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Analysis

Deciphering NCLT's order allowing recapitalisation of promoters Capital

Dipti Mehta
Director

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Mehta & Mehta Legal and Advisory Services Private Limited

Address: 201-206, Shiv Smriti Chambers, 2nd Floor, Dr. Annie Besant Road, Above Corporation Bank, Worli, Mumbai – 400018

CIN: U74140MH2006PTC163236

Phone: +91-22-6611-9696

Email: info@mehta-mehta.com

Website: www.mehta-mehtaadvisory.com

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Background

For the first time in the annals of corporate history of India, the capital of a company is re-capitalised by cancelling the shares of a promoter group and then re-issue of new shares to the same promoter on preferential basis. In the extant case, the promoters were ready to right the wrongs done on the part of the management of the company thereby said that they are ready to infuse necessary funds into the company. The NCLT, on August 24, 2016, in the matter of Ricoh India Limited had passed the aforestated order.

The case will be always be remembered and act as a benchmark in the realms of corporate governance for two reasons:

- Importance of rotation of auditors after a maximum period of 10 years;
- Cancellation of shares of promoters and then re-issue of shares on preferential basis.

In this article we intend to analyse the probe of both the aforestated facts.

About the Company

Ricoh India Limited was incorporated as in 1993. Further, it was redesigned in 1998 as Ricoh India Ltd with about 75% ownership by Ricoh Company Limited, Japan, and the rest by Indian Public. Ricoh, starting its business in 1936, is a global technology company specializing in office imaging equipment, production print solutions, document management systems and IT services. Headquartered in Tokyo, Ricoh Group operates in about 200 countries and regions. In the financial year ending March 2015, Ricoh Group had worldwide sales of 2,231 billion yen (approx. 18.5 billion USD).

What

The matter that forms the crux of the matter is the fact that appointment of new auditor has paved way new realms of the importance of the new concept. The new auditor's observations lead to outside investigation conducted by the company to know that exact details and quantum upto which the books of account of the company were falsified. Also, due to the disability of the company to file its quarterly financial statements with the stock exchange lead to suspension of trading of shares of the company. The Key Managerial Personnel of the company sans the Company secretary were suspended.

When

Here is the timeline for the case:

September 24, 2015

The Company, in compliance with the provision of section 139 of the Companies Act, 2013; had appointed BSR & Co. LLP, Chartered Accountants as statutory auditors of the Company in place of retiring Sahni Natarajan and Bahl, Chartered Accountants who were acting as the statutory auditors of the company for past 15 years.

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Between September to November 2015

The statutory auditors as a part of limited review process for the above quarter raised various suspicions with respect to certain transactions between the company and its customers and vendors.

November 14, 2015

The statutory auditors met the Audit Committee and communicated their observations. To expedite the filing of the financial result with the Bombay Stock Exchange Limited ("BSE") in accordance with the Listing Regulations, the Audit Committee decided to engage the services of S.S. Kothari & Mehta, Chartered Accountants ("SSKM") to conduct another review of the financial statements on an agreed procedure basis.

February 02, 2016

SSKM submitted its report to the Audit Committee ("SSKM Report"). However, the statutory auditors did not agree to the scope of the agreed upon procedures. Because of this no progress was made.

Between February 02, 2016 to March 29, 2016

The Audit Committee to better understand certain areas decided to appoint Shardul Amarchand Mangaldas & Co., Advocates & Solicitors ("SAM") who in turn appointed PricewaterhouseCoopers Private Limited, India ("PwC") to conduct an independent investigation into the concerns raised by the statutory auditors.

March 29, 2016

The following key managerial personnel of the Company were sent on paid leave by the Board on 29 March 2016: Mr. Manoj Kumar, the Managing Director and Chief Executive Officer; Mr. Arvind Singhal, the Chief Financial Officer; and Mr. Anil Saini, the Senior Vice President and Chief Operating Officer.

On 2 April 2016, Mr. Manoj Kumar, MD & CEO, resigned from the board of directors.

Further, Mr. AT Rajan was appointed to discharge the functions of Chief Executive Officer and Chief Operating Officer while Mr. Bibek Chowdhury was entrusted with the functions of Chief Financial Officer of the Company.

All of the three aforesaid mentioned Officials of the Company were subsequently suspended by the Board of Directors of the Company on 8 June 2016.

April 20, 2016

PwC issued a 'Report on Preliminary Findings' ("Preliminary Report"). From Preliminary Report it was apparent that the concerns identified and the consequent falsification of the accounts comprised the following areas: Out of book adjustments; Revenue recognition issues; Suspect transactions and Personal type expenditure.

The Company made disclosures with BSE, The Securities & Exchange Board of India ("SEBI"), Ministry of Corporate Affairs ("MCA") and also filed a criminal complaint with the Delhi Police to investigate into the suspected wrongdoings.

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May 4, 2016

The Company was unable to file financial statements for the quarter and half year ended 30 September 2015 and for the quarter and nine months ended 31 December 2015. As a result on 4 May 2016, the Bombay Stock Exchange Limited (BSE) issued a notice that the shares of the Company would be suspended from 26 May 2016 on account of non compliance with Regulation 33 of SEBI (LODR) Regulations, 2015 for two consecutive quarters.

Further, the Company paid a penalty of Rs 18,86,593/- to BSE for non compliance with Regulation 33 of SEBI (LODR), 2015 on account of failure to file financials for two consecutive quarters i.e. September 2015 and 31st December 2015.

May 18, 2016

The Company published its financial results for the quarter and half year ended 30 September 2015 where the Board of Directors stated that the financial results did not represent a true and fair view of the state of affairs and the reasons thereof. The limited review report by statutory auditors was silent and did not give any opinion.

In between

With the quarter ended 30 September 2015 accounts only being finalised for filing in May 2016, and the inability of the Board to approve these accounts without significant caveats and concerns, the Company realized the need for a change in process. It was recognised that many of the matters identified in the Preliminary Report could best be addressed by a team with Ricoh specific knowledge, engaging PwC where appropriate, so that efficiency and effectiveness was achieved. It was therefore concluded that an internal investigation (staffed and led independently of Ricoh India Limited) could be used to complete certain of the activities.

The investigation with regard to the individual culpability of the alleged wrongdoers should be best left to regulatory authorities and the Company should focus on restoration of the economic value of the shareholders and producing reliable financial results.

Early June 2016

A team comprising various Ricoh group representatives, all of whom were independent of Ricoh India Limited, was established to continue the investigations alongside PwC.

July 19, 2016

The internal investigation team presented the estimated unaudited loss for the year ended 31 March 2016 of INR 11.23 billion to the Audit Committee. This estimated result was approved and filed with BSE.

Also, on the same day, its promoters, Ricoh Company Limited, filed a petition with NCLT seeking various reliefs. The promoters sought major relief in the form of re-capitalisation of shares of the company. This was due to the fact that the Promoter was willing to pay for all the losses caused by the company and its shareholders.

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August 24, 2016

NCLT issued an Order granting the cancellation of the shares of either Ricoh Company Limited, or the Co-Promoter NRG Group Limited, and the preferential issue of the same number of shares for an amount equivalent to the estimated unaudited loss announced on 19 July 2016 i.e. Rs.112,300 Lacs.

October 14, 2016

Extraordinary General Meeting held to approve re-capitalisation by way of cancellation of the shares of NRG Group Limited and preferential issue of the same number of shares to NRG Group Limited.

October 15, 2016

The board approved the cancellation, issue and allotment for the consideration of INR 11.23 billion.

November 17, 2016

PwC presented their final report ("the PwC Report") and the independent team presented their findings to the Audit Committee.

November 18, 2016

The results along with the auditor's report for the quarter ended 31 December 2015 and the quarter and year ended 31 March 2016 were presented to the Audit Committee. These were subsequently approved by the board and filed with BSE. The Company has reported the final loss for the quarter and year ended 31 March 2016 and separately identified, where possible, the loss relating to previous periods.

December 12 and 13, 2016

At the Board meeting held on December 12, 2016, the company filed accounts for the quarter ended 30 June 2016 and the quarter and half year ended 30 September 2016 on December 12 and December 13 respectively.

For resuming the trading on its shares, the company has filed the June 2016 and September 2016 quarter results and will have to pay the prescribed amount of fine. After this, BSE will permit trading of shares only on a trade-for-trade basis for a period of three months. After this period of three months, trading in the shares of the company will be shifted back to the normal trading category.

Some other facts

Shareholding

Largely the shareholding of a company constitutes of 3 categories i.e. promoter and promoters group, institutional investors and retail investors. In case of Ricoh India, Promoters of the company help around 73.60% of the total paid up share capital of the company with retail investors (or non institutional shareholders) holding 23.13% of the total shareholding in the company. Surprisingly, the institutional investors in the company hold only 3.27% shares in the company.

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Our take

It is a well known fact that high promoters' stake and low institutional share in the capital has marginally high potential for failures. By this, what happens is promoters can run through with every resolution that is placed for consideration of members, except related party transactions. After analysing the voting patterns of few of the last years general meetings, it can be seen that all the institutional investors had voted against the re-appointment of Mr. H. Kitada as director liable to retire by rotation at the previous year's Annual General Meeting. Mr. Kitada is a director of the promoter group based out in Japan.

Financial parameters

Particulars	March 15	March 14	March 13	March 12	March 11
Total Revenue (in Rs. Cr.)	1654.62	1050.47	634.64	433.25	298.04
Long term liabilities (in Rs. Cr.)	214.83	10.40	7.73	7.51	6.63
Current Liabilities (in Rs. Cr.)	911.45	710.09	614.34	246.66	115.66
Total Liabilities (in Rs. Cr.)	1126.28	720.49	622.07	254.17	122.29
Shareholders Fund (in Rs. Cr.)	168.60	139.79	122.56	123.88	131.64
Fixed assets (in Rs. Cr.)	64.23	73.87	42.39	37.26	15.85
Trade receivables	661.9	319.18	184.23	97.21	53.74
Profit / (Loss) for the period (in Rs. Cr.)	33.90	17.23	(1.32)	(2.61)	16.38
Ratio Analysis					
Debt / Equity	6.68	5.15	5.08	2.05	0.93
Change in Debt / Equity (in %)	29.71	1.38	147.80	120.43	-
PAT / Turnover (in %)	2.05	1.64	(0.21)	(0.60)	5.50
Change in Debt / Equity (in %)	25.00	880.95	(65)	(110.91)	-

Our take

As seen from the above table, it is evident that during the past 5 years revenue grew by more than 5 times but on the other hand liabilities grew by 9 times, out of which long term liabilities (mainly consisting of debt) swelled by 32 times. Also, the trade receivables grew up to 13 times as compared to revenue growth of 5 times. This trait goes on to prove that the company was inefficient in managing the debtors through the mechanism it followed. The other attributable reason can be the fact that the debtors themselves were questionable debtors.
PAT/Turnover Ratio also improved vastly in last 4 years although not at the same level as was in 2011.

Today, we all know that the books of accounts of the company were cooked and show false values. However, if appropriate concerns were raised at the opportune time, chances are faults can be identified at an early stage as compared to that of post mortem stage.

Managerial impacts

The case today is a testimony of the fact that Directors of the company, especially the independent directors, were not privy of the happening in the company. This also goes on to prove that the directors of the company were not able discharge their duties and responsibilities as codified under the statutes. However, no action lies against the non-executive directors as the benefit available to them under section 149(12) of the Act wherein they can be held liable only in respect of such acts of omission or commission by a company which had occurred with their knowledge and consent or connivance. However, the key managerial personnel of the company were rightfully suspended sans the Company Secretary.

Conclusion

After the Satyam scam came it light wherein the auditors were also involved in the overall fiasco, it becomes imperative that this provision was much needed to ensure that books of accounts and financial statements represent true and fair value. After the introduction of Companies Act, 2013; this seems to be the first case wherein the importance of rotation of auditors, which drew diverse reactions from many in the industry, is necessary to ensure that stakeholders' of all the classes are protected and there is clear transparency in the figures as submitted by the company.

It is not clear when the purported fraud took place. However, when Auditor writes that they are not confident about opening balance of April 01, 2015 being correct; it indicates that fraud could have happened prior to 1st April 2015. It will be in the interest of capital market and investors that SEBI initiates steps in the right direction to allay the fears of investors and by swift action ensure that investors' confidence in market remains intact. Finally, this proves that low institutional equity has inherent governance risk.

The bigger solace lies in the fact the promoters of the company wanted to right the wrongs done by the company. The promoters of the company were ready to infuse such amounts in the company up to which the frauds on the behalf were identified. The promoters in this case *suo moto* filed an application to NCLT wherein they wanted to cancel their existing capital and infuse such funds in the share capital of the company. By this, the debt of the company did not swell further and no minority stake was disturbed. NCLT also understood that there will no point to penalize the officials as the company themselves have suspended the KMPs and the promoters where wanting to right the wrongs.

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