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Vascon Engineering: Time to dig deeper

There has been a sudden and steep fall in the share price of Vascon Engineers Limited this week, after it announced cancellation of the Compulsory Convertible Debenture issue. It is imperative for SEBI to examine both the transaction and its cancellation.

Vascon Engineers Limited (VASCONEQ/533156) sought shareholder approval at an extra-ordinary general meeting on 24 May, for the preferential issue of convertible debentures on private placement basis. As with any preferential allotment, approvals were sought with specifics detailed in the shareholder notice (and the explanatory statement): number of debentures (1.1 mn 17% Compulsory Convertible Debentures of face value Rs.1,000 each) , conversion price (higher of Rs.45.60 per share, or the price determined based on the SEBI ICDR Regulation, 2009), aggregate issue size (Rs.1.1 bn), and importantly the investors to whom the issue was being made (Manan Finserve Private Limited – a part of the Mangal Prabhat Lodha group, and Vinca Rosea Farms and Properties LLP).

The deal was subject to shareholder approval, as specified in the notice:

"The allotment of CCDs shall be completed within a period of 15 days from the date of passing of the Resolution by the Shareholders provided where the allotment is pending on account of any approval from any Regulatory Authority/Body, the allotment shall be completed by the Company within a period of 15 days from the date of such approval."

The resolution received unequivocal support from all shareholders (Exhibit 1)

The placement had two things going for it. One it was an investment by a real estate savvy investor and two it gave the company the company the much-needed liquidity that it was wanting (- it had cited liquidity concerns to investors). The markets viewed this positively, till the company earlier this week (11 June) announced cancellation of the Compulsory Convertible Debenture issue, citing "differences between the company and the proposed investors". The share reacted and in two trading sessions moved down as much as 33%, with investors loosing around Rs 3000 million. In cancelling the issue, the Vascon management clearly short-changed its minority investors.

Exhibit 1: Voting outcome on resolution for preferential issue

Promoter/Public	No. of shares held	No. of votes polled	% of Votes Polled	No. of votes in favour	No. of votes against	% of votes in favour	% of votes in against
Promoter and Promoter Group	61,007,102	61,007,102	100.00	61,007,102	-	100.00	-
Institutional holders	785,940	-	-	-	-	-	-
Others	105,867,144	25,170,392	23.78	25,170,392	-	100.00	-
Total	167,660,186	86,177,494	51.40	86,177,494	-	100.00	-

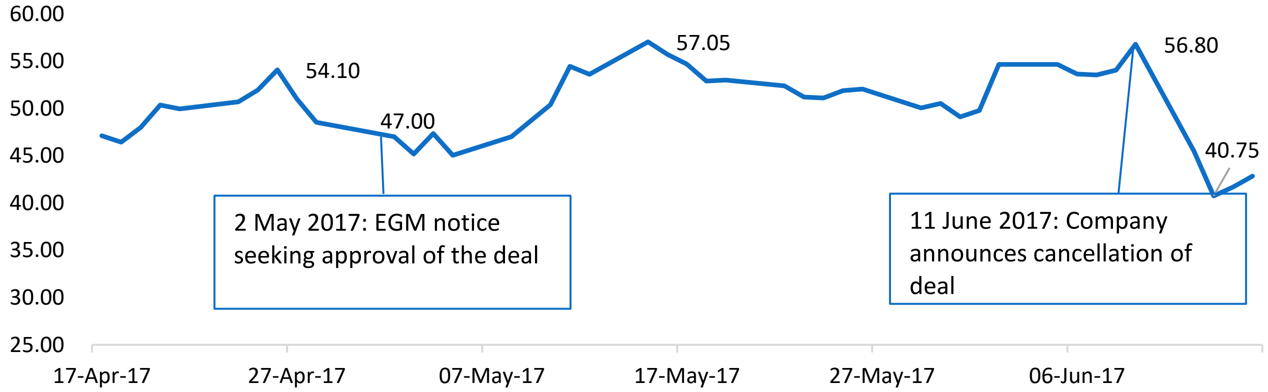
Source: Company filings, IiASAdrian

Is the Board within its right to cancel the transaction?

A preferential issue in a listed company, once agreed upon between a company and the investor, is only subject to shareholder approval (- and stock exchanges confirming that they will list). Once shareholders have accepted the offer, the consideration has to be received.

But the company and the investors in this instance, do not see it this way. A day after the deal was annulled, the company clarified in a conference call with investors (on 12 June), that this was on account of "differences pertaining to strategy on real estate developments and unlocking value of certain assets."

Exhibit 2: Share Price movement last 60 days



Source: BSE

Preferential shares have to be allotted within 15 days. The Vascon management or its board can at best tinker with the terms, they cannot cancel the transaction as they have an obligation to fulfil terms for which it sought shareholder approval. If an investor has decided to back down, the company needs to pursue legal remedy. It cannot say the management and the investor are in agreement and the company will not to go ahead with the allotment.

An alternate explanation

There is an explanation for the developments, including the company readily agreeing to the termination of the agreement, which *prima-facie* fits the events. But this needs enquiry, because if true, has grave consequences for the company and the investors in the placement.

This account avers that this was a strategic investor, with change in control, in the garb of a financial investment. This explains the company readily agreeing to the deal being called off on account "differences between the company and the proposed investors." It also explains another unusual development: even as the Lodha group was negotiating a financial investment in Vascon, members from Lodha's senior team were joining Vascon. Amit Parsuramka President Sales, Lodha and Rajesh Mahatre, another senior employee of Lodha, both moved to Vascon.

In this context, it will also be good for shareholders to understand what changed in the company's strategy between the time the company reached an agreement with its investors and approached its shareholders and received their consent. Or did the investors find out something, that is not known to the (minority) shareholders of Vascon?

Some unanswered questions

SEBI needs to look at this matter very carefully. It needs to ask:

1. Was this a genuine transaction or was this a change of control in the guise of a financial transaction investor or was this a sham transaction with an eye on the market?
2. Did the due diligence reveal something that is not known to the (minority) shareholders of Vascon?
   SEBI needs to examine all relevant documents relating to the transaction, and the correspondence relating to the cancellation. It should also examine the share trading data.

SEBI needs to clarify:

3. What is a preferential issue? Is it only an intent or is it a contractually binding agreement from the investor subject only to approval from shareholders of the company and from stock exchanges for the listing of the securities.
4. Does the management have the authority to cancel a transaction which was subject only to approval by shareholders, and was duly approved by them? Conversely if a preferential issue has been approved by shareholders, can it then be cancelled by the company management without shareholder approval? If so, this will have consequences for the market.

Minority investors should not be expected to pay the price for such occurrences. Safeguards need to be built, penalties levied: Vascon's is the perfect transaction for SEBI to begin.

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Office

Institutional Investor Advisory Services
Ground Floor, DGP House,
88C Old Prabhadevi Road,
Mumbai - 400 025
India

Contact

solutions@iias.in
T: +91 22 6123 5509/ +91 22 6123 5555