives an offer price to buyback before delisting from the stock exchange. As per Securities & Exchange Board of India (Sebi) (delisting of securities) guidelines 2003, promoters have to purchase shares from the investors within one year of passing the resolution for delisting of the entity.

#### **Exit mechanism**

Once the company passes the resolution, the market regulator appoints an independent valuer who fixes the fair value of the delisted shares. “ This exit price is based on the average of the preceding 26-week high and low prices.

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It is in accordance with the book-building process,” explains Alex Mathew, head of research, Geojit BNP Paribas Financial Services. The company promoters subsequently acquire the delisted shares from the public shareholders by paying this fair value. Promoters can, however, pay a higher price for the share if they wish so. The fair value is the minimum price they have to pay to the shareholders.

Even post the delisting offer closing, the window for delisting is usually open for another six months. “ This allows remaining shareholders to tender securities at the same price. Post the six-month period, the investors can get in touch with the companies and normally the companies which have undergone delisting could be willing to acquire the shares,” says Shrikant Shetty, V-P and head of equity advisory at Unicon Wealth. However, where companies are suspended, there is not much option but to wait for its listing.

### **Home work**

As a shareholder, it is advisable to properly understand the tax implications as offering your shares under the reverse book building is considered an off-market transaction. Therefore, some home work must be done to see the potential of the company and its business.

“ Sometimes even if the company is delisted, you may get good returns on your investments in terms of dividends. Occasionally, promoters offer additional premium too to acquire balance shares from the public to minimise the investor base and reduce administration costs,” says Devesh Kumar, managing director of Centrum Broking.

Earlier this year, Kirloskar Systems, Apeejay Tea and Philips India had offered their residual shareholders lucrative exit options to buy back shares from them. However, these are exceptional cases and ideally it is better not to hold on the shares which are getting delisted.

As far as your rights as a shareholder is concerned, they stay the same as when the company's shares were listed on the exchange. As a shareholder, you are eligible to receive annual reports, dividends, bonus and attend annual general meetings. In case of non-receipt of information from the company, you can access information available on the website of ministry of corporate affairs on payment of a nominal fees.

## **ANALYSIS**

Liberalization requires de- and re-regulation, since with internationalization government controls become ineffective, and with the use of new technologies new governance structures are required. The functioning of the reformed Indian regulatory structure is examined in the context of the basic principles of regulation, the special regulatory requirements of capital markets, and the features of Indian markets. The regulator's aim was to achieve international best practices, and encourage market -integrity through clear and self-enforcing rules of the game while encouraging the game itself. It contributed to implementing world-class technology and processes in the markets. Following general principles allowed flexible response to arbitrage and change. Insider groups lost power as the liquidity advantage tipped in favour of automated systems, but there were imperfections in implementation due to design inadequacies. As these are

addressed, and markets revive with growth, thinness of participation and in depth of securities may be overcome.

### **PAST ISSUE REGARDING THE EFFECT OF REVERSE BOOK BUILDING**

After its aborted attempt in September to consolidate stake in the Indian subsidiaries, London Stock Exchange-listed Vedanta Resources on Thursday made an offer to buy back the remaining shares of Madras Aluminium Ltd (Malco), thereby paving the way for its delisting from the Bombay Stock Exchange.

Mauritius-based Twin Star Holdings, a Vedanta subsidiary, has made a buy back offer at a maximum price of Rs 105 a share, for up to 22.5 million fully paid equity shares of Malco, representing 20 per cent of the outstanding issued share capital. The offer tender will be open from March 17 to 20.

The minimum floor price for the reverse book-building process has been set at Rs 74.77 a share.

NRI billionaire Anil Agarwal-controlled Vedanta currently owns 80 per cent in Malco, which has an annual production capacity of 40,000 tonnes. If the buyback offer sails through, Vedanta's ownership in other group companies will also increase. Subsequently, its holding in Sterlite Industries will go up to 64.5 per cent from 63.6 per cent, Hindustan Zinc to 41.9 per cent from 41.3 per cent, Bharat Aluminium to 32.9 per cent from 32.4 per cent, Vedanta Aluminium to 89.5 per cent from 89.3 per cent and Sterlite Energy to 64.5 per cent from 63.6 per cent, said an analyst.



**Blue Dart – Delisting offer: Avoid****Nath Balakrishnan**

With prospects in the logistics space looking promising, we believe shareholders should be in no rush to move out of the Blue Dart, one of the sector's better plays.

Shareholders of Blue Dart Express (BDE) need not participate in the delisting offer announced by DHL Singapore Private Limited (the acquirer). The floor price is Rs 510. 94 and the acquirer is willing to offer up to Rs 550 per share to mop up Blue Dart's residual shareholding.

With the stock trading at a 10 per cent premium to the offer price and prospects in the logistics space, in which BDE is a key player, appearing bright, shareholders would be better off giving the offer a skip.

We have been confident about Blue Dart's prospects, against the backdrop of robust economic growth, a leading indicator of trends in cargo traffic. With a network spanning both surface and air transport, Blue Dart, in our view, is best positioned to take advantage of the strong demand.

Blue Dart continues to make investments to bolster its offerings, as is borne out by its recent acquisition of two freighter aircraft in June. In the latest quarter-ended September, revenue growth at close to 30 per cent remained strong, though earnings were disappointing on the back of an almost 50 per cent jump in freight and handling charges associated with the new acquisition.

The fall in the prices of crude oil and the cooling-off effect it has had on air turbine fuel charges should also benefit Blue Dart. We expect traction on the earnings front in the quarters to follow.

### **The delisting procedure**

Delisting would take place through the reverse book-building route, which is similar to what is being followed in the case of initial public offerings. Blue Dart's shareholding pattern reveals that out of the 19 per cent of equity outstanding, about 65 per cent is held by mutual funds and private corporate bodies and the rest by individual and NRI shareholders.

Under the circumstances, we believe institutional investors will play a crucial role in determining the exit price, as they tend to bid more rationally. In this backdrop, we outline two scenarios; in either case, shareholders would not lose out on liquidity.

If the acquirer does accept the exit price determined through the book-building route and decides to delist the company (assuming the shares acquired go past the delisting threshold, which, in this case, is likely to be 90 per cent), the same exit price would also be applicable to other shareholders for six months.

Shareholders who bid higher than the exit price as well as those who refrained from participating in the offer initially could utilise this time window to exit the stock.

In the event of the acquirer failing to mop up an adequate number of shares to pursue the delisting option, the proposal would fail and Blue Dart would continue to remain a listed entity.

### **Offer details**

The acquirer is making an offer to buy out the remaining 45-lakh shares of Blue Dart and delist the company. DHL's initial stake of 68 per cent in Blue Dart went up to its current level of 81 per cent after its open offer in early 2005 was partially successful; this has, in turn, led to the delisting offer. Ambit Corporate Finance is the manager to the offer, which opens tomorrow and closes on November 8.

### **DOES DE LISTING OF SATYAM HAVE ANY EFFECT ON STOCK MARKET?**

YES, simple analysis on how it would affect various relationships like company-shareholders, share markets, balance sheet s/ analysis, public-private companies, foreign investors, mergers, employees, clients, lenders and finally Satyam itself. So off we go...

Satyam was listed in BSE, NSE, and NASDAQ; so surely, the score of armchair entrepreneurs who rely on the books to place their bets would surely be affected. Since books are their only means to analyze a company. However, it is the share market, which affects such companies and not the vice versa. So, accept for the share price of Satyam this should not affect the share market

### **Does this mean that we can't rely on the balance sheet s anymore?**

Well, book building is not as new a phenomenon as newspapers would have us believe. It has always been the public company's bane that it never

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reflects its true worth on paper. No public company will show an accurate account of what it's worth. It is like a movie heroine who would always present a larger than life. Since, we do not complain about a movie heroine till she's caught in her own web, similarly we would only criticize the company which over hinges or over leverages its worth. Usually, these company's skeletons tumble out after persistent market downturns. So in no way are such company's responsible for the downturns. So go on and rely on the balance sheets, but watch out for companies that regularly and consistently over perform, without having any special USP/ innovative products to justify the same.

### **WOULD IT AFFECT THE INDIAN SOFTWARE INDUSTRY?**

For the answer to this there are various viewpoints which are discussed as follows...

#### **Employee POV:**

Well employee morale surely goes down and this would reflect in their work. The competitors' employees' salaries also would get squeezed because of (a) excess manpower availability and (b) perception that the company's margins are lower than what is shown. Finally, the IT profession, currently highly valued by public would go lower as some other careers come back in reckoning (is the marriage market listening?).

#### **Investor POV:**

Well from the investor POV (point-of-view) surely it would mean a temporary slowdown on Buying and Mergers. However, anyway, investors scrutinize such companies very thoroughly and would usually spot the fudging. Neutral.

**Client POV:**

From Client/ customer's POV, it should not affect since the company did not shortchange it's customers. However, some large project customers may be cautious about the continuity of the company. However, since a company is an Entity on it's own. Hence it should survive this. Thumbs Up.

**Lender POV:**

It indeed is a troublesome thought that the company seems to be totally bankrupt. Which would mean, that it could get cash strapped enough, to be unable to pay the salaries in the short term. But if it manages this phase it can pull back, since it is not a product or a core-industry company but a services company. And services companies don't have any heavy incubation periods. Or in other words there is no product life cycle it can get caught in. However, because of the same reasons the margins are usually low, since their assets keep getting revalued at current prices (salaries keep getting revised to suck any extra profits). Some people may disagree with this – but the truth is that if the salaries of the staff are not revised the top-management revises theirs, so rarely would you find extra cash with such companies.

**Conclusion**

In the current liberalised environment and in a market driven economy, entry and exit into and from the market should be free subject to the regulatory framework. Artificial barriers to free exit to companies could ultimately prove to be entry barriers. It would be desirable therefore not to make any provision in the regulatory framework that may act as an exit barrier.

Internationally, stock exchanges do not impose any restriction on de-listing

and allowed-listing subject to certain conditions such as minimum notice period for the company, exit offers to investors, etc. There is no denying the fact that de-listing, especially of companies whose shares are regarded as value investments by investors narrows the securities market,

Which in turn limits the choice for investors and ultimately reduce the liquidity as well as mobility of investment?

## **BIBLIOGRAPHY**

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