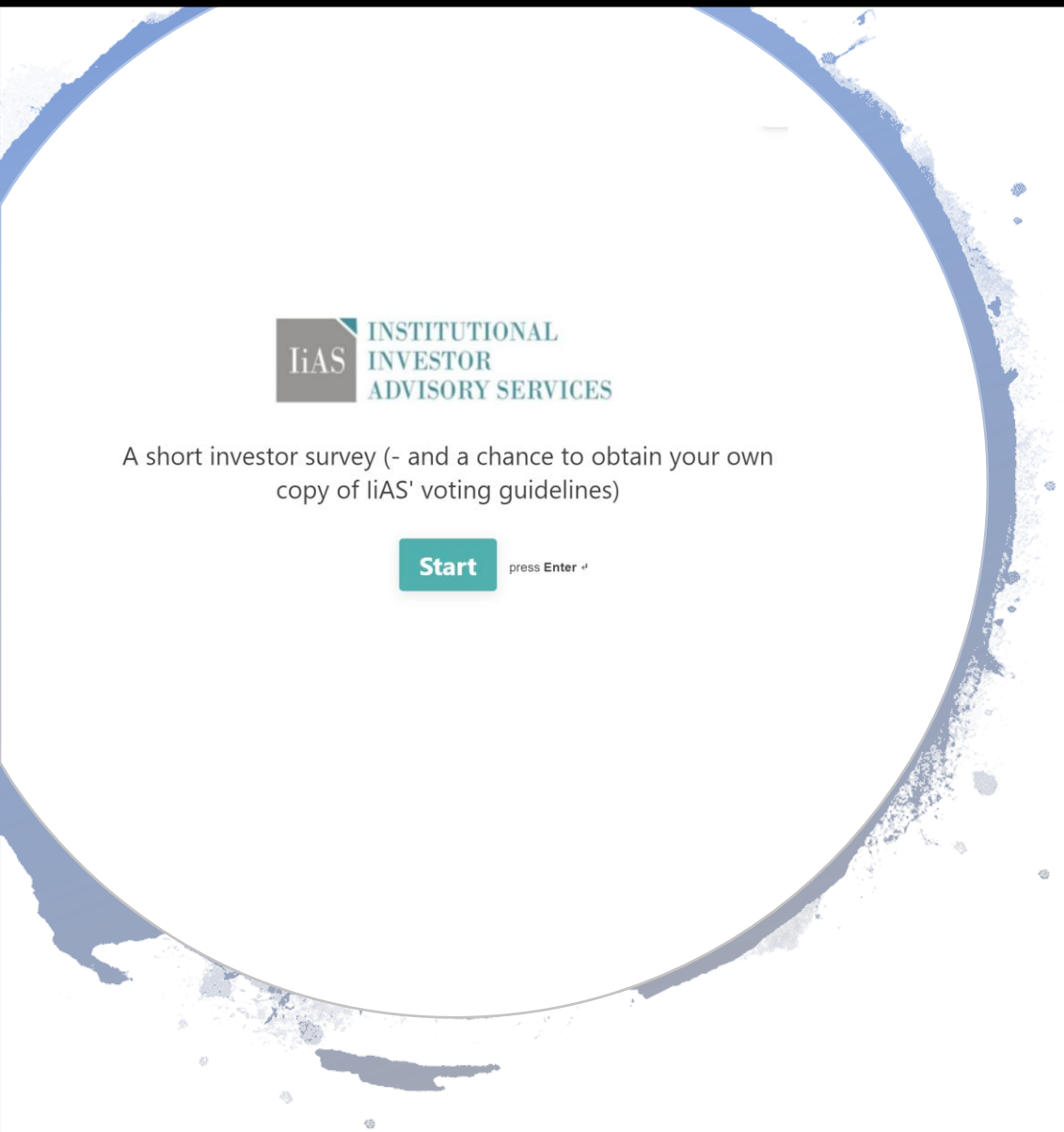
April-May 2020

IiAS: A Short Survey

Survey Results

About ‘a short survey’



IiAS has conducted a short survey to obtain investor and sell side analyst responses on a variety of resolutions that are presented to shareholders.

- The survey was conducted between 13-21 April
- It was conducted using typeform
- The number of respondents for the questions is between 63 and 89

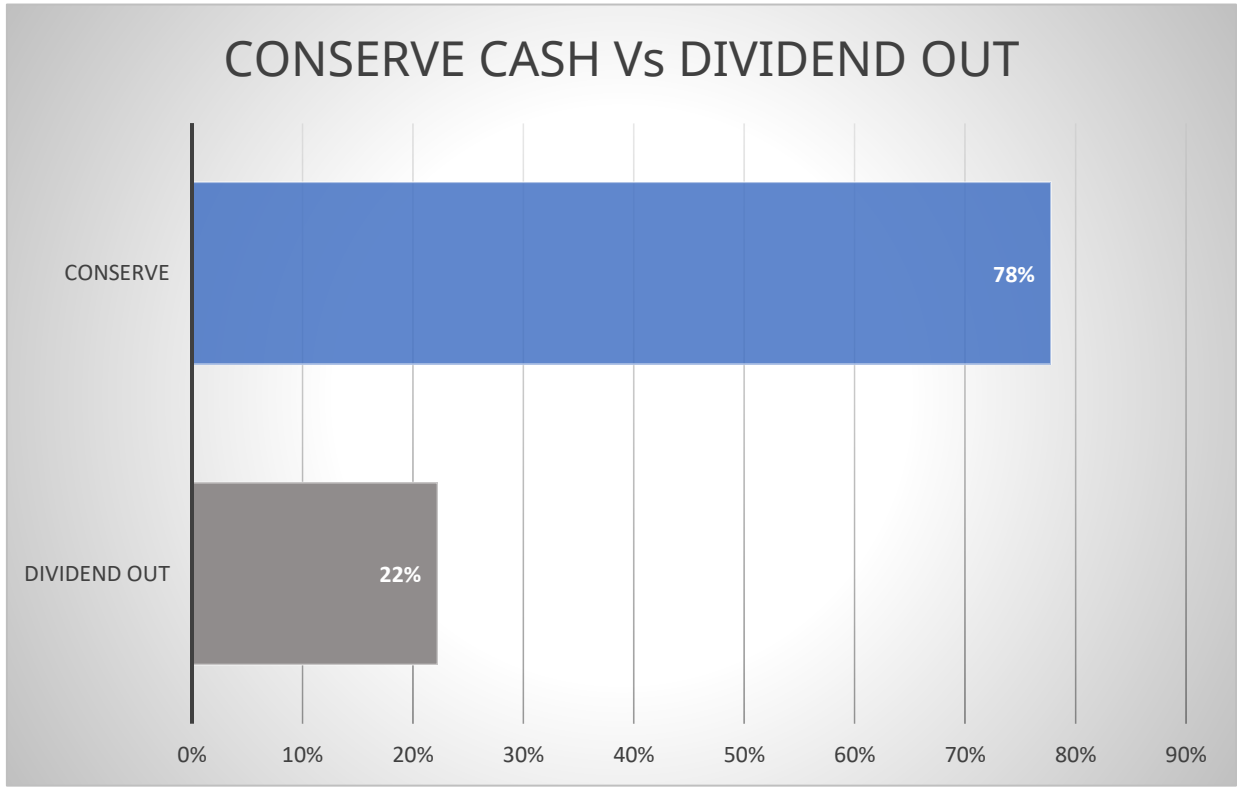
Q1: Extraordinary times call for exceptional responses: companies should suspend dividends and fortify their balance sheets

YES

Companies need to conserve cash and prioritize protecting their balance sheets. They can resume dividends once they restart operations and gain visibility.

NO

These are extraordinary times for investors as well, including retail investors and pensioners. Companies need to continue to pay dividends.



IiAS View

For long IiAS has advocated companies step up dividends. But given the pandemic our view is that companies should prioritize shoring up their balance sheet.

Click on the image to read our analysis, or cut-paste the following url:
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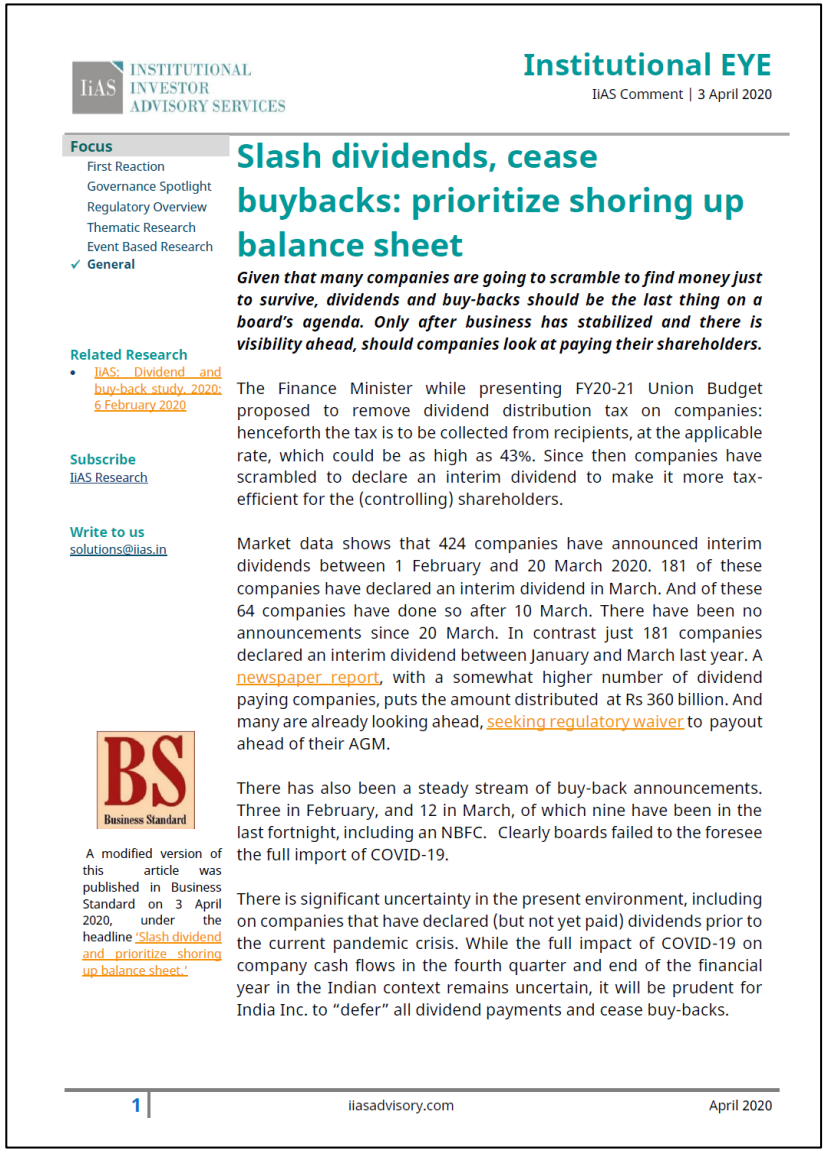

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Slash dividends, cease buybacks: prioritize shoring up balance sheet

Given that many companies are going to scramble to find money just to survive, dividends and buy-backs should be the last thing on a board's agenda. Only after business has stabilized and there is visibility ahead, should companies look at paying their shareholders.

The Finance Minister while presenting FY20-21 Union Budget proposed to remove dividend distribution tax on companies: henceforth the tax is to be collected from recipients, at the applicable rate, which could be as high as 43%. Since then companies have scrambled to declare an interim dividend to make it more tax-efficient for the (controlling) shareholders.

Market data shows that 424 companies have announced interim dividends between 1 February and 20 March 2020. 181 of these companies have declared an interim dividend in March. And of these 64 companies have done so after 10 March. There have been no announcements since 20 March. In contrast just 181 companies declared an interim dividend between January and March last year. A newspaper report, with a somewhat higher number of dividend paying companies, puts the amount distributed at Rs 360 billion. And many are already looking ahead, seeking regulatory waiver to payout ahead of their AGM.

There has also been a steady stream of buy-back announcements. Three in February, and 12 in March, of which nine have been in the last fortnight, including an NBFC. Clearly boards failed to the foresee the full import of COVID-19.

There is significant uncertainty in the present environment, including on companies that have declared (but not yet paid) dividends prior to the current pandemic crisis. While the full impact of COVID-19 on company cash flows in the fourth quarter and end of the financial year in the Indian context remains uncertain, it will be prudent for India Inc. to "defer" all dividend payments and cease buy-backs.

BS Business Standard

A modified version of this article was published in Business Standard on 3 April 2020, under the headline 'Slash dividend and prioritize shoring up balance sheet.'

1 | iiasadvisory.com | April 2020

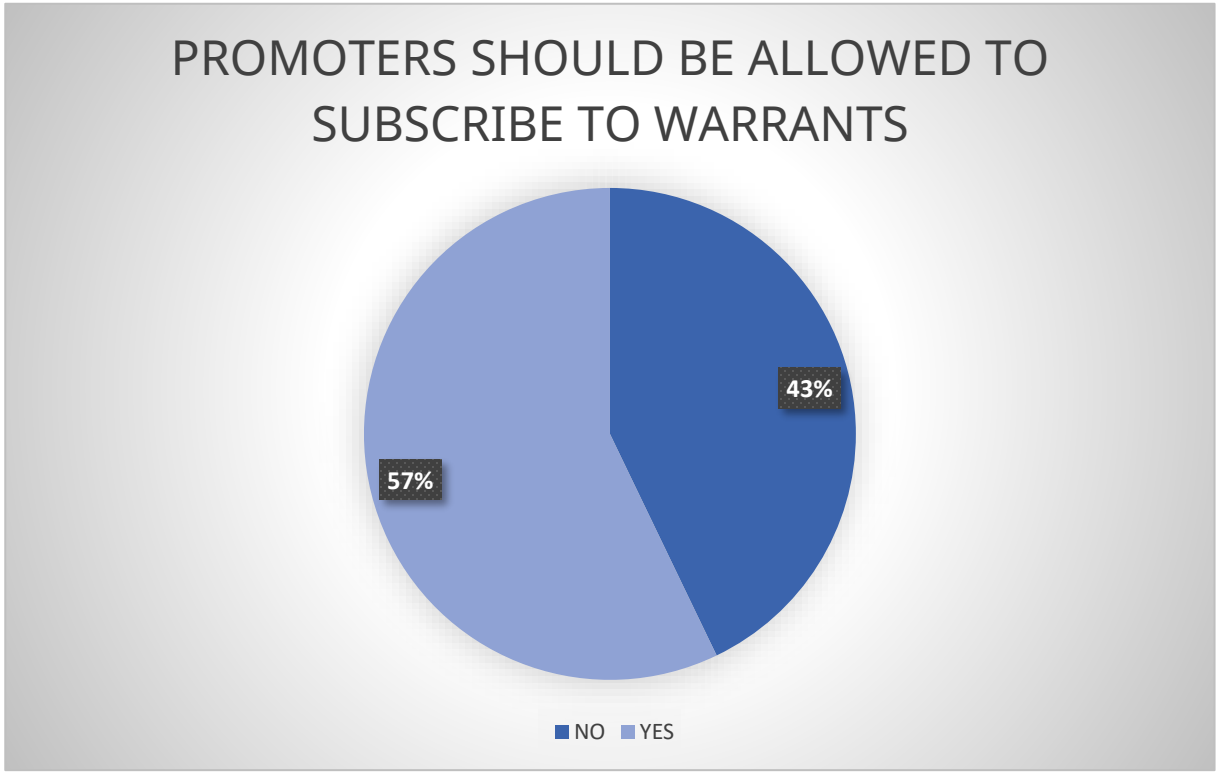
Q2: Should promoters be allowed to subscribe to warrants that are exercised at the end of 18-months?

YES

It is a sign of confidence in the company its operations and its future. They are bringing in 25% of the funds up-front, which they risk losing if they do not exercise these warrants.

NO

They are the ultimate insiders and should not be allowed a free-ride on the share price, something denied to other investors. If the company needs the money it should be through a QIP or preferential issue.



IiAS View

Issue of warrants to promoters:
IiAS does not generally support issue of warrants to promoters since it allows them to ride the stock price for an 18-month period.

IiAS may consider voting FOR where the warrants are being held by institutional promoters or in cases where funding needs are staggered because these are tied to specified capital expenditure plans.

Click on the image to read our voting guidelines, or cut-paste the following url:
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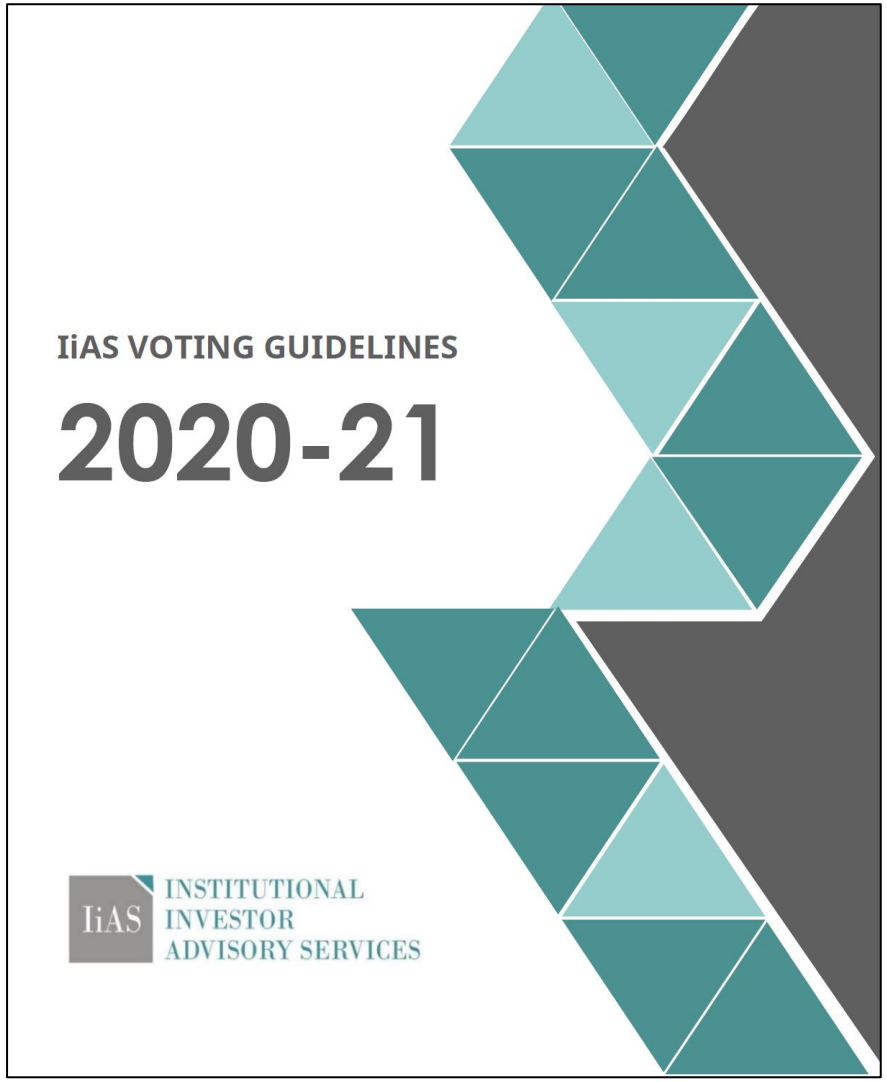
Search: Issuance of warrants



Q3: As an equity investor, when do I worry about dilution?

Not really

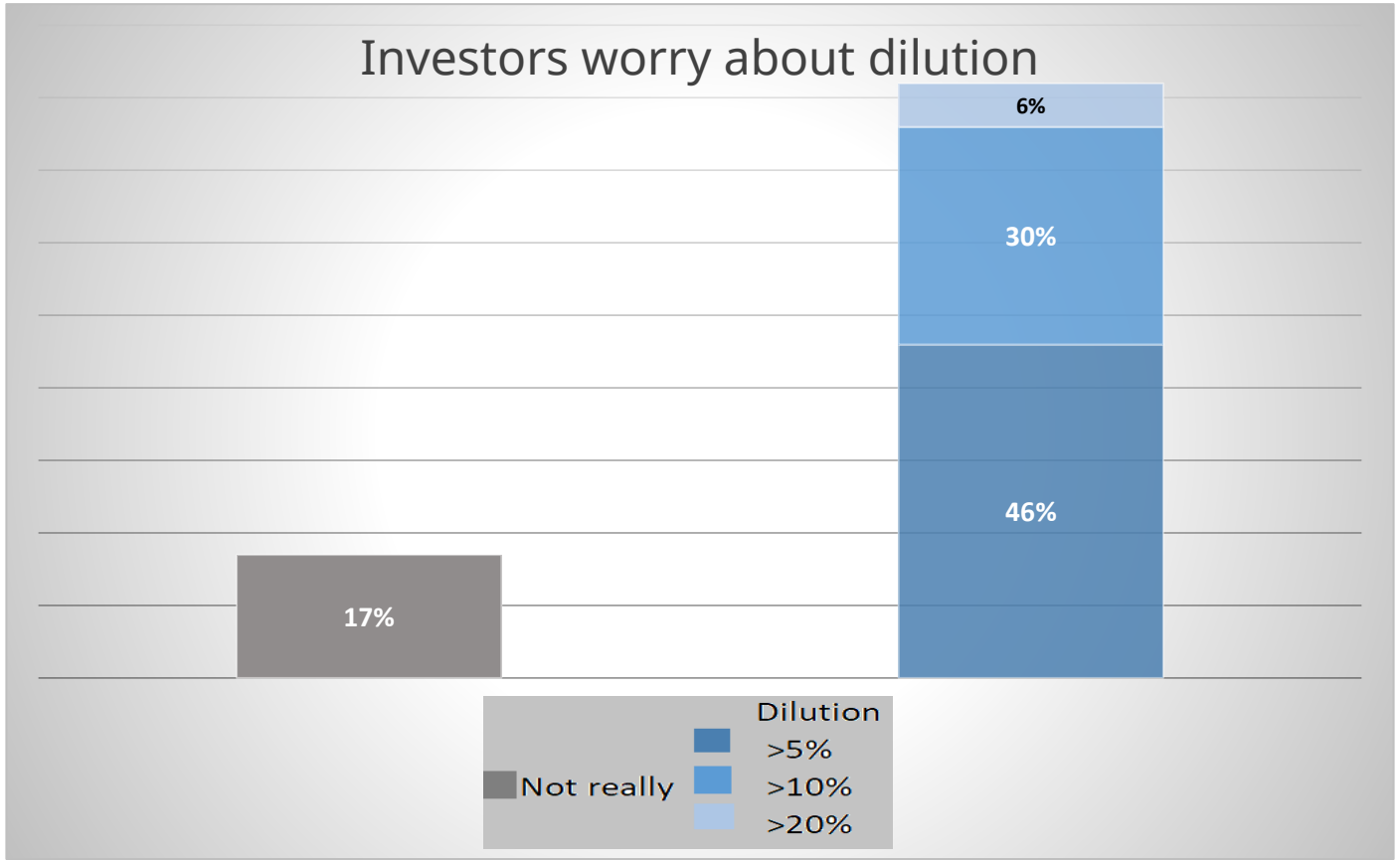
- **I do, but only if it is….**

……. more than 5%

…….. more than 10%

……..more than 20%

(without a granular disclosure of the use of proceeds)



IiAS View

Extent of dilution
IiAS factor's in the extent of dilution while voting on resolutions for issuance of equity shares.

Some of the other factors we consider are:
- List of allottees: promoter/non-promoter
- Type of investor: financial/strategic
- Urgency of funds
- Debt levels and available cash
- Return on capital employed

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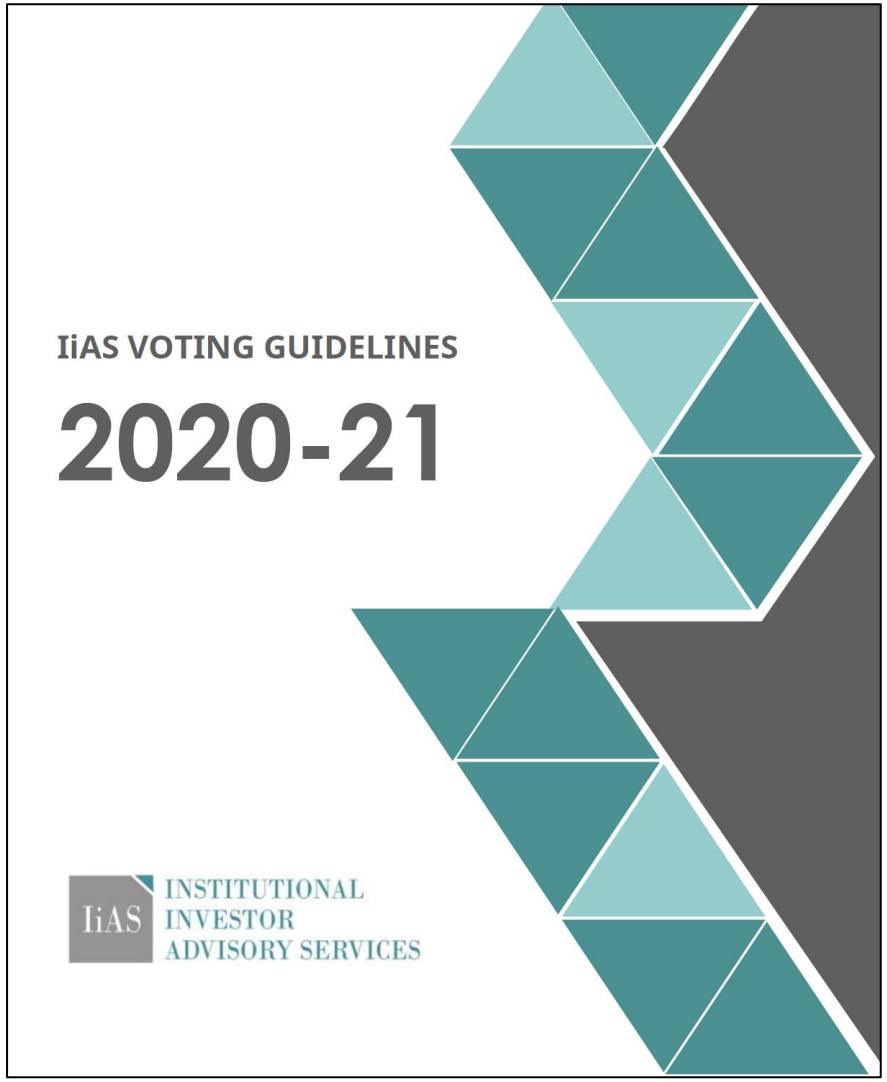


Q4: What is your view on dual class shares?

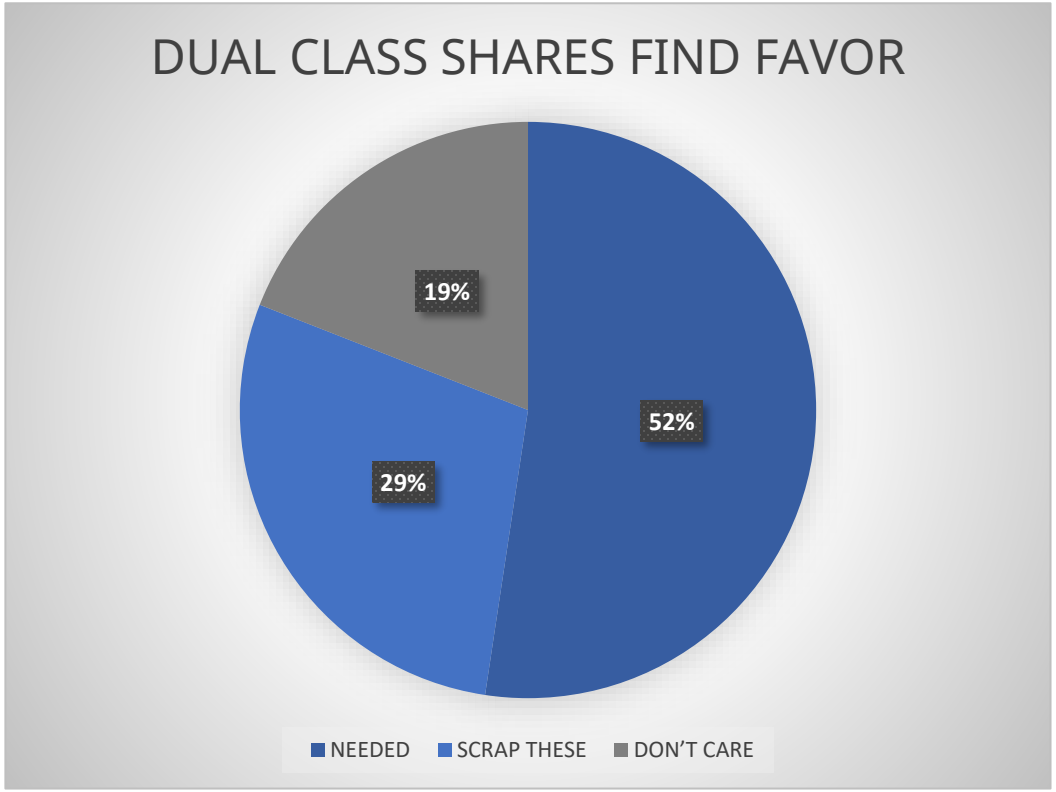
NEEDED

It is one more instrument in a company's armory. And what's more, exchanges like NYSE allow these.

I don’t care, one way or the other 

SCRAP THESE

What was SEBI thinking?



IiAS View

Dual class shares

SEBI's decision to allow companies to issue shares with differential voting rights attempts to facilitate promoters of new age companies while protecting minority shareholders. While the intent may be right, given the weak regulatory environment, and then strength of the corporate lobby, it is the governance agenda that will be compromised the most.

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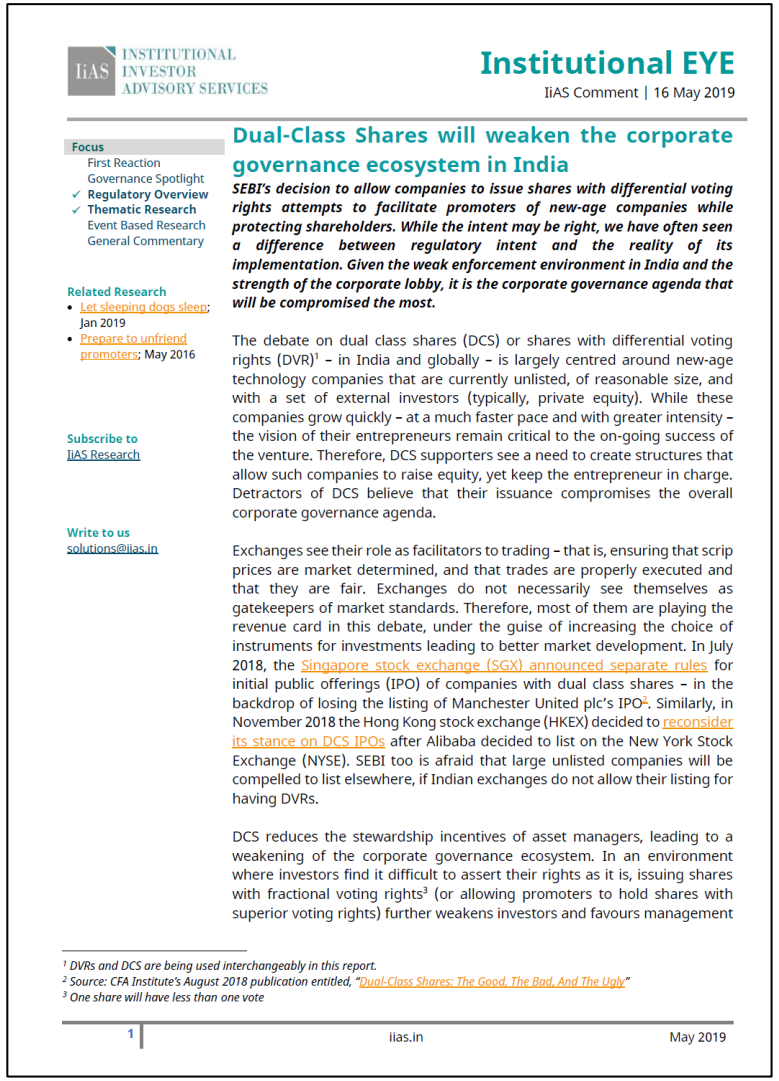

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- Let sleeping dogs sleep; Jan 2019
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Dual-Class Shares will weaken the corporate governance ecosystem in India

SEBI's decision to allow companies to issue shares with differential voting rights attempts to facilitate promoters of new-age companies while protecting shareholders. While the intent may be right, we have often seen a difference between regulatory intent and the reality of its implementation. Given the weak enforcement environment in India and the strength of the corporate lobby, it is the corporate governance agenda that will be compromised the most.

The debate on dual class shares (DCS) or shares with differential voting rights (DVR)[1] – in India and globally – is largely centred around new-age technology companies that are currently unlisted, of reasonable size, and with a set of external investors (typically, private equity). While these companies grow quickly – at a much faster pace and with greater intensity – the vision of their entrepreneurs remain critical to the on-going success of the venture. Therefore, DCS supporters see a need to create structures that allow such companies to raise equity, yet keep the entrepreneur in charge. Detractors of DCS believe that their issuance compromises the overall corporate governance agenda.

Exchanges see their role as facilitators to trading – that is, ensuring that scrip prices are market determined, and that trades are properly executed and that they are fair. Exchanges do not necessarily see themselves as gatekeepers of market standards. Therefore, most of them are playing the revenue card in this debate, under the guise of increasing the choice of instruments for investments leading to better market development. In July 2018, the Singapore stock exchange (SGX) announced separate rules for initial public offerings (IPO) of companies with dual class shares – in the backdrop of losing the listing of Manchester United plc's IPO[2]. Similarly, in November 2018 the Hong Kong stock exchange (HKEX) decided to reconsider its stance on DCS IPOs after Alibaba decided to list on the New York Stock Exchange (NYSE). SEBI too is afraid that large unlisted companies will be compelled to list elsewhere, if Indian exchanges do not allow their listing for having DVRs.

DCS reduces the stewardship incentives of asset managers, leading to a weakening of the corporate governance ecosystem. In an environment where investors find it difficult to assert their rights as it is, issuing shares with fractional voting rights[3] (or allowing promoters to hold shares with superior voting rights) further weakens investors and favours management

[1] *DVRs and DCS are being used interchangeably in this report.*
[2] *Source: CFA Institute's August 2018 publication entitled, "Dual-Class Shares: The Good, The Bad, And The Ugly"*
[3] *One share will have less than one vote*

1 | iias.in | May 2019

Q5: Promoters have rights embedded in the Articles of Association (AoA) of the company, such as permanent chairmanship for family member, non-rotating board seat, right to nominate directors etc. Are you OK with these?

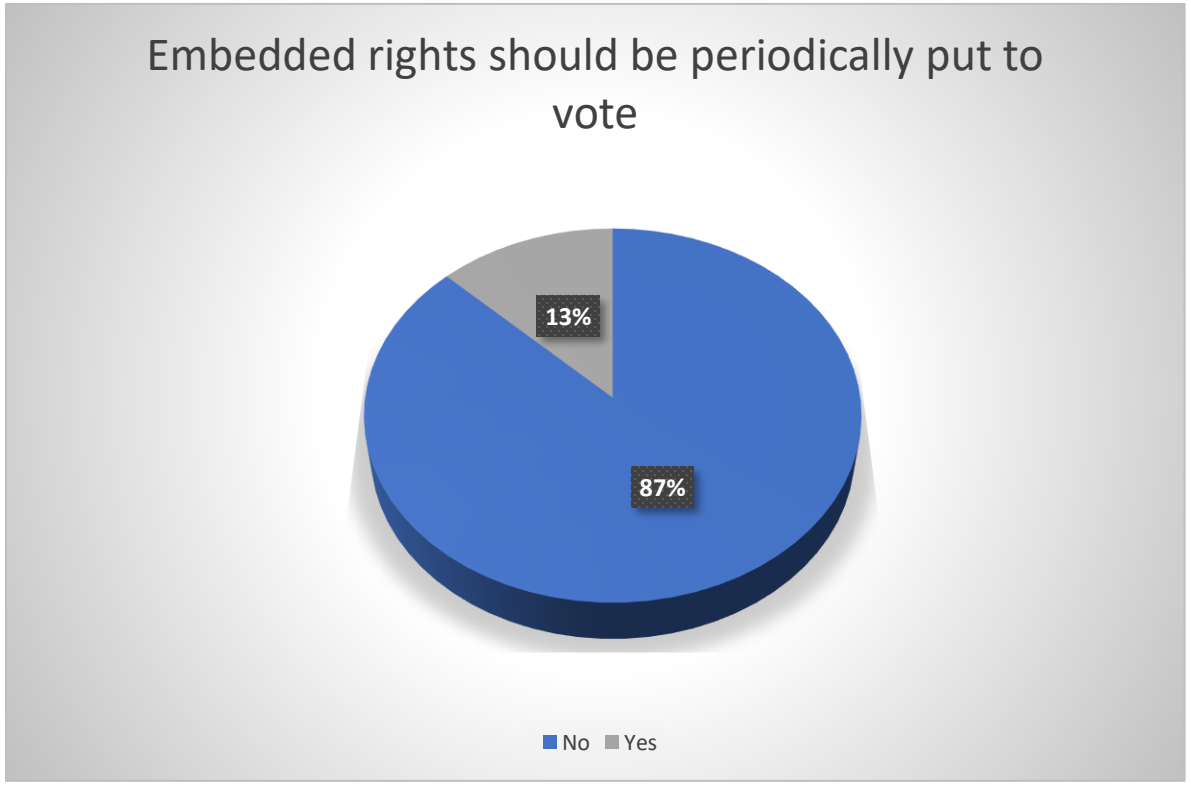
IiAS

YES

They have invested capital and need to protect their interests

NO

These should be periodically put to vote, and the promoter can use their shares to vote for these.

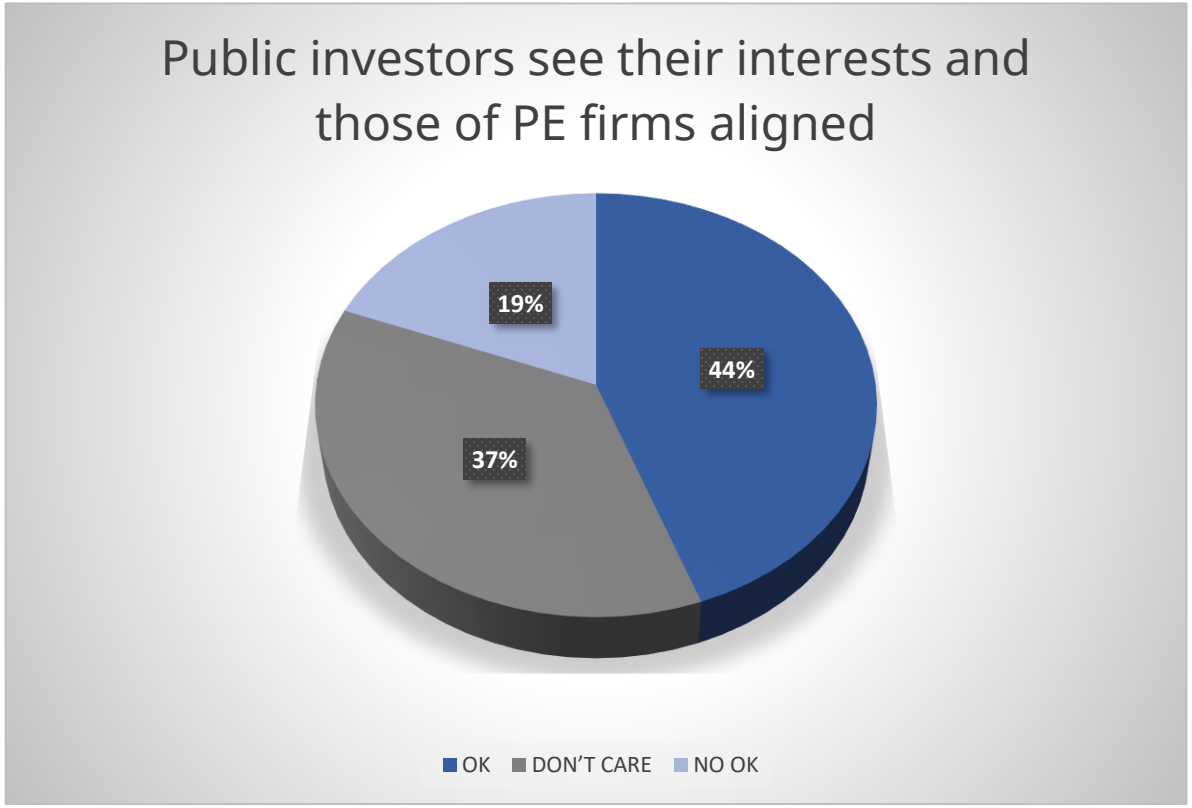


Q6: PE investors have rights embedded in the AoA, like drag-along, tag-along, voting with management, veto, appointment of KMPs. Are you OK with these?

YES
There is an alignment of interest among investors. This will be beneficial to me.

As long as it does not impinge on my rights, it does not matter

NO
All AoA's should be clean

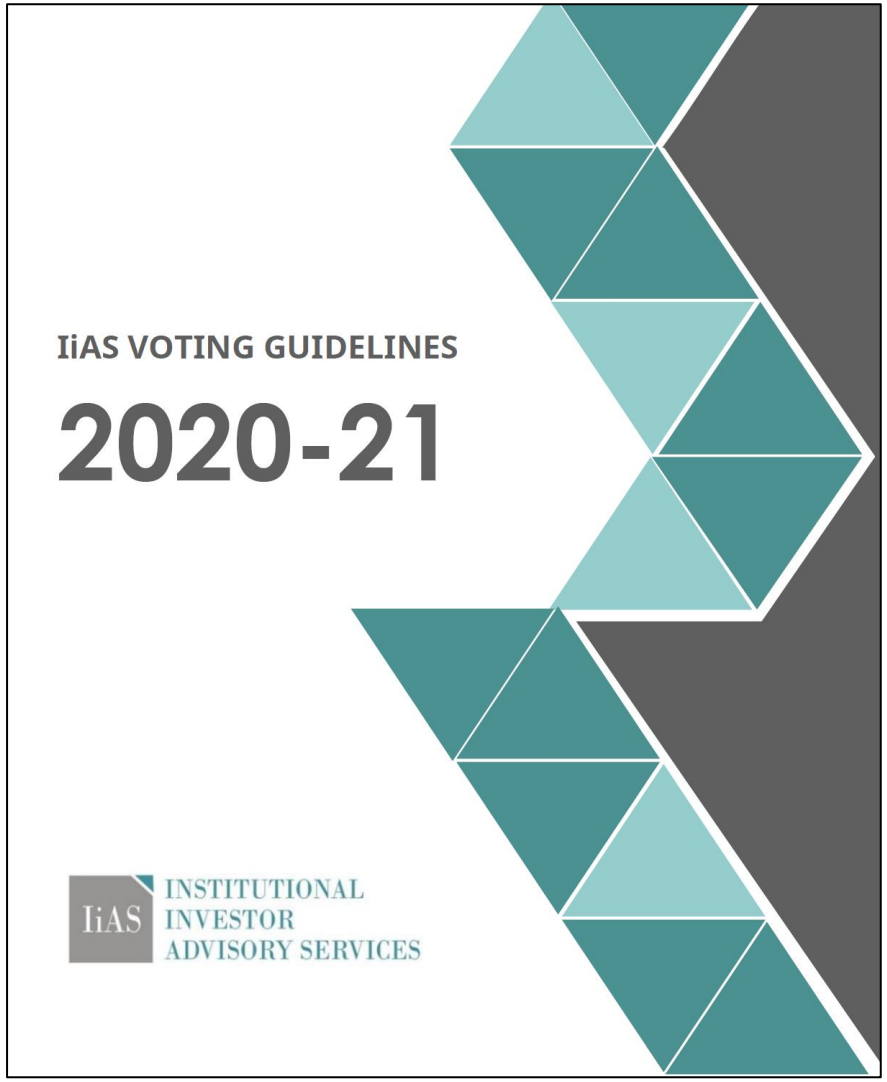


IiAS View

Review of charter documents
IiAS takes a case to case view

However, IiAS does not like specific names to be inserted.

IiAS also expects a company's charter documents to be hosted on its website, and in case of revision, the changes listed out.



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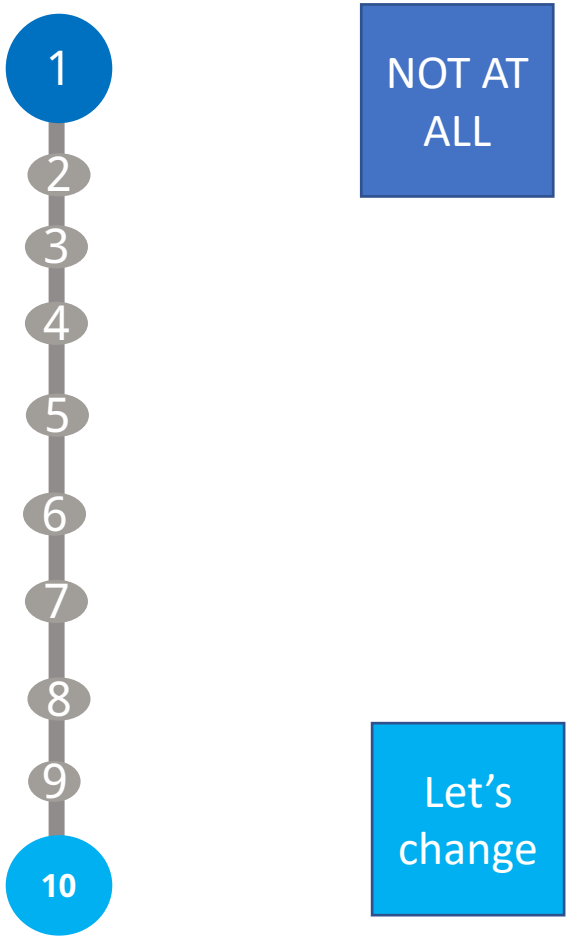
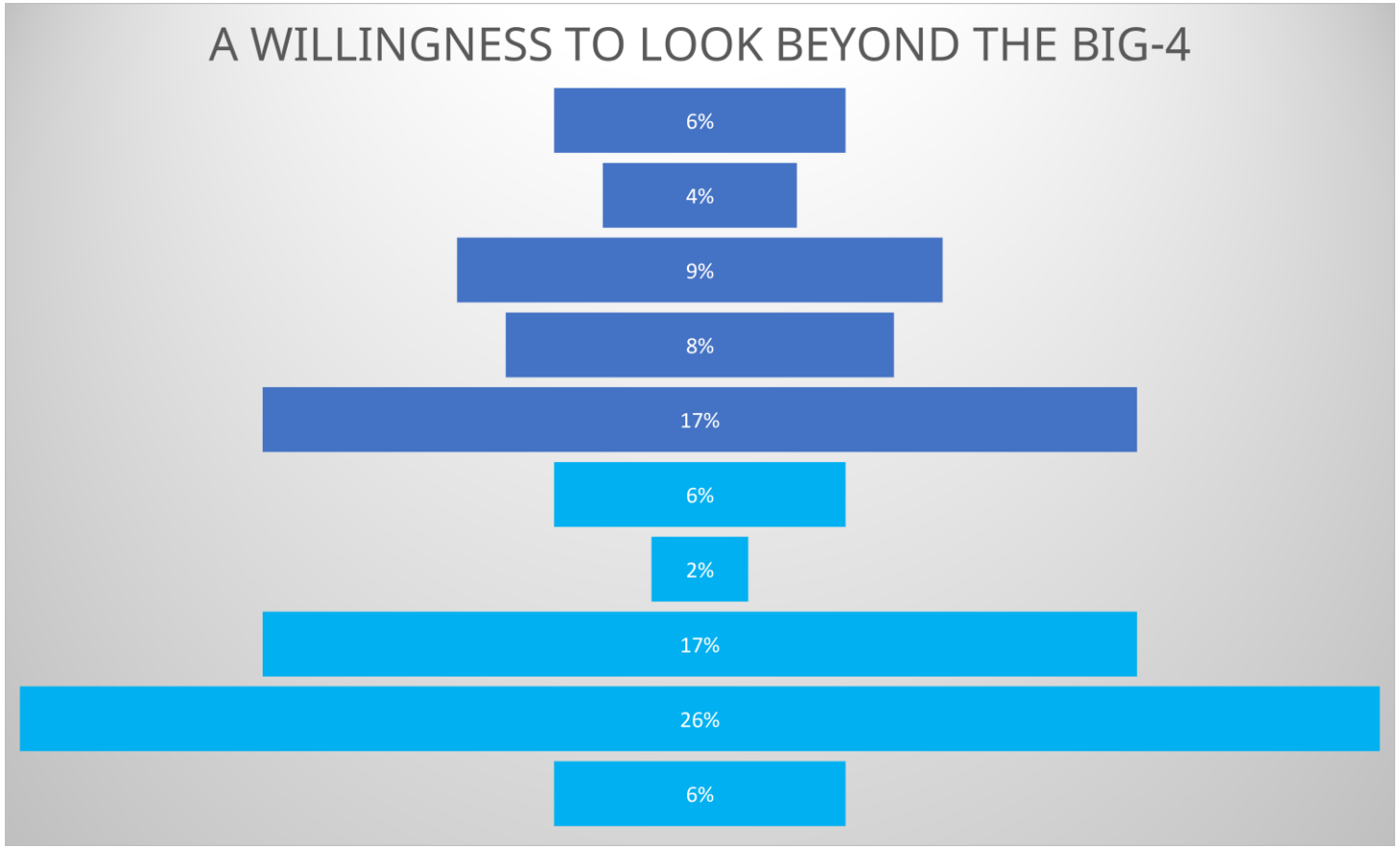
Search: Alteration to charter documents

Q7: Are you comfortable moving beyond the big four audit firms?



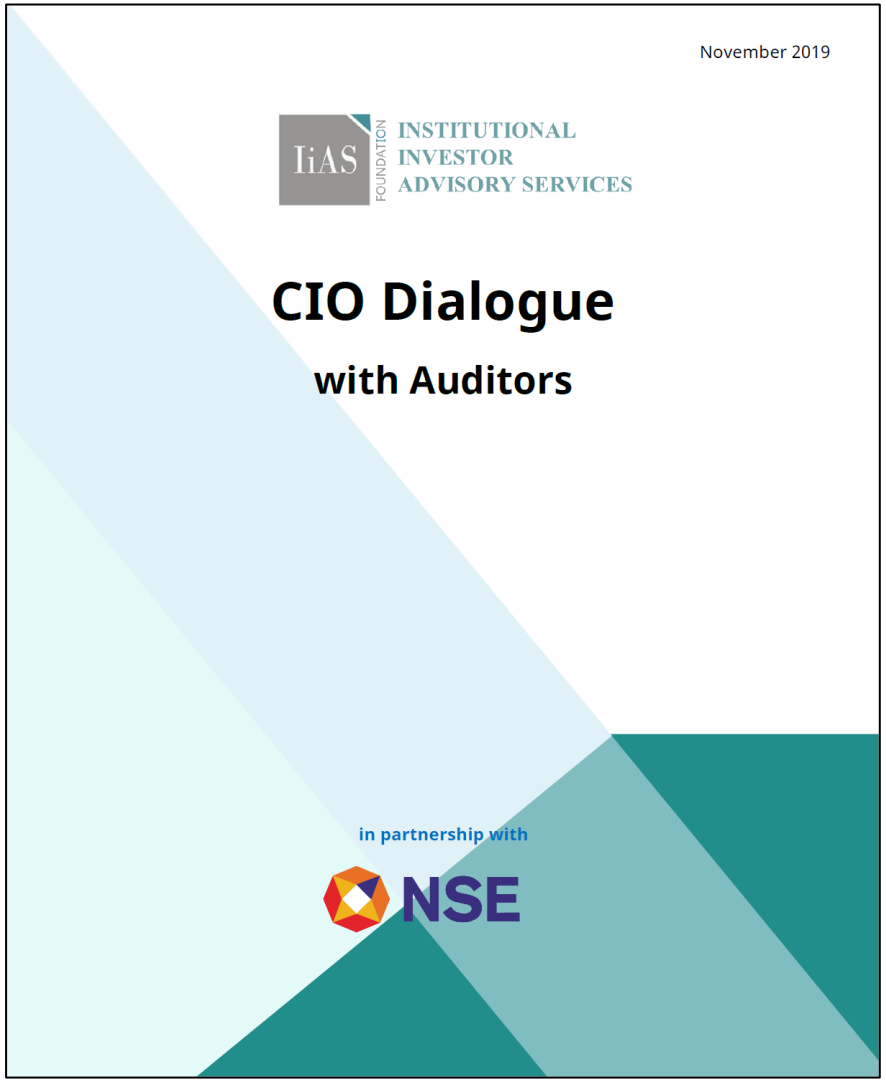


IiAS CIO Dialogue with Auditors

The audit world, especially the Big Four, are under fire from the regulators. Securities and Exchange Board of India banned PwC in 2018 from auditing listed companies for two years. Securities Appellate Tribunal has quashed the ban and SEBI has challenged the decision. In June 2019, the Reserve Bank of India barred SR Batliboi & Company, an affiliate of EY, from carrying out statutory audit assignments of commercial banks for one year. The Serious Fraud Investigation Office (SFIO) has charged Deloitte Haskins & Sells and BSR and Associates (part of the KMPG network), for their failure in not disclosing the true financial health of IL&FS Financial Services and are looking at banning them from undertaking audits.

Add to this, divergences and the frequent resignation of auditors, there are doubts on the quality of the audits that is being presented to investors.

How does one bridge the trust deficit between audit firms and investors? And if the big four firms are 'banned,' where does it leave companies and importantly investors?



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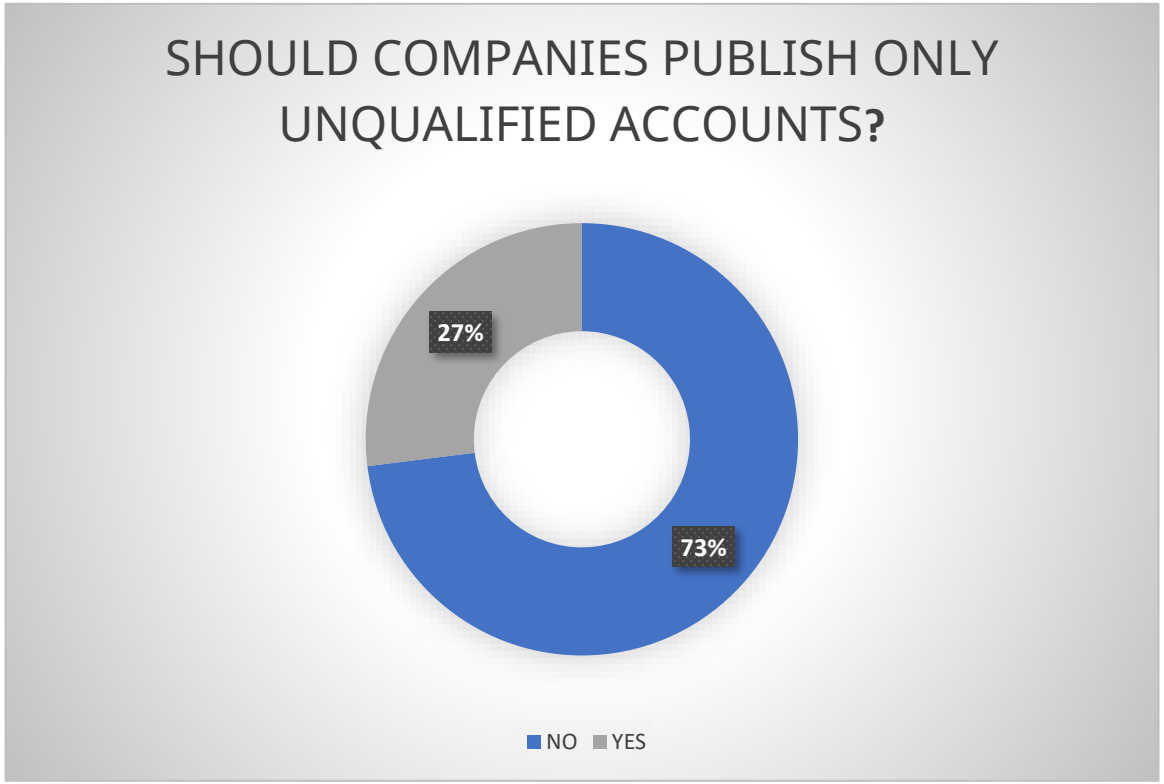
Q8: In the US, auditors cannot publish qualified results. Should Indian standards move in the same direction and insist on unqualified accounts.

YES
Only unqualified accounts are true and fair.

NO
Atleast you get to hear auditor concerns. If you ask for clean accounts, the risk is auditors will be muzzled.



IiAS: A Short Survey - Summary Findings

- While typically investors clamor for dividends, in this environment they showed maturity with 78% of investors preferring company's retain cash and fortify their balance sheet.
  [Note, we have used investor as shorthand for investors and sell-side analysts]

- A majority (57%) of investors see promoters subscribing to warrants as a sign of confidence in the company and its operations.

- Dilution remains a concern for investors. 46% of the investors were uncomfortable if dilution exceeded 5% without a disclosure regarding how funds will be used. 30% put this threshold was 10%.

- Surprisingly a majority support dual class shares - a class of shares that doesn't find much support among investors in most other geographies.

- While a super majority (87%) were less supportive of promoter rights being embedded in AoA's – and periodically being voted upon, they had a more sanguine view about rights of PE Firms being embedded ina firms AoA.

- Investors are showing a willingness to move beyond the Big-4.

- Between qualified accounts and unqualified accounts, 73% supported qualified accounts. Their rationale was that if you accept qualified accounts atleast you get to hear auditor concerns. If you ask for clean accounts, the risk is auditors will be muzzled.

IiAS VOTING GUIDELINES: 2020-21

Published annually since 2013, this is the seventh edition of our Voting Guidelines. The guidelines are revised based on changing regulations, and market feedback from investors, companies, and other market participants.

These guidelines includes references to relevant regulations, the type of resolution (ordinary or special), meeting at which these are voted on (Annual General Meeting, Extra-ordinary General Meeting, Postal ballot, NCTL Convened Meeting), and risks related to specific resolutions. Our report contains data pertaining to investor engagement in the past three years for critical resolutions to provide guidance to both companies and investors on the current thinking vis-à-vis some governance practices. They also provides links to various IiAS reports including its voting recommendations.

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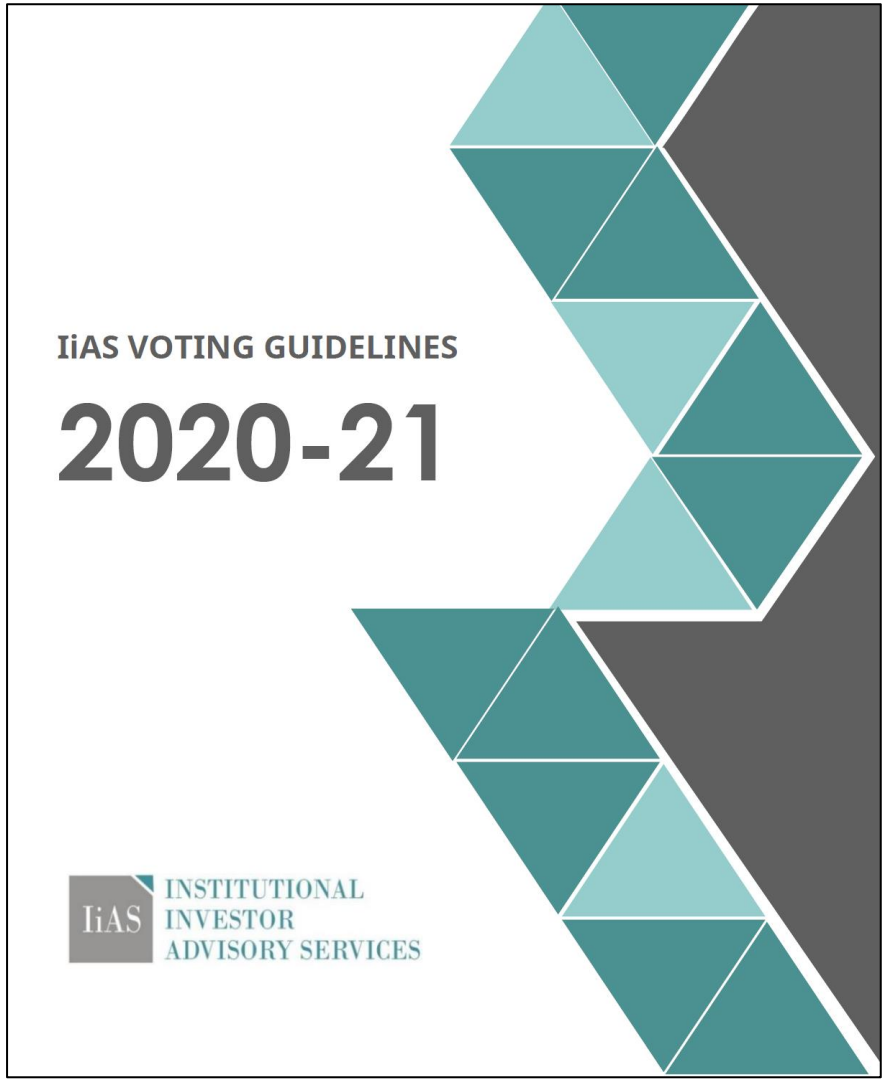

IiAS VOTING GUIDELINES: 2020-21 (Cont.)

Legend

IiAS recommendations are based on IiAS' Voting Guidelines, which can be viewed on our website. The data and regulations reviewed while arriving at a recommendation are disclosed, to provides investors and companies clarity regarding the basis for our recommendations.

IiAS recommendations are non-binding in nature. Investors may have their own voting rationale which may, on aspects, differ from those of IiAS. On such occasions, investors could use these recommendations as a guiding tool.

Our voting recommendations do not constitute advice to buy, sell or hold securities.

To allow for a more nuanced discussion on resolutions, IiAS recommendations may be supplemented with a risk or a transparency indicator (refer table below). This helps balance the narrative for proposals which have multiple connotations in terms of their implications for the company and its stakeholders.

Risk Indicator	Coverage	Description
G	Governance Matters	This symbol is used for resolutions which in IiAS' opinion indicate corporate governance practices that have room for improvement or are non-compliant with regulations or their intent.
I	Inequitable Treatment	This symbol is used for resolutions which in IiAS' opinion benefit the controlling shareholders (or any other class of shareholders) at the expense of the public shareholders. This also includes resolutions which may result in excessive dilution or disproportionate voting powers.
F	Financial Impact	This symbol is used for resolutions which, as per IiAS, will have a negative impact on the company's financials.
V	Valuation Divergence	This symbol is generally used for resolutions associated with corporate restructurings, which include schemes of arrangement, and slump sales, where a fair valuation cannot be ascertained or where IiAS believes the valuation is prejudicial to the interests of public shareholders.
R	Other Risks	This symbol is used for operating decisions taken by the company management and IiAS will usually recommend voting FOR such resolutions. However, they carry an element of risk which may subsequently have a negative impact on the financials. Investors are therefore advised to review the risk factors highlighted by IiAS in its analysis before voting.

Transparency Indicator	Quality of Disclosure	Description
T	Leadership	Indicates that the disclosures on the resolution are significantly superior to other similar resolutions. IiAS encourages other companies to emulate such disclosure levels.
T	Weak	Indicates lack of adequate disclosures supporting the resolution. Investors are advised to seek further clarifications from the company to make a more informed decision.

Indicator	Quality of Disclosure	Description
	Engagement	This icon is used for resolutions wherein IiAS believes that the shareholders should engage with the company for granular details.

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- **ADDENDUM/CORRIGENDUM:** This is used to highlight that the company has issued an addendum or made corrections to its initial shareholder notice and that IiAS' report has been updated to reflect the impact of the same.

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In addition to voting advisory, IiAS offers two cloud-based solutions, IiAS ADRIAN, and comPAYre. IiAS ADRIAN captures shareholder meetings and voting data and provides packaged data that can be used to gain insights on how investors view specific issues and gain greater predictability regarding how they might vote. comPAYre provides users access to remuneration data for executive directors across S&P BSE 500 companies over a five-year period.

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

Contact
solutions@iias.in
T: +91 22 6123 5509/ +91 22 6123 5555
Rromil Shah
rromil.shah@iias.in