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SEBI Consultation Paper on KPIs and Basis of IPO Price

Prompted in large part by the recent spurt in filings for initial public offerings ("**IPOs**") by new-age technology companies ("**NATCs**") that do not meet the prescribed three-year track record of operating profit, the Securities and Exchange Board of India ("**SEBI**") has examined the disclosure of non-traditional key performance indicators ("**KPIs**") in IPO documents in its consultation paper on "*Disclosures for 'Basis of Issue Price' section in offer document under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018*" issued on February 18, 2022 ("**Consultation Paper**"). The Consultation Paper, noting that NATCs "*generally remain loss making for a longer period before achieving break-even as these companies in their growth phase opt for gaining scale over profits*", has considered the significance of certain KPIs and their impact upon the valuation of issuer companies in IPOs. The Consultation Paper accordingly proposes additional disclosure requirements under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, as amended ("**SEBI ICDR Regulations**"), including in relation to KPIs, under the 'Basis of Issue Price' section in IPO-related offer documents.

Key Proposals and Analysis

KPI-related disclosures and requirements: Currently, the SEBI ICDR Regulations require disclosure of traditional parameters such as price to earnings ratio, earnings per share, return on net worth and net asset value under the 'Basis of Issue Price' section. The Consultation Paper proposes the following additional disclosure requirements in relation to "*material KPIs that have been shared with any pre-IPO investor at any point of time during the three years prior to IPO*":

- such KPIs should be described and defined clearly, consistently, and precisely, and should not be misleading;
- all such KPIs should be certified/audited by statutory auditors;
- an explanation of how such KPIs contribute to or form the basis for the issue price in the IPO should also be disclosed;
- comparison of KPIs with Indian listed peer companies and/or global listed peer companies (wherever available);
- comparison of KPIs and financial ratios over the preceding three[1] years and interim period, along with explanation; and
- cross-reference to a tabular disclosure on KPIs that the issuer company deems not relevant to the proposed IPO, with adequate explanation.

While the SEBI has permitted issuers to exclude KPIs that are not relevant from the 'Basis of Issue Price' section, since issuers will nevertheless be required to disclose such non-relevant KPIs and provide an explanation in relation thereto, issuer companies will have to undertake the onerous task of compiling all KPIs shared with pre-IPO investors. Further, in our experience, certain statutory auditors (particularly, the "Big 4" audit firms) have been unwilling/unable to certify/audit KPIs, which have hence typically been certified by independent chartered accountants. This proposal also goes against the grain of the recent amendments to the SEBI ICDR Regulations, pursuant to which restated financial statements and proforma financial statements disclosed in offer documents are now permitted to be certified by independent chartered accountants. Considering such amendments, requiring KPIs to be certified by the statutory auditors would be particularly cumbersome, and would add to the IPO cost incurred by issuer companies, which seems counter-intuitive to supporting accessing of capital markets by NATCs in India. Globally as well, in many jurisdictions such as the United States of America, KPIs disclosed in offer documents are only subject to management certification. In this respect however, we note that the Consultation Paper has specifically sought public comments on whether independent chartered accountants should be permitted to certify such KPIs

Since such KPIs may not be standardized and uniformly recorded by companies, it may not be meaningful and may even be misleading to provide comparison of KPIs with peer companies, even if such data were to be availabl

Furthermore, as noted by the SEBI in the Consultation Paper, it is questionable whether comparison with global peers would be appropriate as some of the KPIs would be relevant only to the company/economy in which the issuer company operates. The SEBI has however contemplated providing notes to explain any such differences between peers and the issuer company for such comparison.

Past issue/transfer price-related disclosures: In addition to KPIs, the Consultation Paper proposes disclosure of valuation of the issuer company based on: (i) secondary sales/acquisitions (excluding gifts); and (ii) primary issuances of equity shares/ convertible securities, during the 18 months prior to the date of filing of the draft red herring prospectus/red herring prospectus, equal to or more than 5% of the fully diluted[2] paid-up share capital of the issuer company (calculated on the pre-issue capital on the date of allotment/transfer), in a single transaction or a group of transactions in a short period of time ("**Prescribed Threshold**"). In this respect, the Consultation Paper proposes a tabular disclosure (in the format prescribed) of weighted average cost of acquisition ("**WACA**") of all primary issuances and all secondary transactions above the Prescribed Threshold during the preceding 18 months, along with detailed explanation for the floor price and cap price for the IPO compared against the WACA as calculated above. This requirement is similar to the recently introduced disclosure in abridged prospectuses of WACA for all transactions during the 18 months preceding the red herring prospectus, which in turn was preceded by the SEBI's November 2021 directive to the Association of Investment Bankers of India to disclose in the price band advertisement WACA for all transactions in shares during the one year and three year periods preceding the red herring prospectus. It is presently unclear whether any redundancy posed by such overlapping requirements will be done away with.

With respect to the Prescribed Threshold, it is unclear what would constitute a "short period of time" for evaluation of a group of transactions/issuances. Furthermore, while gifts have been excluded from the scope of calculation of WACA for secondary transactions, it is unclear whether bonus issuances and conversion of convertible securities (which in our experience typically meet the Prescribed Threshold) would be considered for the purposes of calculation of WACA for primary issuances.

Based on our recent experience, we also note that issuer companies with large and dispersed shareholder bases, where shareholding is in dematerialized form, would typically not have access to share price information in case of secondary transactions. In such instances, issuer companies would have to reach out to all persons that have transacted in their shares during the prescribed period and request price information, which may be practically difficult at best and unfeasible at worst, since there is no assurance that such persons will provide correct information in a timely manner.

Endnotes

1 Note that the Consultation Paper suggests a period of two years and the interim period, however, we presume this is a typographical error, and the prescribed period is three years and the interim period (consistent with the period for which financial statements are required to be disclosed)

2 Excluding employee stock options granted but not vested

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