13

BUY-BACK OF SHARES

13.1 Introduction

A buy-back of shares means a purchase of by a company of its own shares or specified securities. A company may resort to buy-back for a variety of reasons, e.g., excess floating stock in the market, poor performance of the share, utilisation of excess cash with the company, etc. Many times a company has excess cash on its balance sheet which it wants to distribute amongst its shareholders. A buyback is one of the modes by which it can achieve its objectives.

It is important to note that the company can buy-back equity as well as preference shares. It is not necessary that preference shares must always be redeemed as they can also be the subject of a buy-back of shares. Specified securities have been defined to include ESOPs or such other securities as may be notified from time to time. Unlike in the USA, in India, the shares bought back cannot be used for treasury operations and they must be compulsorily extinguished and destroyed. If the company is permitted to retain the shares, then it can trade in them. The buy-back of shares can be made only out of:

(a) Free Reserves (means reserves as per the last audited Balance Sheet which are available for distribution and share premium but not the share application amount)

(b) Share Premium Account

(c) Proceeds of any Securities

However, Buyback cannot be made out of proceeds of an earlier issue of the same kind of securities.

13.2 Companies Act

13.2.1 Under the Companies Act, a buy-back can be made by two ways:

(a) By way of a Shareholders' Resolution passed in a General Meeting; or

(b) By way of a Directors' Resolution passed in a Meeting of the Board of Directors.

13.2.2 The important features of the two types of buy-backs are briefly summarised as follows:

No	Conditions	Shareholders' Buyback	Board Buyback
1.	Enabling Provisions	• Must be authorised by the Articles of Association • A Special Resolution of the shareholders must be passed. For listed companies it must be by way of a Postal Ballot	• Resolution of the Board of Directors
2.	Buyback Limits	• 25% of the total Paid-up Equity Capital + Free Reserves; and • Not more than 25% of total Paid-up Equity in that financial year	10% of the total Paid-up Equity Capital + Free Reserves
3.	Manner of Buyback	• From Open Market • From Existing shareholders on proportionate basis • From Odd Lots • By purchasing ESOP/ Sweat Equity shares	
4.	Debt-Equity Ratio	Not more than 2:1 (Debt/ (Equity Capital + Preference Capital + Reserves) after the Buyback	
5.	Type of shares which can be bought back	Fully paid-up	
6.	Explanatory Statement to Notice calling the General Meeting	Must contain the prescribed details	Not applicable
7.	Pricing	Free Pricing – no fixed basis	
8.	Date of completion	Within 12 months of the Resolution	
9.	Further Buyback		Not within 365 days from the date of Buyback
10.	Extinguishment of shares bought back	Within 7 days of completion of Buy-back	
11.	Further Issue of Shares	A further issue of the same kind of securities or u/s. 81(1)(a) cannot be made within 6 months of the buy-back, except by way of Bonus, Sweat Equity, ESOP, conversion of financial instruments, etc.	
12.	Transfer to Capital Redemption Reserve	If the Buyback is made out of Free Reserves, then an amount equal to the Nominal Value of shares bought back must be to be transferred to the CRR A/c	

13.2.3 In the following circumstances a company cannot buy-back its shares/ securities:

(a) It cannot directly or indirectly purchase its own shares/ securities through any subsidiary company or investment/ group of investment companies.

(b) It cannot directly or indirectly purchase its own shares/ securities if it has defaulted in repayment of the deposit or interest or redemption of debentures or preference shares or payment of dividend or repayment of a loan/ interest payable to a bank/ financial institution is subsisting.

(c) If it has defaulted in filing the Annual Return with the ROC or it has failed to distribute dividends within 30 days or it fails to lay the accounts before the general meeting as required u/s. 211.

13.3 SEBI Guidelines

13.3.1 Under the SEBI Guidelines on buy-back of securities which are applicable to listed companies, a buy-back may take place by one of Four methods

(i) Tender Offer: from existing shareholders on a proportionate basis

(ii) Open Market Route:

  (a) By Stock Market Operations

  (b) By Book Building process

(iii) Odd-lot Holders Buyback.

13.3.2 The procedure for Tender Offer and Odd-lot Buyback is the same. The SEBI Guidelines contain very elaborate and numerous procedures which need to be followed in case of a buy-back. Summarised below are only the key/ crucial features and conditions of buy-back under different methods are as under:

Criteria	Tender Offer	Stock Market	Book-Building
Meaning	Buy-back by a Letter of Offer to shareholders @ Fixed Price	Buy-back through the Stock Market @ market related prices but maximum price must be fixed	Buy-back through Bidding Process – bids are received from shareholders
Price	Fixed Price	Market related but maximum price must be fixed	Price at which Maximum Bids are received
Time for which Buy-back remains open	Min. 15 days Max. 30 days	12 months from the date of Resolution u/s. 77A	Min. 15 days Max. 30 days
Public Notice in newspapers	Yes if the Buy-back is by way of a Board Resolution. It must be issued within 2 days of the Board Resolution		

Public Announcement (PA) in newspapers in the specified format	Yes	Yes - 7 days prior to Buy-back	Yes - 7 days prior to Buy-back
Specified Date concept	Yes: to etermine eligible shareholders – it must be within 30 days from the date of PA	No	No
Letter of Offer (in specified format) to be sent to shareholders	Yes – Within 21 days of filing with SEBI which must be within 7 days of the PA	No	No
What happens in case of an Over-subscription	Pro-rata Buy-back	Not applicable	Not applicable
Completion of Buy-back	Within 15 days of the closure, all offers must be verified. Unless otherwise communicated, offers are deemed to be accepted.		
Escrow Account	25% of consideration for a consideration up to Rs. 100 cr + 10% for excess	No Escrow	25% of consideration for a consideration up to Rs. 100 cr + 10% for excess
Form of Escrow	Cash, Bank Guarantee, Securities	NA	Cash, Bank Guarantee, Securities
Can Promoters participate in the buy-back	Yes	No	Yes
Merchant Banker required	Yes	Yes	Yes
Trading system	Not applicable	Order matching mechanism of the Stock Exchanges having nationwide trading terminals – BSE and NSE.	30 bidding centres must be designated

13.3.3 In addition to the above, the SEBI Guidelines contain the following important restrictions for a buy-back by listed companies:

- Consideration for Buyback can only be paid in cash
- The company cannot issue any specified securities including bonus shares, till the date of closure of the offer
- The company cannot withdraw the offer to buy-back once the Letter of Offer has been filed with the SEBI or the Public Announcement has been made
- Promoters cannot deal in the specified securities in the stock exchange during the period when the buy-back is open
- The company cannot buy-back locked-in and non-transferable securities until they become free.

13.4 Pricing

There are no Guidelines to determine the buy-back price or the maximum price. It could depend upon a variety of factors, such as:

(a) Market price
(b) Book value
(c) Effect of Buyback on EPS
(d) Return on Net Worth

The price could even be at a discount to one or both of the following:

(a) Market Price
(b) Book Value

13.5 Unlisted Company Rules

13.5.1 Just as there are SEBI Guidelines for buy-back by a listed company, the Government has framed Rules for buy-back of securities by private companies and unlisted public companies. The Rules contain various procedures and information requirements which the company undertaking the buy-back must adopt.

13.5.2 Unlisted Public/ Private companies are permitted to buy-back shares in of the following methods:

(a) from the existing shareholders on a proportionate basis through private offers;
(b) by purchasing securities issued to employees under an ESOP or Sweat Equity.

13.5.3 In addition to the procedures, the Rules also contain the following important restrictions for a buy-back:

- Consideration for Buyback can only be paid in cash

- The company cannot issue any specified securities including bonus shares, till the date of closure of the offer
- The company cannot withdraw the offer to buy-back once the Letter of Offer has been filed with the ROC
- The company cannot utilise any money borrowed from Banks/ Financial Institutions for the buy-back of shares.

13.6 FEMA Regulations

13.6.1 In case the company buys back securities from foreign shareholders, NRIs, FIIs, etc., then the FEMA Regulations would apply. Earlier the same required the prior permission of the RBI. However, the Reserve Bank of India has now put the buy-back of shares from foreign investors on an automatic route. Thus, prior permission of the FIPB and the RBI would not be required for buy-back of shares by an Indian company from a foreign investor. The key conditions to be fulfilled in order to avail of this automatic route transfer are as follows:

(a) the company must be eligible for automatic route investment under the FDI policy, i.e., it must not be in a restricted sector;

(b) the pricing guidelines specified by the RBI are adhered to;

(c) Form FC-TRS along with the relevant annexures is filed with the Authorised Dealer;

(d) this route is not available for companies operating in the financial service sector, e.g., banks, insurances, NBFCs, etc.