Quadrant II - Notes

Course Code: COC102

Module Name:

- Introduction
- Buy Back of equity shares is a process of capital restructuring. It is a financial strategy which allows a company to buy its equity shares issued earlier. A company can buy back its own shares by obtaining permission of the Company Law Board, under the provisions of the Companies Act 2013 u/s 68 which corresponds to Section 77A to the Companies Act 2013, it has become possible for a company to buy back its own shares subject to fulfillment of certain conditions.

Purposes

Buying back a portion of equity share capital is preferred for the following purposes:

- To facilitate reduction of share capital or redemption of capital
- To generate higher return to be left over to equity shareholders
- To return Surplus cash to the shareholders in the form of buy back when there is no proper investment opportunities
- To maintain shareholder’s value in the situation of poor secondary market
- To arrest downtrend in the value of shares

Sources of Buy Back

- ❑ A Company can buy back its own shares or other specifies securities out of three sources.
- Free Reserves
- Securities Premium Account
- Proceeds of earlier issue of any shares or other specifies securities
- ❑ Free Reserves

Generally free reserves include the following

- Amount of surplus as shown in the Profit & Loss account carried forward under the heading “ Reserves and Surplus”
- Subsidy received under the Central Government outright Grant or Subsidy Scheme 1971
- General Reserve
- Profit & Loss Account
- Dividend Equalization Reserve or Dividend Fluctuation Reserve

- Sinking Fund
- Investment Allowance (Unutilized) Reserve

❑ Following adjustments should be made against free reserves to arrive at the net amount of free reserve that can be utilized for buy back:

- Unamortized miscellaneous expenditure
- Unamortized deferred revenue expenditure
- Purchased Goodwill
- Contingent liabilities likely to mature and not provided for
- Any diminution of long-term investments not provided for
- Any impairment in the value of tangible assets not provided for

❑ Other Reserves not available for Buy back

- Revaluation Reserve
- Capital Redemption Reserve
- Debenture Redemption Reserve
- Forfeited Shares Account
- Profit prior to incorporation
- Capital Reserve
- Statutory Reserve

❑ Securities Premium Account

- As per the Companies (Amendment) Act 1998, the term "Share Premium Account" has been substituted by the term, " Securities Premium Account". It is possible that loss on redemption of debentures and issue expenses remain unamortized under the head "Miscellaneous Expenditure" while the balance on Securities Premium Account is utilised for buy back. Securities Premium Account after making all the adjustments forms part of free reserves.

❑ Statutory Reserves

Statutory Reserves such as Investment Allowance Reserves, " Development Rebate Reserve" Export Profits Reserve, Foreign Project Reserve, Foreign Exchange earnings Reserve after 8 years are free Reserves.

❑ Proceeds of an earlier issue

Buy back of shares of any kind is not allowed our of fresh issue of shares of the same kind. If it was so, it would frustrate the very purpose of buy back. Fresh issue of equity shares for buying back equity shares makes no financial sense.

Hence, issue of preference shares for buy back of equity shares makes a financial sense. Preference shares carry fixed rate of dividend. It may yield better return to shareholders. Buy back of equity shares is allowed by issue of any pure or hybrid debt instruments.

- Conditions and limits of Buy back

- It is authorized by its Articles of Association
- The Board of Directors of a Company can decide to buy back 10% of total paid up equity capital and free reserves of the company in a year without waiting for shareholders' approval. Only if the buy back of the company is more than 10% of its paid up capital plus free reserves, a special resolution passed in the General meeting would be mandatory.
- The buy back is 25% or less of the aggregate of paid up capital and free reserves of the company. A company cannot buy back more than 25% of its paid up equity capital in any financial year.
- The aggregate of secured and unsecured debts owed by the company after buy back is not more than twice the paid up capital and its free reserves
- Only fully paid up shares can be acquired under buy back.
- The guidelines issued by SEBI in this regard are complied with for buy back of shares listed.
- Shares bought back should be extinguished and physically destroyed within 7 days from the date of buy back.
- Where a company purchases its own shares out of free reserves or securities premium account, a sum equal to Nominal value of shares so purchased shall be transferred to Capital Redemption Reserve a/c.
- Buy back must be completed within 12 months from the date of special resolution
- A kind of security under buy back cannot be issued within 24 months after buy back except as bonus shares or conversionof security
- A company can buy back from any of the following:

- From existing shareholders on a proportionate basis.
- From open market
- From employees to whom shares under ESOP or sweat equity.
- The company must file solvency declaration with the Registrar and SEBI in the form of an affidavit signed by at least two directors of the company.
- The notice of meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating full disclosure of material fact and the necessity for the Buy back, class of shares, amount to be invested and the time limit for completion of buy back.

- Where a company buys back its shares shall maintain a Register of the shares so bought, the consideration paid for the shares, the date of cancellation of shares and the date of destroying the shares.
- A company shall after completion of buy back, file with the Registrar and SEBI a Return containing such particulars relating to Buy Back within 30 days of such completion.
- In case of default the company shall be punishable with a fine which shall not be less than Rs. 1,00,000 which may extend to Rs. 3,00,000 and every officer who is in default shall be punishable with imprisonment for a term of 3 years with fine which shall not be less than Rs. 1,00,000 but may extend to Rs. 3,00,000 or both.

❑ Modes of Buy Back

▪ Buy Back through Tender Offer

✓ Opening of Escrow Account

✓ Payment to Shareholders

✓ Extinguishment of Certificates

▪ Buy back through Stock Exchange Operations

✓ Specification of maximum price and public announcement

✓ Carrying out buy back through stock exchange

✓ Extinguishment of share certificates

▪ Buy back through book building process

✓ Open escrow account

✓ Book building process

✓ Price fixation through Dutch Auction Method