Pricing Guidelines Under FEMA

Presentation

By

CA Anil Sharma

Introduction

- Section 6(2A) read with Section 46 (2)(ab) of FEMA, 1999
  - **Foreign Investment in India**
    - FEM (Non-debt Instruments) Rules, 2019.

- Section 6(2)(a) read with Section 46(2)(aa) and 47(2)(a) of FEMA
  - **Overseas Investment**
    - FEM (Overseas Investment) Rules, 2022.
    - FEM (Overseas Investment) Regulations, 2022
    - FEM (Overseas Investment) Directions, 2022.

Foreign Investment- Definitions

- Foreign Investment
- Foreign Direct Investment
- Foreign Portfolio Investment
- Capital Instruments

Capital Instruments- Definition

- ‘Capital Instruments’ means :
  - Equity shares issued in accordance with the provisions of the Companies Act, 2013 shall include equity shares that have been partly paid;
  - Fully, compulsorily and mandatorily convertible debentures;
  - Fully, compulsorily and mandatorily convertible preference shares; and
  - Share Warrants issued by an Indian Company in accordance with the Regulations issued by the Securities and Exchange Board of India.

Pricing guidelines for Issue of Capital Instruments

- Capital Instruments issued by listed companies:
  - Public Issue
  - Right Issue
  - Preferential Issue
    - Frequently traded
    - Infrequently traded
- Capital Instruments issued by unlisted companies.

Issue Price of Capital Instrument- Listed Company

- The price of capital instruments issued to a person resident outside India shall not be less than the price worked out in accordance with the relevant SEBI Guidelines.

- Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) regulations, 2009.

SEBI Guidelines for Issue Price of Capital Instruments

Public Issue:

An issuer may determine the price of specified securities in consultation with the lead merchant banker or through the book building process.

Right Issue:

The issue price shall be determined in consultation with the designated stock exchange.

SEBI Guidelines for Issue Price of Capital Instruments Preferential Issue- Frequently traded

- If the equity shares of the issuer have been listed on a recognised stock exchange(RSE) for a period of twenty six weeks or more as on the relevant date- the allotment to be made at a price not less than higher of the following:
    - The average of the weekly high and low of the volume weighted average price of the related equity shares quoted on the RSE during the twenty six weeks preceding the relevant date; or
    - The average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a RSE during the two weeks preceding the relevant date.
- In other cases the equity shares shall be allotted at a price not less than the higher of the following:
    - the price at which equity shares were issued by the issuer in its initial public offer or the value per share arrived at in a scheme of arrangement the Companies Act, pursuant to which the equity shares of the issuer were listed, as the case may be; or
    - the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on the RSE during the period shares have been listed preceding the relevant date; or
    - the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a RSE during the two weeks preceding the relevant date.

SEBI Guidelines for Issue Price of Capital Instruments Preferential Issue- Infrequently traded shares

- The price determined by the issuer shall take into account valuation parameters including book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies:
- Provided that the issuer shall submit a certificate to the stock exchange where the equity shares of the issuer are listed stating that the issuer is in compliance of this regulation, obtained from an independent merchant banker or an independent chartered accountant in practice having a minimum experience of ten years.

Issue Price of Capital Instruments- Unlisted Company

- In case of an unlisted Indian Company, unless otherwise specified in these Regulations or the relevant Schedules, the price of capital instruments of an Indian company issued by such company to a person resident outside India shall not be less than:
  - the valuation of capital instruments done as per any **internationally accepted pricing methodology** for valuation on an arm's length basis
    - duly certified by a Chartered Accountant or
    - a Securities and Exchange Board of India registered Merchant Banker or
    - a practicing Cost Accountant.

Internationally Accepted Pricing Methodology for Valuation

- Asset Based Approach
  - Net Assets Value (NAV) Method.
  - Price to Book (P/B) Multiple Method.
- Earning Based Approach
  - Price Earnings Capitalisation Value (PECV) Method.
  - Enterprise Value(EV)/ EBITDA Multiple - (CCM) Method.
  - Discounted Cash Flow (DCF) Method.
- Market Based Approach
  - Market Price Method.

- Other factors :
  - Control premium,
  - Minority discount
  - Judicial pronouncements

Issue price of convertible capital instruments

- in case of convertible capital instruments, the price/ conversion formula of the instrument should be determined upfront at the time of issue of the instrument.
- The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with these Regulations.

Acquisition through a rights issue or a bonus issue

- A person resident outside India and having investment in an Indian company may make investment in capital instruments (other than share warrants) issued by such company as a rights issue or a bonus issue provided that:
  - The offer made by the Indian company is in compliance with the provisions of the Companies Act, 2013;
  - Such issue shall not result in a breach of the sectoral cap applicable to the company;
  - Such investment made through rights issue or bonus issue shall be subject to the conditions as are applicable at the time of such issue.
- In case of a listed Indian company, the rights issue to persons resident outside India shall be at a price determined by the company;
- In case of an unlisted Indian company, the rights issue to persons resident outside India shall not be at a price less than the price offered to persons resident in India.

Pricing guidelines for transfer of Capital Instruments

- Capital instruments of a listed Indian company
  - Transfer by a resident to a person resident outside India
  - Transfer by a person resident outside India to a resident

- Capital instruments od a unlisted Indian company
  - Transfer by a resident to a person resident outside India
  - Transfer by a person resident outside India to a resident

Transfer of capital instruments of an Indian listed company by a resident to a person resident outside India

- the price of capital instruments of an Indian company transferred from a person resident in India to a person resident outside India **shall not be less than:**
  - the price worked out in accordance with the relevant Securities and Exchange Board of India guidelines in case of a listed Indian company;
  - the price at which a preferential allotment of shares can be made under the Securities and Exchange Board of India Guidelines, as applicable, in case of a listed Indian company or in case of a company going through a delisting process as per the Securities and Exchange Board of India (Delisting of Equity Shares) regulations, 2009;

Valuation of Capital instrument for transfer by a person resident outside India to a resident- listed company

- transferred by a person resident outside India to a person resident in India shall not exceed:

  - the price worked out in accordance with the relevant Securities and Exchange Board of India guidelines in case of a listed Indian company;

  - the price at which a preferential allotment of shares can be made under the Securities and Exchange Board of India Guidelines, as applicable, in case of a listed Indian company or in case of a company going through a delisting process as per the Securities and Exchange Board of India (Delisting of Equity Shares) regulations, 2009;

Transfer of capital instruments of an Indian unlisted company by a resident to a person resident outside India

- the price of capital instruments of an Indian company transferred from a person resident in India to a person resident outside India **shall not be less than**:
  - the valuation of capital instruments done as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by
  - a Chartered Accountant or
  - a Securities and Exchange Board of India registered Merchant Banker or
  - a practicing Cost Accountant.

Valuation of Capital instrument for transfer by a person resident outside India to a resident- Unlisted company

- transferred by a person resident outside India to a person resident in India shall not exceed:
    - the valuation of capital instruments done as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by
        - a Chartered Accountant or
        - a Securities and Exchange Board of India registered Merchant Banker or
        - a practicing Cost Accountant.

Valuation in case of swap of Capital instruments

- in case of swap of capital instruments, subject to the condition that irrespective of the amount, valuation involved in the swap arrangement will have to be made by a Merchant Banker registered with Securities and Exchange Board of India or an Investment Banker outside India registered with the appropriate regulatory authority in the host country.

Valuation of share warrants

- in case of share warrants, their pricing and the price/ conversion formula shall be determined upfront.

Valuation of Capital instrument for transfer by a person resident outside India to a resident- Conditions

- The guiding principle would be that the person resident outside India is not guaranteed any assured exit price at the time of making such investment/ agreement and shall exit at the price prevailing at the time of exit.
- where shares in an Indian company are issued to a person resident outside India in compliance with the provisions of the Companies Act, 2013, by way of subscription to Memorandum of Association, such investments shall be made at face value subject to entry route and sectoral caps.
- These pricing guidelines shall not be applicable for investment in capital instruments by a person resident outside India on non-repatriation basis.

Overseas Investment by a person resident in India

- Overseas Investment.
- financial commitment.
- Overseas Direct Investment.
- Overseas Portfolio Investment.

Overseas Direct Investment (ODI)

- "ODI" means
  - investment by way of acquisition of unlisted equity capital of a foreign entity, or
  - subscription as a part of the memorandum of association of a foreign entity, or
  - investment in ten per cent, or more of the paid-up equity capital of a listed foreign entity

  or
  - investment with control where investment is less than ten per cent of the paid-up equity capital of a listed foreign entity.

Pricing Guidelines for shares of a foreign entity

- Issue of share of a new company – through subscription
- Issue of shares of an existing company
  - When investment is more than $5Million
  - Other cases
- Transfer of shares of a foreign entity
  - By person resident outside India to person resident in India
  - By person resident in India to person resident in India
  - By person resident in India to person resident outside India
- Acquisition through swap
- Conversion of ADR/GDR

Basic Pricing guidelines

- (1) The issue or transfer of equity capital of a foreign entity from a person resident outside India or a person resident in India to a person resident in India who is eligible to make such investment or from a person resident in India to a person resident outside India shall be subject to a price arrived on an arm’s length basis.

- (2) The AD bank, before facilitating a transaction shall ensure compliance with arm’s length pricing taking into consideration the valuation as per any internationally accepted pricing methodology for valuation.

Valuation of shares of the foreign company

- For the purposes of investment, by way of remittance from India, in an existing company outside India, the valuation of shares of the company outside India shall be made:
  - where the investment is more than USD 5 million, by
    - a Category I Merchant Banker Registered with Securities and Exchange Board of India (SEBI), or
    - an Investment Banker/Merchant Banker outside India registered with the appropriate regulatory authority in the host country.
  - in all other cases, by a Chartered Accountant or a Certified Public Accountant.

Valuation of shares of the foreign company acquired through swap

- For the purposes of investment, by acquisition of shares of an existing company outside India, where the consideration is to be paid fully or partly by issue of the Indian party's shares, the valuation of shares of the company outside India shall in all cases, be carried out by
  - a Category I Merchant Banker registered with the Securities and Exchange Board of India (SEBI) or
  - an Investment Banker/Merchant Banker outside India registered with the appropriate regulatory authority in the host country.

Valuation of shares of the foreign company acquired against ADRs/GDRs

- An Indian Party may acquire shares of a foreign company, engaged in bonafide business activity, in exchange of ADRs/GDRs issued to the latter in accordance with the scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993, the valuation of the shares of the foreign company is made:
  - as per the recommendations of the Investment Banker if the shares are not listed on any stock exchange; or
  - based on the current market capitalization of the foreign company arrived at on the basis of monthly average price on any stock exchange abroad for the three months preceding the month in which the acquisition is committed and over and above, the premium, if any, as recommended by the Investment Banker in its due diligence report in other cases.

Transfer of shares of a foreign entity by an Indian entity to another Indian Entity

- An Indian party may transfer by way of sale to another Indian party, share or security held by him in a Joint Venture or Wholly Owned Subsidiary outside India **Provided that**
  - The sale does not result in any write-off of the investment made;
  - the sale is effected through a stock exchange where the shares of the overseas Joint Venture or Wholly Owned Subsidiary are listed;
  - if the shares are not listed on the stock exchange, and the shares are disinvested by a private arrangement, the share price is not less than the value certified by a Chartered Accountant /Certified Public Accountant as the fair value of the shares based on the latest audited financial statements of the Joint Venture or Wholly Owned Subsidiary.

Thank You.

Contract:
mobile: 9811320203
e-mail ID: anil54@gmail.com