

Guidance to Merchant Bankers for Preparation of Offer Documents – SME IPO

Introduction

This **Guidance Note** has been prepared to assist merchant bankers in the preparation and submission of offer documents for **SME Initial Public Offerings (IPOs)**. The process of launching an IPO is a critical step for small and medium enterprises (SMEs) seeking to raise capital from the public markets. To ensure transparency, regulatory compliance, and investor protection, it is imperative that the offer document contains complete and accurate disclosures.

The guidance provided herein outlines the key regulatory requirements, compliance standards, and best practices that merchant bankers must adhere to when preparing the offer documents. It aims to help ensure that the information presented to potential investors is clear, accurate, and sufficiently detailed, enabling them to make informed decisions. Additionally, the note emphasizes the importance of conducting thorough due diligence to verify the accuracy of the disclosures made by the issuer.

The document also highlights the critical role of the merchant banker in ensuring that the offer document complies with the provisions of the **SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (SEBI ICDR Regulations)**, as well as other applicable laws and regulations.

By following these guidelines, merchant bankers will be better equipped to navigate the complexities of the SME IPO process and help ensure a successful and compliant offering.

Key Points to Remember:

1. Disclosure Requirements (SEBI ICDR Regulations, 2018)

- **Schedule VI Compliance:** Ensure that all disclosures required under **Schedule VI** of the SEBI (ICDR) Regulations, 2018, are included in the offer document.
 - **Technical Terms:** Clearly define all technical terms and jargon used in the offer document in the "**Definitions and Abbreviations**" chapter.
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2. Compliance-Related Disclosures

- **Past Non-Compliance:**
If there has been any past non-compliance with the Companies Act, 2013, or other applicable laws, the following should be disclosed:

- Whether a compounding application has been filed with the Registrar of Companies (RoC) or other relevant authority for any non-compliance.
 - A statement explaining the reasons for the non-compliance and the corrective measures taken to prevent recurrence. This disclosure should be made in the "**Risk Factors**" section.
 - **Independent Directors:**
 - Ensure that the appointment of independent directors is in compliance with **Section 149(6)** of the Companies Act, 2013, and related rules.
 - Independent directors must be registered with the **Indian Institute of Corporate Affairs (IICA)**.
 - **Board Committees:**
 - Ensure that all statutory committees, including the **Audit Committee, Nomination & Remuneration Committee, and Stakeholder Relationship Committee**, comply with the relevant provisions of the Companies Act, 2013 in letter and spirit.
 - **Conversion from Partnership Firm:**

If the issuer was incorporated through the conversion of a partnership firm, the partnership must have been registered under the **Indian Partnership Act, 1932**.
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3. Key Disclosures Related to Business Operations

- **Separate Auditor Appointment:**

If a separate, peer-reviewed auditor (other than the statutory auditor) is appointed, this must be disclosed as a key risk factor.
- **Trade Receivables:**

If the issuer has substantial trade receivables, disclose the steps being taken to expedite the collection process.
- **Loan Repayment:**

If the proceeds from the IPO are intended for loan repayment, a **certificate from the statutory auditor** confirming the purpose and utilization of the loan should be included.
- **Use of Issue Proceeds of IPO in a subsidiary:**
 - Provide a clear breakdown of the specific purposes for which the funds raised from the IPO will be utilized (e.g., capital expenditure, investment in subsidiaries).

- Monitoring of proceeds of issue shall be continued until the issue proceeds is utilised by subsidiary of the given object of the issue and not merely on funding of IPO proceeds to the subsidiary.
 - **Related Party Transactions (RPT):**
 - Ensure that all related party transactions (RPTs) are conducted at arm's length.
 - Include the percentage of total RPTs and the risk factors associated with them in the "**Risk Factors**" section.
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4. Other Disclosures and Due Diligence:

- For any past fundraising activities, ensure the following are duly verified:
 - A **valuation report (if applicable)** justifying the allotment price.
 - **Bank account statements** showing the movement and utilization of funds, along with terms and conditions filed with the RoC.
 - A detailed evaluation of any **third-party vendors** (especially for capex), including their credentials in respect of capability and financial strength.
 - **Litigation Risk:**

If there are ongoing or potential litigations with amounts exceeding the net worth of the issuer, disclose the plan of action in case the litigation materializes.
 - **Changes in Auditors:**

If the issuer has experienced frequent changes in auditors, a justification should be provided, and it must be included in the "**Risk Factors**" section.
 - **Working Capital:**

Justify the working capital requirements based on the issuer's past financial performance and projected requirements.
 - **Financial Performance:**

Provide clear explanations for any significant changes in financial metrics such as **Profit After Tax (PAT)**, **inventories**, and **receivables** over the past three years.
 - **Net Worth & Leverage:**

Ensure that the calculations for **Net Worth**, **Net Tangible Assets**, and **Leverage Ratios** are accurate and in line with standard accounting practices.
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5. Return / Rejection of Draft Offer Document

In case the disclosures in the draft offer document are found to be inadequate or non-compliant with applicable regulations, the Exchange may return or reject the draft offer document. The merchant banker should refer to the Exchange's criteria for the return/rejection of draft offer documents, which is outlined in **Annexure A** attached to this guidance document.

6. Notes:

- The guidance is only indicative and is provided for a minimum standard of disclosures expected from the issuer and merchant banker
- Exchange may call for the backup documents with respect to the aforesaid disclosures in the offer document.
- The issuer and the merchant banker will always be guided by the ICDR Regulations and applicable law.
