SHARES BUY-BACK UNDER SEBI REGULATIONS

PRACTICAL ASPECTS

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Background

Securities and Exchange Board of India Act, 1992 (SEBI Act) is the parent statute under which these Regulations are promulgated. SEBI derives its powers to make such regulations under sections 11(1), 11(2) & 30 of the SEBI Act, read with section 68(2)(f) of the Companies Act, 2013.

Before 1998, Buy-Backs were not allowed in India. Companies were forbidden from buying their own shares. But the trend of Buy-Back that started in USA in 1942, gradually travelled to Europe, and then to Asia. As per the Companies Act, 1956, a company was prohibited from directly or indirectly purchasing its own shares.

Background… Contd.

In order to allow Buy-Back of shares, an exercise to amend the Companies Act was undertaken. SEBI constituted a committee under the chairmanship of Justice D.R. Dhanuka, former judge of the Bombay High Court, to examine, and make recommendations for amendments in the Companies Act, 1956. Three new sections 77A, 77AA and 77B were introduced w.e.f. 31st October, 1998, introducing the concept of Buy-Back in India. SEBI formulated the SEBI (Buy-Back of securities) Regulation 1998 to monitor and set the procedure to be followed for Buy-Backs. On September 11, 2018, the 1998 Buy-Back Regulation was repealed and replaced by the current 2018 Regulation. the "target company".

Background... Contd.

- Investors, at times get confused. Open offer and Buy-Back – similar.
- In Buy-Back
  - there is no “Target Company”
  - Company itself acquires its own shares.
  - No involvement of any third party.
- In Open offer, a third party, not the company is the key player.

Difference Between Takeover/Open Offer and Buy-Back

No.	Feature	Takeover / Open Offer	Buy-Back
1.	Mandatory	➢ Mostly mandatory ➢ Many a times, unwilling acquirers are forced to acquire shares as a consequence of the acquisition of majority stake or control in a “target company”.	➢ Voluntary. ➢ The company voluntarily decides to buy-back its own shares
2.	Motive/ object	The acquisition of the Target Company.	Rewarding the shareholder and enhancing the shareholder value

No.	Feature	Takeover / Open Offer	Buy-Back
3.	Key players	➢ The acquirer ➢ The promoters/ selling shareholders ➢ Public shareholders; and ➢ The Target Company - dormant player	➢ Company is not a dormant player, ➢ Company is the key player and the acquirer. ➢ Company's shareholders are sellers.

No	Feature	Takeover / Open Offer	Buy-Back
4.	Emphasis of the Regulations on treatment of shareholders	➢ Equal & fair treatment to small shareholders ➢ Same price to the public shareholders ➢ Minimum offer for 26% of the share capital.	➢ Ensure fair treatment to public shareholders. ➢ Advantage to small shareholders. ➢ Open market purchase; Promoters- cannot participate ➢ Tender Method; 15% of offer is reserved for Small Public shareholders.

No.	Feature	Takeover / Open Offer	Buy-Back
5.	Change of management & control	Generally, there is a change in management and control.	No change in management and control.
6.	Treatment of acquired shares	Shares acquired remains with the acquirer as his investment	The shares acquired are extinguished by the company.

No.	Feature	Takeover / Open Offer	Buy-Back
7.	Litigation	➢ Great degree of litigation. ➢ The acquirers try to wriggle out of the legal obligations ➢ Manipulating offer price ➢ SAT—several cases related to the Takeover Code.	➢ Since it is a voluntary mechanism and is generally well planned, the scope for controversy or litigation is low.

SMALL SHAREHOLDERS

Regulation 2(i)(n)

Shareholders whose market value of holding Rupees two lakhs or less are categorized as Small Shareholders.

The distribution of shareholding as submitted to the stock exchanges, indicate face value rather than the market value.

Currently, the shareholding is disclosed as per SEBI Circular No. CIR/CFD/CMD/13/2015 November 30, 2015. Table III - Statement showing shareholding pattern of the Public shareholder; Individuals – at point 3(a) states:

i. Individual shareholders holding nominal share capital up to Rs. 2 lakhs.

ii. Individual shareholders holding nominal share capital in excess of Rs. 2 lakhs.

Nominal value serves no purpose.

The market prices of shares are really relevant.

In case of TCS, Nestle or Eicher Motors etc. 2 lacs nominal value of shares will be valued at Crores,

WORKING DAY

Regulation 2(i)(s)

'Working day' means any working day of the Board.

A list of holidays as per RBI, for the month of August 2020 has been summarized below:

Holiday Description in the Month of August 2020 as per Reserve bank Of India Website : https://www.rbi.org.in/Scripts/HolidayMatrixDisplay.aspx as visited on 19 August 2020 at 06.00 Hrs.	Date	Number of States/cities where it is a holiday
Bakri ID (Id-Ul-Zuha)/COVID-19 containment measure	01	28
Raksha Bandhan	03	05
Sri Krishna Janmastami	11	04
Janmashtami	12	13
Patriot's Day	13	01
Independence Day/COVID-19 containment measure	15	31
Tithi of Srimanta Sankardeva	20	01
Teej (Haritalika)	21	01
Ganesh Chaturthi/Samvatsari (Chaturthi Paksha)/Vinayakar Chathurthi	22	07
Karma Puja/Ashoora/COVID-19 containment measure	29	04
Indrajatra/Thiruvonam	31	03

While Bakri Id is a holiday in 28 states/cities, Janmashtami is a holiday only in 17 states. Ganesh Chaturthi is a holiday only in 7 cities.

DVRs

- Shares can be issued with a Differential Voting Rights (DVRs)
- Such voting rights may be superior or inferior.
- Shares with inferior voting rights; not "shares" (Reg 3).
- Jagatjit Industries: DVR --with superior voting rights- 20 votes per share. But no dividend.
- In 2008, Tata Motors DVR, inferior voting rights: 1 vote per 10 DVR but 5% higher dividend.
- There can be a Buy-Back program for the DVR shares of Jagatjit Industries, but not for DVR shares of Tata Motors.

Difference Between Buy-Back through Tender method Vs Open market

No.	Feature	Tender method	Open market
1.	Maximum amount that can be utilised for buyback	25% of the net worth.	15% of net worth,
2.	Record date	No cut-off / record date.	Anyone can participate regardless of their date of purchase.

No.	Feature	Takeover / Open Offer	Buy-Back
3.	Process	Tendered bought after the offer is closed	Shares are bought on daily basis.
4.	Daily declaration	❖ No daily declaration. ❖ Book built position can be viewed live on SE website.	Daily disclosure of shares acquired and total accumulated acquisition.
5.	Payment	Made to all one date after the closure of the offer.	Payment is made on daily basis
6.	Basis of acquisition	Proportionate	Regardless of holding
7.	Small shareholders	15% shares reserved	No special treatment

No.	Feature	Tender method	Open market
8.	Promoters' participation	Cannot participate	Optional. They have to declare their intention upfront
9.	Price	Fixed price, usually at a premium over the current market price	At the ruling market price, not fixed but within the maximum price range and for the maximum amount. Bajaj Auto Board has approved a buyback price of upto 4,600 but till 15-07-22 it has bought 11,65,237 shares for a total cost of 441.20 Crs. at an average of Rs.3,786.

No.	Feature	Tender method	Open market
10.	Objective/cost	More expensive. Matrimony buyback price Rs.1,150/- as against market price of 770 (Buy-Back closing on August 4, 2022). All shares will be bought at 1150. Objective is to reward the shareholders.	❖ In contrast, Bajaj Auto, the highest approved price of 4,600 has not been paid to anyone till now. ❖ Objective is to support the market price so that they find their true value.
11.	Percentage of amount to be utilised	Full amount earmarked must be utilised	At least 50% of the amount so earmarked for the Buy-Back

SOME KEY POINTS

MAXIMUM AMOUNT FOR BUY-BACK

❖ Not to exceed 25% (Tender method) or 15% (Open Market purchase) of the net worth of the company, both on the basis of both standalone and consolidated financial statements of the company (w.e.f. 19.10.2019).

❖ Post Buy-Back, Debt : Equity ratio should not be more than 2: 1,

❖ Buy-Backs cannot be used to achieve the object of delisting.

❖ No negotiated deals.

SOME KEY POINTS..contd.

- Minimum gap of one year between 2 Buy-Back programs.
- Share capital should be reduced by extinguishing the bought back shares.
- The Buy-Back amount should be paid from the capital and free reserves.
- A company cannot purchase its own shares through a subsidiary company or an investment company of the same group.
- A defaulting company not allowed to Buy-Back for 3 years.

CASE STUDY

1. **Larsen & Toubro Ltd.**

In a historic first order of its kind, SEBI rejected the Rs.9,000 crores Buy-Back proposal.

In a filing with the BSE, the company informed as follows :

"Buy-Back Of Shares. Security Code: 500510. Company: Larsen & Toubro Ltd. Exchange Received Time: 19-01-2019, 12:52:08. Exchange Disseminated Time: 19-01-2019 12:52:16. Time Taken 00:00:08.

CASE STUDY Larsen & Toubro Ltd. ..Contd.

The Company had proposed a Buy-Back of up to 6,10,16,949 equity shares from its equity shareholders as on the record date, being October 15, 2018, on a proportionate basis by way of the tender offer route through the stock exchange mechanism at a price of Rs. 1,475 per equity share, aggregating up to Rs. 9,000 crore, in accordance with the applicable provisions of the Companies Act, 2013 and the Securities and Exchange Board of India (Buy-Back of Securities) Regulations, 2018 ('Buy-Back Regulations' and such Buy-Back herein after referred to as 'Buy-Back'), inter alia, considering the debt-equity ratio requirement on the basis of standalone financial statements, post Buy-Back.

Pursuant to the approval of the Buy-Back by the shareholders of the Company, a draft letter of offer ('DLOF') was submitted to the Securities and Exchange Board of India ('SEBI') in terms of Regulation 8(i)(a) of the Buy-Back Regulations, for their comments.

CASE STUDY Larsen & Toubro Ltd. ..Contd.

By way of a letter dated January 18, 2019, SEBI conveyed the following comment on the DLOF in terms of Regulation 8(ii) of the Buy-Back Regulations:

'Since the ratio of the aggregate of secured and unsecured debts owed by the Company after buy-back (assuming full acceptance) would be more than twice the paid-up capital and free reserves of the Company based on consolidated financial statements of the Company, the Buy-Back offer is not in compliance with Section 68(2)(d) of Companies Act, 2013 and Regulation 4(ii) of SEBI (Buy-back of Securities) Regulations, 2018. You are therefore advised not to proceed with this Buy-Back offer.'

After this case, the Regulations were further strengthened by amendment w.e.f.

19.10.2019 by adding "based on both standalone and consolidated financial statements of the company" for the computation of the company's paid up capital and free reserves. Further, the requirement to comply with the Companies Act was specifically included.

CASE STUDY - Open market purchase

E-Clerx Services Ltd.

Contrary to regulation 4(iv), it appears that the company had entered into a negotiated deal. The Buy-Back started on 15 July 2020, and on 16 July 2020, the very second day of the offer, more than 50% of the offer size was purchased from one single entity - the troubled Franklin Templeton Mutual Funds. This clearly leads to a belief that this was a negotiated settlement, which is expressly barred by law. Small Investors Welfare Association has taken up the matter with SEBI.

E-CLERX completed recently announced Buy-Back by company in 9 working days (no buying on 3 days) as under :

DATE	QTY
15-7-20	66,000.00
16-7-20	14,00,000.00
17-7-20	1,10,814.00
20-7-20	40,000.00
21-7-20	3,03,500.00
22-7-20	1,73,501.00
TOTAL	**20,93,815.00**

CASE STUDY E-Clerx Services Ltd. ..Contd.

Observations/Suggestions for SEBI to consider

- On 2nd day of buyback i.e. on 16-7-20 out of 14,00,000 shares were purchased. 11,26,444 shares from Franklin Templeton Mutual Fund i.e. 53.79% of maximum Buy-Back size bought from one entity.
- Whether this Buy-Back was announced to bail out troubled Franklin Templeton Fund.
- In tender method special quota of 15% is fixed for small shareholders but in the open market purchase like this more than 50% of the quota was usurped by one single entity.
- Who put order first ? Whether buy order was put first or sell order was put first ?
- This may bring out Insider Trading violations committed by both parties involved,
- This fact about purchase from a single entity should have been disclosed in "Daily Reporting of Shares Bought" by the company which has not been done.

CASE STUDY E-Clerx Services Ltd. ..Contd.

- Sebi should have a percentage cap of maximum buy size on buying from one entity.
- Buy-Back opportunity should be enjoyed by all shareholders not only 1 or 2 big holders.
- Preference given to minority shareholders in tender method, why not in Open market purchase?
- SEBI Regulations needs to be tightened so that companies do not deprive small shareholders from exit opportunity.
- Limit of maximum 2% from one single shareholder should be imposed.
- Not more than 2% or 5% of the total amount to be bought can be bought in one single day.

CASE STUDY Open market BAJAJ AUTO

The impact of announcement for Buy back, on the share prices of a company is quite evident in the recent announcement by Bajaj Auto Ltd. on **22-06-2022**

EXTRACT FROM BSE WEBSITE

Exchange Received Time **22-06-2022 18:02:23** Exchange Disseminated Time **22-06-2022 18:02:24** Time Taken **00:00:01**

BAJAJ AUTO LTD. has informed BSE that the meeting of the Board of Directors of the Company is scheduled on 27/06/2022 ,inter alia, to consider and approve further deliberation on the proposal for buyback of fully paid-up equity shares of the Company in accordance with the Securities and Exchange Board of India (Buy-back of Securities) Regulations, 2018.

When Buyback was announced, the price of the shares shot up. But when the Board deferred the decision, the price fell; again rose when buyback was finally confirmed. The price continues to rise daily because the buyback is through Open market purchase and the company is empowered to buy up to a price of 4,600/- and there is still much head room available. However for the last 2-3 days(25-28 July 2022) company did not buy any shares resulting in fall in the prices of shares.

BUY-BACK THROUGH TENDER OFFER

Corporate entities, can also qualify as small shareholder value of their holding is not more than 2 lakhs.

CASE Study

In the case of HEG Ltd. (Offer closing date - 22 March 2019)

Clause 20.5(h) the Entitlement ratio was as follows:

a) Small Shareholders 17 out of every 227 Equity Shares held. on the Record. (approximate 7.5%)

b) For General Category 19 out of every 447 Equity Shares held on the Record. (approximate 4.25%)

Going by this ratio, if someone is holding say 227 shares, then he may decide to tender only 27 shares and in that case all the 27 shares shall be accepted. But in case entire 227 shares are tendered, the acceptance would have been 41 shares. This is because many shareholders do not participate in the offer. The entitlement of these shareholders is then distributed in a proportionate manner.

BUY-BACK THROUGH TENDER OFFER ...contd.

Key points to consider for participation.

- Likely acceptance ratio
- Likely price after the offer
- Accordingly tender
  just the exact number of shares
  entire shareholding.
- In case of HEG Ltd., the offer closed on 22 March 2019. The offer price was Rs. 5,500/- market price was Rs. 2,100/- approx. The acceptance was about 17%, however, after the offer closed, the prices fell to around Rs. 820/- in August 2020. Investors who were looking for an arbitrage opportunity lost heavily.

BUY-BACK THROUGH TENDER OFFER ...contd.

- To be completed within one year of approval
- Announcement made must be completed, cannot be withdrawn
- A small window available for doing mischief - the time gap between the announcement for a board meeting and the actual Board meeting.
- Market may be informed that the company is planning a buy-back at a hefty premium. This will have the immediate impact of increasing the market price, but Board may not approve it.
- Some unscrupulous person may take undue advantage and sell shares at such high price.
- In the case of Transgene Biotek, the board meeting for considering the buy-back was announced but the actual buy-back was never completed.

GENERAL OBLIGATIONS

Obligations of the company for all buy-back procedure:

- Consideration to be paid only by way of cash;
- Cannot withdraw the offer after the draft letter of offer is filed or public announcement
- Further capital cannot be raised for a period of one year
- No buy-back during pendency of any scheme of amalgamation or compromise.
- Cannot buy-back the locked-in shares and non-transferable shares
- During the Buy-Back period, no shares or any other securities shall be issued, not even bonus shares.

GENERAL OBLIGATIONS ...contd.

- Till such time shares remain partly paid up, there cannot be any change in the capital of the company.
- Special resolution is not required if Buy-Back for 10% or less of networth
- The Buy-Back period cannot exceed one year as per the Companies Act , but as per these Regulations, the time limit has been further shortened to 6 months.
- No negotiated deals
- Buy-Backs can only be done for fully paid up shares, not for partly paid up shares.

TAXATION

From Investors point of view, Buy-Back is quite beneficial

Dividend is taxable and even TDS is deducted

Long term Capital Gains is taxable beyond one Lacs

Short term Capital Gain is taxable at a special rate of 15%

Buy-Back is tax free.

No TDS or Income tax.

TAXATION…contd.

Income on buyback of equity shares is exempt from tax under section 10(34 A) of the ITA, irrespective of the characterization of the shares, i.e., whether long term or short term or held as investment or stock-in-trade.

The company buying back their shares on or after July 5, 2019, have to pay tax under Section 115QA of ITA, on the distributed income.

Distributed income is the difference between the amount paid for buying back the share and the amount for which such shares were issued. This has to be determined in the manner specified in Rule 40BB of the Income Tax Rules, 1962.

TAXATION...contd.

In case of Open market purchase, although regulation provide

> *Regulation 17. (i) The identity of the company as a purchaser shall appear on the electronic screen when the order is placed;*

In practice it is not being followed.

Identity of the buyer not known.

After sale, Stock exchanges will identify the buyer and if bought under Buy-back, send a message to the selling investors.

Deterrent for the loyal long-term investors.
Assuming for example, an investor is holding shares in Bajaj Auto since 2008 when the price was , say, 300, is selling his shares now at, say 4000. The entire gain of 3700 shall be tax free for the investor if the unidentified buyer turns out to be the company else he has to pay heavy taxes.

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