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**BEFORE APPELLATE BENCH NO. III**

In the matter of

**Appeal No. 26 of 2006**

1. Nazir Ahmed Peracha, Chairman
  2. Feriha Nazir Peracha, Director
  3. Cyma Fazal Peracha, Director
  4. Qamar Nazir Peracha, Director
  5. Uzma Asif Amin, Director
  6. Taymur Alam Peracha, Director
- of Shahpur Textile Mills Limited
- ..... Appellants

Versus

Commissioner (CL)  
Securities and Exchange Commission of Pakistan

..... Respondent

Date of hearing

22-12-11

**ORDER**

**Present:**

**For the Appellant:**

Muhammad Haroon Mumtaz, Advocate

**Department representative:**

Amina Aziz, Director

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1. This order shall dispose of appeal No. 26 of 2006 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the order dated 18/01/06 (the "Impugned Order") passed by the Respondent.

2. Examination of annual accounts of Shahpur Textile Mills Limited (the "Company") for the year ended 30/09/04 (the "Accounts") revealed that share capital of the Company increased from Rs. 99.804 million in 2003 to Rs. 139.804 million in 2004 as a result of 40.08% right issue ( the "Rights Issue") at par on 30/12/03. Further, the directors' report disclosed the following trades in the Company during the year under review:

Name	Sale	Purchase
Nazir Ahmed Peracha, Chairman	None	3,175,596
Qamar Nazir Peracha, Director	None	173,386
Feriha Nazir Peracha, Director	None	433,465
Cyma Fazal Peracha, Director	None	217,153

It was also noted that purchase of right shares by Appellant No. 1 was on account of underwriting of right shares, he being underwriter to the Rights Issue. The appointment of Appellant No. 1 as underwriter was prima facie violation of the Balloters, Transfer Agents and Underwriters Rules, 2001 (the "BTAU Rules"). It was also noticed that the circular dated 06/01/04 (the "Circular") sent to the members along with the notice offering new shares stated that the main projects/objects for which the additional funds were required were as follows:

*"The management of the Company has decided to upgrade the production facilities of the unit by carrying on Balancing,*



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*modernization and Replacement of the existing plant, to meet the challenges of quota free era commencing in 2005.”*

Further, the following was stated to be the expected benefits in profitability or otherwise likely to accrue from the additional funds:

*“The increased production would result in reduced unit cost and the economies of scale. The improved quality of yarn would ensure customer satisfaction and better prices in future from the local and international market. Hence increasing the overall profitability of the company and paving good returns to the shareholders.”*

Later on it was noticed from perusal of the financial statements that the project implementation was not completely in accordance with the financial projections; instead, the additional proceeds appeared to have been utilized for cash repayment of directors' loan. The resulting shortfall in finance was covered by obtaining financing from banks which was not envisaged in original financial projections.

3. Show cause notice dated 11/07/05 (“SCN”) under the BTAU Rules, Companies (Issue of Capital) Rules, 1996 (the “Capital Issue Rules”) and section 472 and 492 of the Companies Ordinance, 1984 (the “Ordinance”) was issued to the Appellants. The Appellants filed reply to the SCN and hearing in the matter was held. The Respondent, dissatisfied with the response of the Appellants, passed the Impugned Order and imposed a penalty of Rs. 50,000 on each Appellant under section 492 of the Ordinance and directed the Appellants under section 472 of the Ordinance to provide a financial plan after carrying out due diligence, with particular reference to the following:

- i. working capital requirement planned and the current requirement;



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ii. business strategy to bring the Company out of current situation of operational losses.

4. The Appellants preferred the instant appeal against the Impugned Order. The Appellant's counsel argued that:

a) the Company had been making losses for several years and as a result the equity was in negative. In order to reverse this adverse state of affairs, it was decided by the Board of Directors of the Company to undertake Balancing, Modernization and Replacement of the existing plant of the Company (the "BMR"). The BMR was to be financed through various sources, including the Rights Issue, however, seeking approval for the Rights Issue from various competent authorities would have taken time and in view of the urgency of funds for the BMR, the Appellants started injecting personal funds into the Company: Rs. 14.065 million was injected in the year 2002 and Rs. 2.543 million in the year 2003, amounting to a total of Rs. 16.608 million (the "Appellants' BMR Injection"). The Appellants' funds injection for the purposes of BMR was to be treated as directors' loan to the Company and was clearly indicated in the cash flow statement on the annual report of the Company for the year 2003;

b) for the purposes of underwriting the Rights Issue in terms of Rule 5 of the Capital Issue Rules; the Company approached financial institution(s), but none of the said financial institution(s) were willing to underwrite the Rights Issue, primarily due to the Company's poor financial condition at that time. Faced with this adverse circumstance, and in full knowledge of the fact that the Company's shares valued at Rs. 10/- each were actually being traded at Rs. 2.50/- only on the stock exchanges, Appellant No.1



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volunteered to underwrite the Rights Issue and the Company entered into an underwriting agreement with Appellant No.1. Copy of the underwriting agreement was intimated to the Commission and no objections to the appointment of Appellant No. 1 as the underwriter was raised at that time. The Company also obtained relevant approvals from the KSE and a copy of KSE's approval letter was forwarded by KSE to the Commission and no objection was raised regarding the Rights Issue even at that time. Therefore, the Company proceeded with the Rights Issue with good faith;

- c) for the purposes of the Rights Issue, the Circular under section 86(3) of the Ordinance was issued to members and copy of Circular was provided to the Commission. As far as the contents of the Circular are concerned, the Item No. 18 in the format of the circular prescribed by the Commission states as follows:

*"Purpose of the present issue specifying the main projects/objects for which the additional funds required"*

[Emphasis added]

A plain reading of the underlined portion in Item No. 18 of the circular quoted above, reveals that a circular need only reveal the nature of the 'main projects/objects' for which the relevant issue of capital is being undertaken. The financing of the BMR was the main object for which funds were required. Rights Issue was meant to be a part of the larger scheme of BMR, and, therefore, the Circular for Rights Issue stated as follows in Item No. 18:



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*"The management of the Company has decided to upgrade the production facilities of the unit by carrying on the Balancing, modernization and Replacement of the existing plant, to meet the challenges of quota free era commencing in 2005".*

It is, therefore, not a tenable argument that the Circular did not reveal the purpose of the Rights Issue; and

d) by the year 2002, the aggregate total amount of the directors' loan to the Company, including the Appellants' BMR Injection, stood at Rs. 53,956,944/-. During the years 2002 and 2003, the Company generated, through its operations, funds of Rs. 14.222 million and Rs. 14.661 million respectively. Out of these generated funds, the Company repaid Rs. 24 million to the Appellants on account of repayment of part of the directors' outstanding loan. The Appellants' counsel argued that the Appellants have at various times contributed substantial funds to the Company as directors' loan etc. for the benefit of the Company and did their best to ensure the Company stays afloat and viable. The Appellants had not received any unlawful personal benefits but in fact suffered substantial personal losses by subscribing to over-valued shares and writing-off directors' loan.

5. The department representative argued that:

a) the additions to fixed assets amounting to Rs 123.295 million were made from the year 1999 to the year 2004, which were financed by the director loan, funds generated from operations and bank borrowings. The amount of loan injected by the directors for the purposes of BMR was Rs 15.225 million, whereas, repayment of Rs 40.738 million was made to the directors, therefore, the funds advanced to the Company by the directors, as claimed were not used for the purposes of BMR;



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- b) the Appellants themselves valued the shares for the Rights Issue. They had the option to issue shares at discount, thereby, attracting the shareholders or financial institutions, however, the Appellants, in order to increase their shareholding and to avoid getting the relevant approvals, deliberately over-priced the shares;
- c) the proceeds of right issue were not utilized for the purposes disclosed in the financial projections submitted to the shareholders at the time of approval of Rights Issue; instead the proceeds were utilized for repayment of directors' loan. Even, if it is assumed that the Circular did reveal the purpose of the Rights Issue, the post Rights Issue scenario presented before the shareholders through the Circular was not implemented; and
- d) varying explanations have been rendered by the Company at different times. In response to department's explanation letter dated 04/05/05, based on which SCN proceedings were initiated, it was submitted that:
- "[...] The share subscription money was received in cash in Company's bank account. Subsequently, directors decided to repay the directors loan in order to enhance the debt equity ratio of the company. However, the company did not convert the directors' loan into equity shares but utilized the shares subscription money for this purpose."*

In reply to the SCN proceedings it was stated that:



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*“There was no money paid to the directors out of the proceeds of the RI. The transaction is in accordance with the company financial projection plan for the RI as in the projected balance sheet it was envisaged and planned that the directors loan/share deposit money given in the year 2003 for the purpose of expansion plan shall be repaid, it has been shown in the year 2004 projected accounts as reduction of Rs. 31 million (year 1 page 15,) wherein the directors loan/share deposit money has been reduced from Rs. 53.96 million to Rs. 22.96 million. [...]”*

The Appellant’s had stated that repayment of Rs. 24 million was made on account of repayment of part of the outstanding directors’ loan. The actual cash flow statement of the Company for the year 2004 shows a repayment of loan amounting to Rs. 40.739 million and proceeds from Rights Issue amounts to Rs. 40 million. The Company’s stance is also not verified from the actual financial statements and it is clear that against actual financing of BMR amounting to Rs. 15 million only, Rs 40 million were withdrawn from the Company as repayment of directors’ loan, thereafter, equity amounting to Rs. 40 million was also issued to them.

6. We have heard the parties.

a) the facts stated by the department regarding the loan of Rs 15.225 million advanced by the directors to the Company and the repayment of Rs 40.738 million stands established from the financial statements of the year ended 2002 and 2003. The directors’ assertion that loans were advanced for BMR is in fact a misstatement, which facilitated the





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conversion of directors long term loans into equity and caused dilution of ordinary shareholders' equity;

- b) breakup value of the Company as on 30/09/03 was Rs. 11.62 (2002: Rs. 11.88) per share, therefore, the claims of the Appellants that they have brought the shares at par value of Rs 10 instead of the market price of Rs 2.5 per share and have suffered substantial loss is baseless. Appellants themselves valued the shares for the Rights Issue. They had the option to issue shares at discount thereby attracting the shareholders or financial institutions, however, the Appellants in order to increase their shareholding and to avoid getting the relevant approvals, deliberately over-priced the shares. The Respondent in the Impugned Order had taken a lenient view and no penalty was imposed on the Appellants for violation of BTAU Rules;
- c) the Circular inviting shareholders to subscribe for their rights explicitly lays down that the funds will be used for BMR. In fact the Appellants misrepresented the facts by not stating that Rights Issue was being undertaken to pay back the loans of the directors; and
- d) the actual cash flow statement of the Company for the year 2004 shows a repayment of Rs. 40.739 million on account of directors loan and proceeds from Rights Issue amount to Rs. 40 million. The actual financing of BMR through director loan amounted to Rs. 15 million only. The perusal leads us to the conclusion that the purpose of the issuance of Rights Issue was to pay back the loans of the directors under the cover of purported BMR.



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The Appellants also failed to comply with the direction of the Respondent and showed their inability to provide information regarding the working capital requirements and business strategy to bring the Company out of operational losses. In view of the above, we see no reason to interfere with the Impugned Order. The appeal is dismissed with no order as to costs.

(Mohammed Asif Arif)  
Commissioner (Insurance)

(Imtiaz Haider)  
Commissioner (SMD)

Announced on: 09/03/12